1825 Portfolio 5

Commentary Third Quarter 2017

This summary provides market commentary from our investment experts, and details any changes made to Portfolio 5 during the third quarter of 2017. The commentary is intended to give you a general overview of the market, and does not constitute advice.

In brief:

- Global equities delivered another quarter of positive performance.
- Central banks indicated their intention to slowly reduce the level of monetary stimulus currently deployed.
- In the US, lower-than-expected inflation, Korean tensions and damaging hurricanes all encouraged risk-aversion.
- UK commercial real estate delivered positive performance during the third quarter.

Environment

Global equities delivered another quarter of positive performance, driven by encouraging economic news world-wide. Corporate earnings growth continued upwards, while consumers in the US and Europe remained upbeat. Central banks indicated their intention to slowly reduce the level of monetary stimulus currently deployed. This would mean raising interest rates (in the US and, potentially, the UK) and reducing quantitative easing (in the US and, perhaps, Europe). Meanwhile, emerging market equities were once again the standout performer, lifted by a weak US dollar, improving economic growth and recovering earnings.

Government bonds ended the quarter where they began. In the US, lower-than-expected inflation, Korean tensions and damaging hurricanes all encouraged risk-aversion, before vague plans around tax reform managed to unsettle US Treasury markets. The most extreme turnaround in interest rate expectations was in the UK gilt market, resulting in a sharp underperformance against other markets. As government bond yields rose (prices fell) in September, corporate bond markets lost some of the performance generated in the first two months, though overall returns were positive for the quarter.

UK commercial real estate delivered positive performance during the third quarter. In keeping with recent trends, rental income was marginally ahead of capital growth in terms of returns. Industrials were the strongest performers, supported by favourable supply/demand dynamics, as well as the structural shift to online retailing. There was some improvement in sentiment towards the retail sector. However, the bankruptcy of Toys R Us served as a reminder of the threat to traditional ‘bricks & mortar’ retailers from internet shopping.

Activity

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

In terms of our Tactical Asset Allocation (TAA), we retained an overweight position in equities (versus the SAA) and an underweight allocation to bonds. We expect the positive economic growth environment and a gradual tightening of monetary policy to benefit equities over the next six to 12 months. Over the same period, we expect developed bond markets to offer only flat to negative returns. We made the following TAA changes over the period.

- **Increased our allocation to Asia Pacific equities** – to reflect positive economic growth data coming from China, where GDP growth has been moving back up towards 7%. Commodity prices have also picked up.
- **Reduced the allocation to US equities** – the reflationary backdrop remains positive albeit President Trump's policies are proving harder to implement than expected. The potential for further upside is therefore somewhat limited. We remain overweight versus the SAA.

In addition, we have listed below some of the main TAA positions held during the period.

- **Underweight position in UK equities** – the UK economy has been surprisingly resilient and the UK consumer has kept spending, despite negative wage growth when inflation is taken into account. However, we retain a cautious outlook on the UK economy going forward. We are mindful of supply side constraints to growth as well as the structural shift of Brexit.
- **Overweight exposure to European equities** – GDP growth expectations for 2017 have increased, Eurozone unemployment continued to fall, inflation has picked up beyond expectations while business and consumer sentiment reached new highs. Meanwhile, political risks have somewhat diminished, although we are cognisant of the recent Catalonian dispute and upcoming Italian elections early next year.
- **Overweight position in emerging markets, both in equities and bonds** – we have a positive stance on global growth, as well as seeing support from improving commodity prices and strength in the Chinese economy.
- **Overweight position in Japanese equities** – we see falling unemployment levels but little wage pressure. Much of the improved profitability is stemming from firms' increase in technology investment. Japan is set for its longest continuous run of economic growth since 2001, a sign that the reforms implemented by President Abe may be coming to fruition.

In terms of the underlying funds, there were no significant changes during the quarter.

