Discretionary Portfolio Service

Market Commentary for the Period 1st January 2017 – 31st March 2017

Global equity markets were strong over the period with emerging markets outperforming on a relative basis. In the World Economic Outlook the IMF raised its US growth forecast by 0.1% to 2.3% in 2017 and by 0.4% to 2.5% in 2018 while maintaining its outlook on global growth. The organisation cited Trump's plans for fiscal stimulus including increased infrastructure spending and tax cuts as the key reasons. They outlined that risks to the global growth outlook were skewed to the downside over the medium term picking up on increased restrictions on global trade, impaired balance sheets, emerging market economic vulnerabilities and geopolitical risks. Higher inflation was a continued theme over the quarter which was driven primarily by higher fuel costs. Bond markets delivered marginally positive returns with conflicting pressures impacting prices.

US equity markets posted attractive returns leading the country's largest 500 companies (S&P500 index) to be valued at $20 trillion in aggregate in mid-February. Following his inauguration as President, Donald Trump withdrew the US from the Trans-Pacific Partnership (TPP), pulling out from trade deals with 11 countries in the Pacific Rim. He later directed a review of the Dodd-Frank act adopting the view that financial regulation was too onerous on businesses due to the inability to borrow funds. The Federal Reserve raised interest rates by 0.25% in March following strength in economic activity and the labour market. The central bank maintained their original forecast of 3 interest rate hikes over 2017 which remain dependent on the economic outlook as informed by incoming data. US fourth quarter GDP fell to 2.1% q/q (annualised). This was below the previous quarter driven in part by lower investment and net trade subtracting from growth. US inflation rose to 2.7% y/y in February, reaching the highest rate since March 2012, driven predominately by higher fuel prices. Unemployment fell to 4.7% in February, lower than 4.8% the previous month.

UK equity markets performed well noting that the FTSE 100 index recorded its longest ever run of positive daily returns since the index was created in 1984. Early in the quarter the UK's representative to the EU Sir Ivan Rogers quit months before initiating Brexit negotiations. He expressed to his colleagues that they should 'challenge ill-founded arguments and muddled thinking'. Britain later initiated its exit from the EU after invoking Article 50 of the Lisbon Treaty. The Bank of England left interest rates and stimulus levels unchanged in their most recent meeting. The Monetary Policy Committee stated that they were balancing the trade-off between the speed at which inflation returns to target with the support that policy provides to jobs and activity.

UK fourth quarter GDP rose to 0.7% q/q with net trade and consumer spending both contributing positively and business investment having a negative impact on the overall growth figure. Inflation rose to 2.3% y/y in February, marking the highest rate since September 2013, with rising fuel prices having a significant impact. Unemployment fell to 4.7% in January marking the lowest rate since September 2005. Despite the low unemployment rate, wage growth was reported lower than expected at 2.2% y/y (inc bonuses) which was also lower than inflation. In addition, there was a substantial

rise in the number of people on zero hour contracts which rose to a total of 905,000 people in December.

European equity markets delivered strong returns despite uncertainty over looming elections in both France and Germany. The European Central Bank made no changes over the period, but reiterated that monthly asset purchases would reduce by €20bn per month to €60bn from April in an attempt to reduce stimulus measures. ECB President Mario Draghi however mentioned that this could quickly reverse should the outlook become less favourable. The IMF and EU initially failed to reach an agreement on lending €7bn that Greece required to avoid bankruptcy. With the debt due in July, Eurozone ministers were keen to reach an agreement to prevent issues of confidence over European elections. Mark Rutte of the centre-right VVD party won the Dutch election giving him a third successive term as Prime Minister. He surpassed Geert Wilders of the anti-immigration Freedom Party playing down fears of a rise in nationalism across Europe. The VVD will now have to form a coalition with 3 other parties, which they have expressed will not include the Freedom Party.

Eurozone fourth quarter GDP remained at 0.4% q/q, unchanged from the previous quarter. Eastern European countries such as Estonia and Lithuania posted the highest levels of growth, whilst the Greek economy continued to contract. Inflation rose to 2% y/y in February marking the highest rate since January 2013 driven by increasing fuel prices. Unemployment remained at 9.6% in January, the lowest rate since May 2009.

Japanese equity markets ended the quarter marginally negative amid a period of fairly lacklustre data. The Bank of Japan maintained interest rates and the stimulus program at their most recent meeting. The central bank expressed their expectations of an uptrend in domestic demand driven by spending in both the household and corporate sectors following highly accommodative financial conditions and fiscal spending. Japanese fourth quarter GDP remained at 0.3% q/q in line with the previous quarter. The overall growth rate was boosted in part by exports and government spending while household consumption was flat. Inflation fell to 0.3% y/y in February with easing food prices and falling cost of housing. Unemployment fell to 2.8% in February marking the lowest unemployment rate since June 1994.

