

1825 Portfolio 3

Commentary Third Quarter 2018

This summary provides market commentary from our investment experts, and details any changes made to Portfolio 3 during the third quarter of 2018. The commentary is intended to give you a general overview of the market, and does not constitute advice.

In brief:

- The US was the standout market, with the S&P 500 Index hitting an all-time high, driven by a buoyant economy and robust corporate profits
- Several emerging and Asian equity markets declined, with investor sentiment dampened by an escalation in the protracted US/China trade war
- Japan had a strong quarter as a weak yen boosted exports
- UK commercial property remained stable, although there were some indications during the quarter that the market is moderating

Environment

Global equity markets delivered robust returns over the third quarter, albeit with marked regional variations. The US was the standout market, with the S&P 500 Index hitting an all-time high, driven by a buoyant economy and robust corporate profits. Several emerging and Asian equity markets declined, with investor sentiment dampened by an escalation in the protracted US/China trade war. The strong US dollar also adversely affected many in the region. By contrast, Japan had a strong quarter as a weak yen boosted exports. Rounding off, Brent crude oil hit a four-year high at the close of the review period.

Risk aversion was a primary influence on global government bonds during the period, which was largely rooted in an escalation of the trade spat between the US and China. Against that, a slew of encouraging US economic data caused the market to price in two interest rate rises before the end of 2018, pushing the 10-year Treasury yield decisively above the 3% mark. Meanwhile, it was a challenging but positive quarter for corporate bonds, with fears of faster-than-expected US interest rate rises and escalating global trade tensions fuelling volatility.

UK commercial property remained stable, although there were some indications during the quarter that the market is moderating. Total returns have been marginally weaker in recent months, with the return for August (the latest data available) the lowest since September 2016. Although capital growth is weaker, rents have held up fairly well – particularly for industrial and office property. Market trends continue to see industrial and retail property move in opposite directions. Industrials are still outperforming all the other commercial sectors as the relentless demand for all types of storage and distribution facilities drives the sector higher.

Activity

We review the Strategic Asset Allocation (SAA) for each of the 1825 funds every quarter, with the aim of ensuring that we continue to meet investors' long-term interests. At the most recent review, we made no changes to the SAA model.

We continue to seek growth opportunities and are mindful of the need for income in a world of low yields. By historical standards, global growth remains low but we still see opportunities as economic activity broadens out to a wide range of countries.

Some political risks have reduced but others could still surprise investors, positively or negatively. Furthermore, we do not see the need for monetary policy to tighten aggressively as underlying inflation remains restrained. In light of this, we continue to tactically favour equity risk assets plus selected high-yielding fixed income assets.

During the third quarter of 2018, we made the following Tactical Asset Allocation (TAA) changes:

- **We reduced our cash position**, while remaining modestly overweight versus the SAA
- **We added to our holdings in UK equities**, while remaining underweight versus the SAA
- **We reduced our Japanese equities position**, while remaining overweight versus the SAA
- **We reduced our Asia-Pacific equities position to neutral**
- **We increased our global real estate investment trusts (REITs) position to overweight**

In terms of underlying funds, we closed our position in Janus Henderson Institutional Cash Fund.

Outlook

While there are grounds to remain positive on certain equity markets and sectors, we are unlikely to enjoy the stellar returns seen in prior years. The Federal Reserve has started to raise interest rates, while the US/China trade dispute has intensified. The strength of the US dollar is also posing problems, notably in those emerging markets with high dollar-denominated debt. Meanwhile, the EU and UK are running out of time to strike a deal on Brexit. Nonetheless, the overall economic backdrop is broadly supportive and, while valuations in many areas of the market look stretched, there remain numerous opportunities for stock pickers.

We continue to see value in investment grade credit, given the sizeable market correction in the first half of 2018 and the strong fundamental backdrop for most corporates. However, the combination of trade tensions, continuing political uncertainty around Brexit and the US mid-term elections could increase near-term volatility. Meanwhile, the path and speed of interest rate changes will continue to determine the short-term outlook for government bond markets.

Although some progress has been made in Brexit negotiations, uncertainty around the ultimate economic impact continues to affect sentiment towards UK commercial real estate. We envisage a period of low returns over the next five years, with the forecast annual total return being slightly below the market income return. With income expected to be the main driver of returns over the period, the degree of income risk – from potential tenant default or the ability to maintain income at lease events – will be key to asset performance.

The figures above refer to the past. Past performance is not a guide to the future. As with any investment, the value of your portfolio can fall as well as rise - you may get back less than you pay in.