Performance

Overall, at the SAA level, the strategic allocations were positive. The synchronised upturn in the global economy supported equities. Our allocation to European, emerging market, Asia Pacific, US and UK equities drove our SAA contribution to performance over the quarter. The contribution to performance by our TAA was flat. Our overweight in European equities was the key driver, partly offset by our positioning in UK equities. In terms of our selection of managers, the contribution to performance was marginally positive over the quarter. Positive performances from our choices within Japanese, Asian and US equities were largely offset by selection in European equities.

Outlook

We are relatively positive about the prospects for global equities. The economic backdrop remains supportive, while business sentiment is fairly sanguine. Meanwhile, the withdrawal of monetary stimulus is likely to be a slow and measured process. For many, this is an indication that the global economy is on a sound footing. There will be challenges – notably around the path of US politics (including whether President Trump can get his agenda back on track), potential monetary policy missteps and geopolitics (such as those related to North Korea). However, the overall outlook remains positive.

We continue to view bond markets with caution and believe that the road to higher yields (and lower prices) is likely to be difficult. Central banks have made it clear that they believe economic growth and employment levels now argue for an unwinding of emergency monetary policies, despite consistently low inflation. As a result, they are steering towards a tighter monetary policy stance. We believe the current 'goldilocks' environment for corporate bonds - of low-but-positive growth and low inflation - can continue in the short term, although valuations are not cheap.

UK real estate dynamics remain supportive, although we expect market returns to moderate as the economy experiences a period of weaker growth towards the end of this year and into 2018. In the short term, sentiment around the UK's withdrawal from the European Union and its economic impact will drive the market.

The comments above refer to the past. Past performance is not a reliable guide to future performance. As with any investment, the value of your fund can go down as well as up and may be worth less than you invested.

Fund selection: 1825 Portfolio 5

Fund selection	1825 Portfolio 5 as at end September 2017	1825 Portfolio 5 as at end June 2017	Change +/-
Vanguard US Equity Index	12.62%	12.90%	-0.28%
Vanguard FTSE® UK All Share Index	11.28%	11.28%	0.00%
SLI Global Absolute Return Strategies (GARS)	7.76%	7.76%	0.00%
TM Fulcrum Diversified Absolute Return	6.79%	6.79%	0.00%
Fidelity Index US	5.74%	5.86%	-0.12%
Majedie UK Equity	5.64%	5.64%	0.00%
Invesco Perpetual Global Targeted Returns	4.85%	4.85%	0.00%
L&G Japan Index	4.83%	4.83%	0.00%
Old Mutual North American Equity	4.59%	4.69%	-0.10%
Invesco Perpetual European Equity Income	3.73%	3.73%	0.00%
SLI UK Equity Income Unconstrained	3.37%	3.37%	0.00%
CF Morant Wright Nippon Yield	3.22%	3.22%	0.00%
SLI European Equity Income	3.19%	3.19%	0.00%
Hermes Asia Ex Japan Equity Fund	3.00%	2.75%	0.25%
Mirae Asset Asia Sector Leader Equity	3.00%	2.75%	0.25%
Invesco Perpetual Emerging Countries	3.00%	3.00%	0.00%
Vanguard Emerging Markets Stock Index	3.00%	3.00%	0.00%
BlackRock Continental European Equity Tracker	2.66%	2.66%	0.00%
Fidelity UK Smaller Companies	2.26%	2.26%	0.00%
Henderson UK Property	1.59%	1.59%	0.00%
Mirabaud Equities Europe Ex-UK Small and Mid	1.07%	1.07%	0.00%
Ignis UK Property Feeder	1.06%	1.06%	0.00%
Cash (£)	1.00%	1.00%	0.00%
SLI Emerging Market Local Currency Debt	0.50%	0.50%	0.00%
BlackRock Global Property Securities Equity Tracker	0.25%	0.25%	0.00%
	100.00%	**100.00%**	

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