Emerging markets experienced a strong quarter amid a period of stability in the US dollar, taking away some of the adverse pressure on returns. Chinese fourth quarter GDP rose to 6.8% y/y, remaining within the government's target range and supported by strong consumer spending, higher government expenditure and robust bank lending. Interest rates were cut in Brazil by 0.75% to 12.25% with the future path of interest rates to be dependent on expectations for inflation. Conversely, Mexico raised interest rates by 0.50% to 6.25% over concerns of a weakening currency leading to higher inflation. In China, financial regulators drafted a consultation paper directed to lower financial leverage and risk in asset management products. India's budget was taken positively easing concerns over the introduction of a capital gains tax and policy aimed at boosting consumption. The oil price suffered a sharp fall in March as data from the Department of Energy showed US inventories at a record high. This, combined with growth in US shale oil production, has led to higher levels of supply putting downward pressure on oil prices.

In fixed income markets, yields remained largely unchanged on a broad basis leading to marginally positive gains for investors. An interest rate rise in the US, reduced monetary stimulus in Europe and rising inflation all put pressure on returns, whereas continued structural demand stabilised bond prices. Yields on the UK, US and German 10 year bond ended the quarter at 1.14%, 2.39% and 0.33% respectively.

Our comments on the following page relate to our general approach to portfolios over the period. Actual activity on trading accounts may differ from this depending on personal circumstances, and timing of investment. Please refer to your Valuation and Transaction Statements for details.

Portfolio Activity

Early in the quarter, within income focused portfolios, the Investment Committee sold positions in First State Global Listed Infrastructure to reduce global equity exposure following a period of strong performance encouraged by gains in overseas currencies. In addition, around 1/3rd of the Aviva Multi Strategy Target Income fund was sold to reduce concentration risk to the strategy following availability of a new fund in the marketplace.

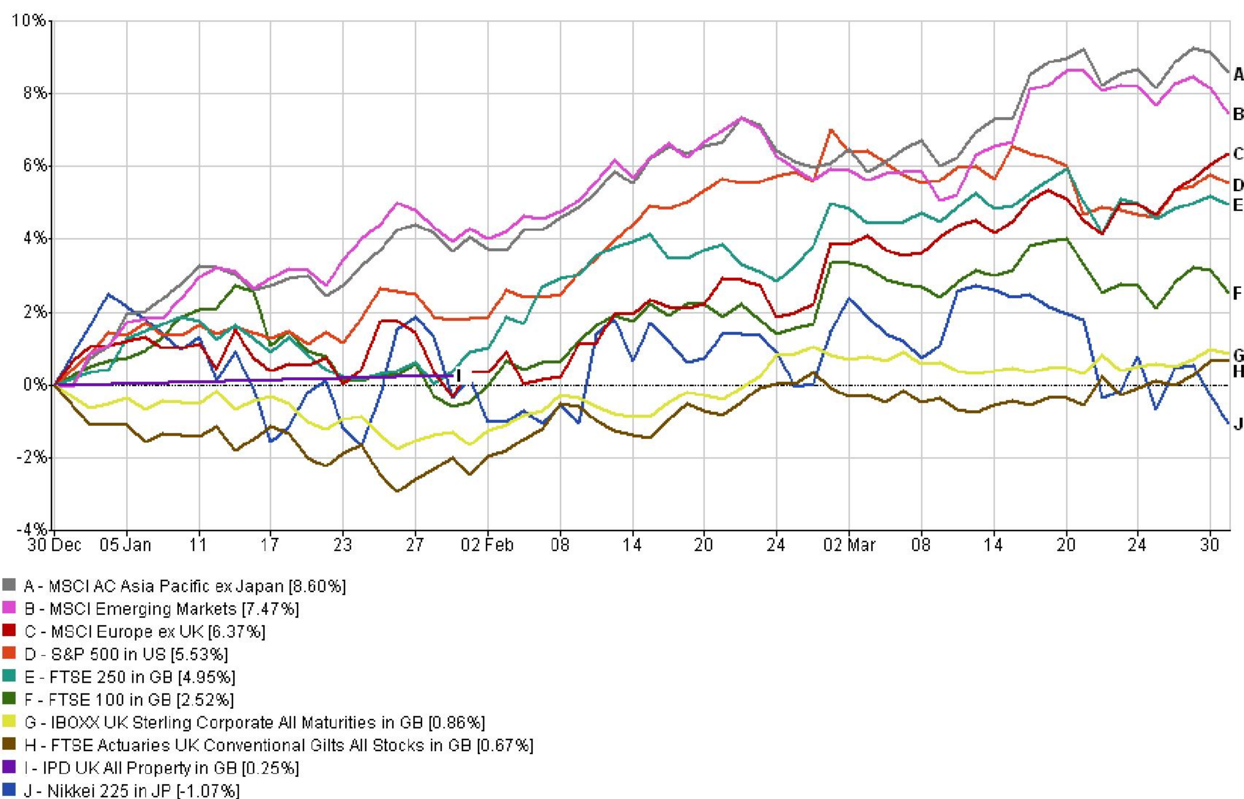
The proceeds were invested into the recently launched Invesco Perpetual Global Targeted Income fund which operates an absolute return strategy with an income target of cash + 3.5% per annum. The fund demonstrates a robust unconstrained ideas based investment process, which is supported by highly experienced fund managers, as well as a dedicated team of macroeconomic specialists.

