Discretionary Portfolio Service

Market Commentary for the Period 1st July 2018 – 30th September 2018

Global equities were mixed over the period. There were strong gains posted across Japanese and US equity markets, far surpassing others which were negative to near flat. In the US, Apple became the first company in history to reach $1 trillion in size, shortly followed by Amazon. While President Trump was making most of the headlines with ongoing disputes on trade, there was a raft of interest rate rises across a number of developed and emerging economies, but for very different reasons. There was much news around the people involved with the Brexit process, but little announced in terms of policy developments. Economic turmoil among multiple emerging countries caused volatility across financial markets, particularly within currency. Fixed income markets were negatively impacted by action and expectations on interest rates.

US equity markets delivered strong consistent returns over the period despite escalating tensions between the US and a number of countries. There was a mass of exchanges between President Trump and other countries around trade and implementation of tariffs. A joint statement was made with Europe outlining that they would work together toward zero tariffs, zero non-tariff barriers, and zero subsidies on non-auto industrial goods. US import tariffs on steel and aluminium imposed in March would however remain. A trade agreement was reached with Mexico with the provision that 75% of products must be made in the two countries to receive tax-free treatment, greater than in the existing deal.

The more volatile discussions were with China where Trump confirmed that the US would be imposing tariffs on around 6,000 items totalling around $200bn of Chinese exports. He threatened to increase this by the start of 2019 should the two countries fail to agree a deal. China retaliated with tariffs on around $60bn of US goods. Trump then responded heavily by threatening to raise tariffs on another $267bn of Chinese imports.

The US Federal Reserve hiked interest rates by 0.25% to 2.25% over the quarter as widely expected by the market. This was in recognition of a strengthening labour market and rising economic activity. They outlined their expectations to raise rates once more over the year and a further three increases over 2019. US second quarter GDP rose to 4.2% q/q annualised marking the highest growth rate in just under four years boosted largely by a rise in exports. Inflation fell to 2.7% y/y in August encouraged by a slowdown in fuel, gasoline and shelter costs. Unemployment remained unchanged at 3.9% in August, close to its 18-year low.

UK equity markets ended the period slightly in the red amid a number of developments around Brexit. David Davis resigned as Brexit Secretary commenting that he no longer believed in the plan for the UK's future relations with the EU. Boris Johnson also resigned shortly after, giving up his post as Foreign Secretary. EU Chief Negotiator Michel Barnier dismissed PM May's proposal on the governance of UK financial services firms' access to European markets. He later stressed that he was strongly opposed to her latest plans which were largely around UK customs. Barnier believed it was

possible to have a deal in place within weeks if both sides were 'realistic' in their agreement. Mark Carney offered to maintain his position as Bank of England Governor in order to support a smooth Brexit which was endorsed by both the Prime Minister and the Chancellor. This followed comments he expressed that the possibility of a no-deal Brexit was uncomfortably high and highly undesirable.

The Bank of England raised interest rates by 0.25% to 0.75% at its August meeting by unanimous vote as widely expected by the market. In September the central bank reiterated that future increases would be at a gradual pace and to a limited extent. UK second quarter GDP rose to 0.4% q/q led in part by a rise in household consumption. Inflation rose to 2.7% y/y in August boosted by higher prices for transport, recreation & culture and food & non-alcoholic beverages. Unemployment remained at 4% in July, its joint-lowest rate since 1975, while the number of job vacancies hit a record high.

European equity markets posted marginally positive returns in a relatively quiet period for market data and newsflow. The European Central Bank maintained interest rates but confirmed that they would commence the reduction of stimulus at their most recent meeting. This would see the central banks monthly stimulus program cease by the end of 2018. European second quarter GDP remained at 0.4% q/q supported by an increase in fixed investment while net trade detracted from overall growth. Inflation fell to 2% y/y in August following softer price rises in services, energy, industrial goods and unprocessed food. Unemployment fell to 8.1% in August, the lowest rate since late 2008.