Performance

Global equity markets delivered robust returns over the third quarter, albeit with marked regional variations. The US was the standout market, driven by a buoyant economy and robust corporate profits. Several emerging and Asian equity markets declined, with investor sentiment dampened by an escalation in the protracted US/China trade war.

The portfolio experienced a positive return over the quarter, attributable to our SAA, with US equities being the main driver as US equity markets hit record highs. Our allocations to European and Japanese equities also did well. Our overweight position in US equities resulted in a positive contribution from the TAA, whilst fund manager selection detracted from performance, as our US managers struggled to beat a strong S&P 500.

The tables below show the performance of the 1825 Portfolio 3 over individual 12-month periods (year-on-year performance), and cumulative growth.

Year-on-year performance				
Year to 30/09/14	Year to 30/09/15	Year to 30/09/16	Year to 30/09/17	Year to 30/09/18
N/A	N/A	+12.28%	+8.82%	+4.94%

Cumulative growth				
6 months	1 year	2 years	3 years	Since launch (1/07/15)
+4.53%	+4.94%	+14.19%	+28.21%	+24.15%

Performance figures shown are based on representative model portfolios. They are provided by Bloomberg and are calculated net of all fund costs, but do not include product or specific adviser charges. Values are subject to change. Actual returns may differ slightly, for example, as a result of cash inflows or withdrawals.

Fund selection	1825 Portfolio 3 as at end September 2018	1825 Portfolio 3 as at end June 2018	Change +/-
Vanguard US Equity Index	7.98%	7.98%	0.00%
Vanguard FTSE UK All Share Index	6.95%	6.70%	0.25%
SLI Global Absolute Return Strategies (GARS)	5.68%	5.68%	0.00%
TM Fulcrum Diversified Absolute Return	4.97%	4.97%	0.00%
PIMCO Global Investment Grade Credit	4.20%	4.20%	0.00%
Janus Henderson UK Property	3.84%	3.84%	0.00%
Fidelity Index US	3.62%	3.62%	0.00%
Invesco Perpetual Global Targeted Returns	3.55%	3.55%	0.00%
Majedie UK Equity	3.48%	3.35%	0.13%
L&G Japan Index	3.12%	3.42%	-0.30%
SLI Global Index Linked Bond	3.00%	3.00%	0.00%
First State Global REITS	2.95%	2.20%	0.75%
T. Rowe Price Funds OEIC Dynamic Global Bond	2.90%	2.90%	0.00%
SLI Absolute Return Bond	2.90%	2.90%	0.00%
Old Mutual North American Equity	2.90%	2.90%	0.00%
BlackRock Continental European Equity Tracker	2.90%	2.90%	0.00%
SLI Ignis UK Property Feeder	2.56%	2.56%	0.00%
L&G Emerging Markets Local Government Bond Index	2.40%	2.40%	0.00%
Nomura US High Yield Bond	2.24%	2.24%	0.00%
Invesco Perpetual Emerging Countries	2.15%	2.15%	0.00%
Vanguard Emerging Markets Stock Index	2.15%	2.15%	0.00%
CF Morant Wright Nippon Yield	2.08%	2.28%	-0.20%
SLI UK Equity Income Unconstrained	2.08%	2.01%	0.07%
Robeco Global Credits - Short Maturity	2.00%	2.00%	0.00%
Robeco Global Credits	1.80%	1.80%	0.00%
Invesco Perpetual European Equity Income	1.74%	1.74%	0.00%
Hermes Asia Ex Japan Equity Fund	1.65%	1.90%	-0.25%
Mirae Asset Asia Sector Leader Equity	1.65%	1.90%	-0.25%
TwentyFour Corporate Bond	1.56%	1.56%	0.00%
Royal London Short Duration Global Index Linked	1.50%	1.50%	0.00%
Fidelity UK Smaller Companies	1.39%	1.34%	0.05%
Cash (£)	1.25%	1.00%	0.25%
SLI European Equity Income	1.16%	1.16%	0.00%
Royal London Short Duration Credit	1.05%	1.05%	0.00%
Vanguard Short Term Investment Grade Bond Index	1.05%	1.05%	0.00%
Vanguard UK Investment Grade Bond Index	1.04%	1.04%	0.00%
Baring European High Yield	0.56%	0.56%	0.00%
Janus Henderson Institutional Cash	0.00%	0.50%	-0.50%
	100.00%	100.00%	

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