Individual account activity picked up towards the end of the 16/17 tax year as funds were sold within various general investment accounts in order to realise gains, utilising a proportion of the capital gains tax allowance. The proceeds were allocated to comparable strategies, with the view of repurchasing original positions later in the new tax year.

Markets

Financial Markets	Index	30 Dec 2016	31 Mar 2017	Change %
UK Government Bonds	FTSE Actuaries UK Conventional Gilts All Stocks	182.56	183.79	0.67%
UK Corporate Bonds	IBOXX UK Sterling Corporate All Maturities	104.73	105.64	0.86%
UK Commercial Property	IPD UK All Property*	185.12	185.59	0.25%
UK Large Cap Equity	FTSE 100	7,142.83	7,322.92	2.52%
UK Mid Cap Equity	FTSE 250	18,077.27	18,971.83	4.95%
US Equity	S&P 500	2,238.83	2,362.72	5.53%
Europe ex-UK Equity	MSCI Europe ex-UK	1,210.70	1,287.80	6.37%
Japan Equity	Nikkei 225	19,114.37	18,909.26	-1.07%
Asia ex-Japan Equity	MSCI AC Asia Pacific ex-Japan	480.75	522.10	8.60%
Emerging Market Equity	MSCI Emerging Markets	47,650.99	51,212.06	7.47%
Economic Measures		**30 Dec 2016**	**31 Mar 2017**	**Change %**
Inflation	Retail Price Index**	267.10	268.40	0.49%
Interest Rate	Bank of England Base Rate	0.25%	0.25%	0.00%
FE Adviser Fund Index		**30 Dec 2016**	**31 Mar 2017**	**Change %**
AFI Cautious Index		199.16	205.32	3.09%
AFI Balanced Index		230.80	240.74	4.31%
AFI Aggressive Index		268.17	283.62	5.76%

[Source: FE] *Values between 30th December 2016 and 31st January 2017 as end of quarter figure not yet published. ** Values between 15th December 2016 and 15th February 2017 as this is the most recent published data.



House View

If there is one certainty around Brexit, it is uncertainty. In the 43 years of Britain's relationship with the EU, there have been agreements in thousands of subjects, many of which will now have to be addressed. This challenge is compounded by the fact that no country has ever left the EU before. Nonetheless, negotiations between Britain and other EU countries are expected to start from May/June with the maximum time-frame of 2 years. The outlook regarding Brexit will be very much pinned to the outcome from these negotiations and therefore investors will be watching closely for progress.

Following the election of Donald Trump, markets have broadly remained optimistic over his ability to implement pro-growth policies. There is now a significant gap between what investors call soft data and hard data meaning that consumer confidence and business sentiment are high but this has yet to be matched by the hard economic numbers to support this. This leaves markets susceptible, if either economic data does not catch up or if Trump fails to enact policies as planned. Markets have already experienced an example of the latter when the Trump administration was short of votes needed to repeal and replace Obamacare.

Putting Brexit and Trump to one side, the next series of events on investors' radars is the upcoming European elections. The recent Dutch election result provided some relief with the Dutch nationalist party failing to gain enough traction on election day. The next election on close watch will be France with the first round commencing late April. The polls currently show socially liberal centrist Macron and far-right Le Pen in close competition with a potential Le Pen win causing some apprehension in markets.

With regards to asset allocation within portfolios, the Investment Committee comprehend that there are opposing forces currently operating within bond markets. Rising inflation and the potential for higher growth within developed economies is placing upward pressure on bond yields. But,

conversely, this is challenged by longer-term pressures on growth including aging populations, low levels of productivity and the continual high structural demand for fixed income driven by regulation. The Committee maintain their preference for strategic bond funds which offer more trading flexibility and improved levels of liquidity. High yield bonds continue to benefit given investors increasing demand for yield within the current market environment.

Alternative investments such as absolute return funds continue to provide some capital preservation and higher levels of diversification given their independent investment strategies. The Committee continue to advocate the characteristics some of these funds provide and believe that holding fair exposure is warranted given current momentum in markets.

Portfolios continue to avoid bricks & mortar property exposure taking account of liquidity risks and a more dampened outlook on the asset class. Investment flows continue to be weak leading to some property managers becoming forced sellers of their properties and thus having a negative impact on performance. The Committee continue to invest this element of the portfolio into infrastructure assets which offer some capital preservation and a high degree of inflation protection.

Global stock markets have been strong, particularly since the election of Donald Trump. While corporate earnings have generally been improving, momentum in share prices has been high. Valuations have continued to increase meaning that investing in equities has become more expensive. This however has to be weighed against the current market backdrop where yields within bond markets are low and cash returns are almost non-existent. At this time, the Committee place greater emphasis on active management.

In summary, there remains much uncertainty present in the marketplace such as the outcome from Brexit, US politics post Trump and the stability of the European Union among others. Despite this, fund managers are still able to find sufficient opportunities investing in companies which offer strong prospects to investors over a medium to long-term timeframe. The Committee continue to seek out strong managers and blend strategies within portfolios to best mitigate against a single style or approach.

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4th April 2017

Contacts

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