Japanese equity markets ended the quarter with significant returns following a surge towards the end of the period. The Bank of Japan maintained interest rates at their most recent meeting reiterating that they would remain extremely low for an extended period. Japanese second quarter GDP rose to 0.7% q/q boosted by business spending and a rebound in private consumption. Inflation rose to 1.3% y/y in August following a rise in food and transport prices. Unemployment fell to 2.4% in August while the number of jobs available to applicants remained at its highest level since 1974.

Emerging market equities were slightly negative over the period despite economic crises developing across multiple countries. Interest rates rose across a number of countries including India and Russia, both rising by 0.25% to 6.5% and 7.5% respectively. There were however more turbulent rate rises across others. Firstly, Argentina hiked rates by 15% to 60% to prop significant falls in the Peso currency. They also appealed for a bailout loan from the IMF to support the economy. The government then launched new austerity measures including a rise in tax on certain exports and abolishing a significant number of the nation's government ministries.

Turkey raised interest rates by 6.25% to 24%. This was against the request of President Erdogan and followed a shock to the Turkish lira as well ongoing deterioration in their economy. The President implemented additional measures including calling on citizens to exchange their foreign currency and gold for the lira to support weakness, as well as ruling that property sales and rental agreements had to be made in lira.

There were heated exchanges between Trump and the President of Iran with Trump tweeting that another threat to the United States would lead to consequences the likes of which few throughout history have ever suffered before. This was in response to the Iranian President commenting that a war with Iran would be the mother of all wars. President Trump also targeted Russia with more sanctions including limiting certain US exports and restrictions on access to US financial services. This was following the poisoning of a former Russian agent in the UK earlier this year.

In fixed income markets, bond yields rose across a number of the larger developed economies having a negative impact on investment returns. This was influenced by interest rate rises in both the US and UK, as well as confirmation that the stimulus program in place by the European Central Bank would cease by the end of the year.

In Japan, while interest rate rises are not expected for some time, there was some speculation that the Bank of Japan would also tweak its stimulus program. Yields on UK, US and German 10 year bonds ended the quarter at 1.57%, 3.05% and 0.47% respectively.

Our comments below 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

The Investment Committee initiated a portfolio rebalance of the Balanced Income mandate whilst making a number of changes in the process.

Firstly, positions in the Aviva Multi Strategy Target Income were sold. While the fund was meeting its absolute return and income target, the Investment Committee had increasing concerns over the capital element of its total return which had been in continual decline. The Committee had lost confidence in the funds process, structured in a way which may limit the ideas and opportunities identified by individual members of the team. Positions in the Gravis UK Infrastructure Income fund were reduced slightly following the introduction of the following holding.

The bulk of the proceeds were invested in the F&C Property Growth and Income fund to regain exposure to UK commercial property in a hybrid fund investing in a combination of direct (bricks & mortar) property and property related shares. The key benefit of this approach being its enhanced liquidity profile supported by its track record having never been forced to close to redemptions since launch in 2005. The remainder of the proceeds topped up existing holdings in Invesco Global Targeted Income, Royal London Short Duration Global High Yield Bond and the other strategic bond funds within the mandate to retain the defensive element of the Aviva disposal.

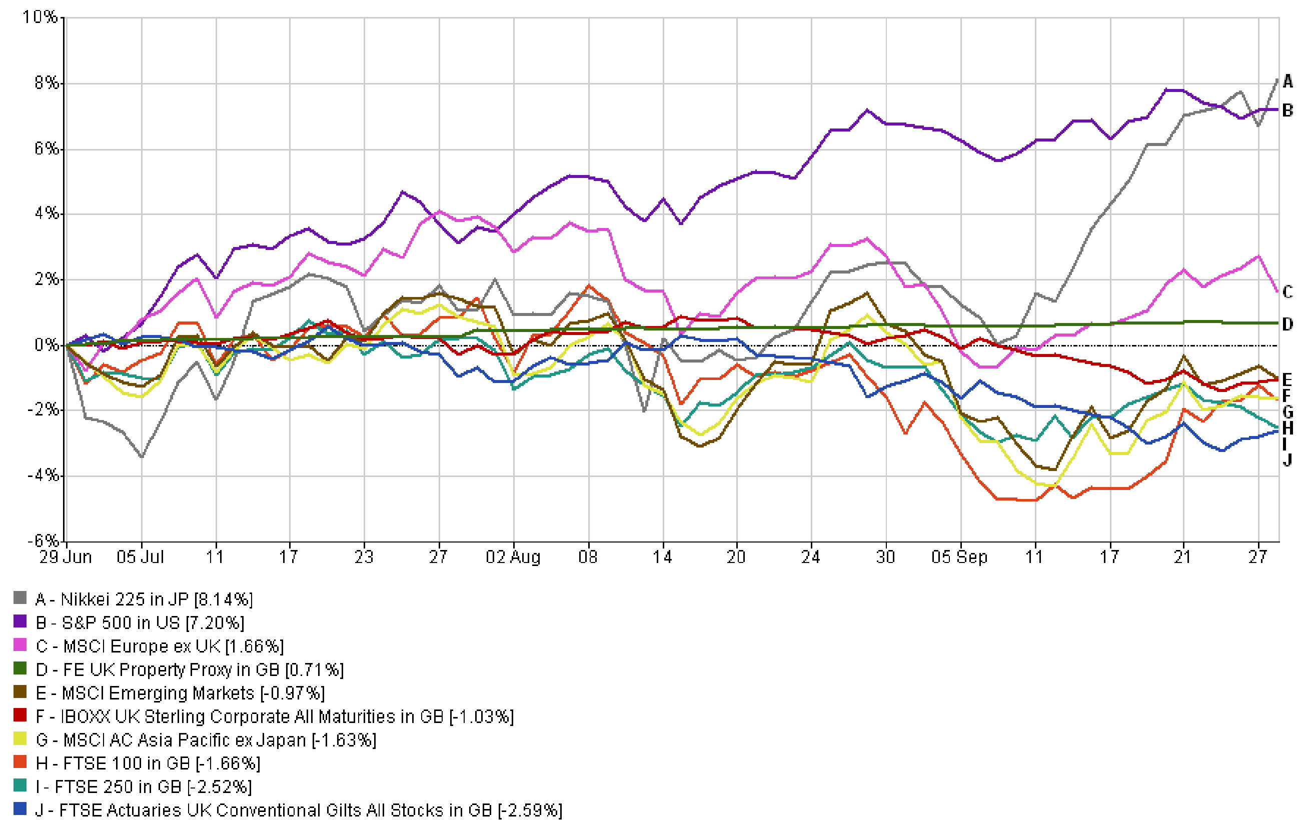
Secondly, the Jupiter North American Income fund was replaced by Threadneedle US Equity Income. The Jupiter fund was removed noting that it had held elevated levels of cash for some time which had been a drag to performance. In addition the yield generated by the fund had at times been below that of its benchmark. Several favourable factors were identified with the Threadneedle fund including its fully invested strategy, broad based market exposure and higher income yield.

Thirdly, positions were sold in the JPM Global Macro Opportunities fund in favour of the Merian Global Equity Absolute Return fund taking into consideration its more complimentary fund characteristics. A number of other minor position changes were made for a number of reasons such as to enhance diversification on a holding and source of income basis.

Markets

Financial Markets	Index	29 Jun 18	28 Sep 18	Change %
UK Government Bonds	FTSE Actuaries UK Conventional Gilts All Stocks	178.95	174.32	-2.59%
UK Corporate Bonds	IBOXX UK Sterling Corporate All Maturities	101.44	100.39	-1.03%
UK Property	FE UK Property Proxy	1,941.73	1,955.52	0.71%
UK Large Cap Equity	FTSE 100	7,636.93	7,510.20	-1.66%
UK Mid Cap Equity	FTSE 250	20,830.97	20,307.04	-2.52%
US Equity	S&P 500	2,718.37	2,913.98	7.20%
Europe ex-UK Equity	MSCI Europe ex-UK	1,302.84	1,324.48	1.66%
Japan Equity	Nikkei 225	22,304.51	24,120.04	8.14%
Asia ex-Japan Equity	MSCI AC Asia Pacific ex-Japan	593.29	583.61	-1.63%
Emerging Market Equity	MSCI Emerging Markets	58,512.95	57,943.25	-0.97%
Economic Measures		**29 Jun 18**	**28 Sep 18**	**Change %**
Inflation	Retail Price Index*	281.50	284.20	0.96%
Interest Rate	Bank of England Base Rate	0.50%	0.75%	0.25%
ARC Private Client Indices		**29 Jun 18**	**28 Sep 18**	**Change %**
ARC Cautious Private Client Index		181.81	181.81	0.00%
ARC Balanced Asset Private Client Index		214.88	215.74	0.40%
ARC Steady Growth Private Client Index		247.26	249.23	0.80%
ARC Equity Risk Private Client Index		279.08	282.70	1.30%

[Source: FE] *Values between 15th June 2018 and 15th August 2018 as this is the most recent published data.



House View

The UK is set to leave the European Union in less than six months and as it stands negotiations are in stalemate and there remains no formal agreement in place regarding the terms of the country's withdrawal. The current Brexit Secretary Dominic Raab has made it clear that the UK would sooner leave without a deal in place, rather than sign a one-sided arrangement. This has led many to question what the outcome would be in a no-deal scenario.

While many factors are left to speculation, the UK would almost certainly revert to World Trade Organisation (WTO) rules around trade meaning that the EU's external tariffs would apply. This would lead to price rises across a number of goods imported from the EU, as well as likely shortages among other goods. The UK would be free to enter immediate negotiations with other countries, but it could take years to agree and implement deals with each country. The UK would be free to set its own rules on immigration by EU citizens, but then this also would apply to the EU. With around 3.7 million Europeans in the UK and 1.3 million British in the EU their rights to live and work would be uncertain, including recognition of professional qualifications.

The Investment Committee are often asked about the implications of Brexit as investors and the potential risks. Our response is that there are always risks associated with investing and this is just one risk among a number of wider potential risks at this current time. The challenge with Brexit related risk is not only the high level of uncertainty with the outcome but how the finer details of any deal, if agreed, will have an impact on wider markets.

Since the EU referendum took place, sterling has remained relatively weak which has in fact generally acted as a tailwind for UK equity market performance on the basis that around 75% of the revenue of FTSE100 companies is from overseas, thus a higher relative currency from overseas has been a boost to the earnings of larger more internationally orientated companies. That said, if the outcome of Brexit increases uncertainty, or is perceived to create further challenges for companies in aggregate, this is likely to have an adverse market impact, independent of other market factors.

We do not believe it is prudent at this time to take a strong view on the outcome of Brexit given the high level of uncertainty involved. With regards to portfolio protection, in recent years we have generally increased exposure to a number of 'alternatives' within portfolios. Many of these investments are broadly uncorrelated to the wider market and have specific objectives of preserving capital in the event of adverse market conditions. On this basis, we believe that portfolios are reasonably well insulated against a number of risks which may have a negative impact on markets in the coming period.

Please see recent earlier market commentaries for comments around general portfolio positioning, as our stance on this is broadly unchanged.

Shane Bennett BA (Hons) IMC
Research Analyst

3rd October 2018

Contacts

For issues relating to your financial planning, please contact your usual adviser. For further detailed information with regard to your investments managed within the Discretionary Portfolio Service, please contact a member of the Investment Committee in the Exeter office:

Shane Bennett	shanebennett@cfmltd.co.uk
Tim Ames	timames@cfmltd.co.uk
Neil Gore	neilgore@cfmltd.co.uk
Harry Bailey	harrybailey@cfmltd.co.uk

Past performance is not a guide to future performance. The value of investments and any income from them can fall as well as rise and is not guaranteed. The comments in this Market Commentary are based on our views at 3rd October 2018. These views are subject to change. They are for information only and do not contain any forecasts or recommendations.

Cathedral Financial Management Ltd Reg'd Office: Ground Floor, Eagle House, 1 Babbage Way, Exeter Science Park, Exeter, EX5 2FN.
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