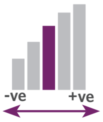
Asset Allocation

Equities

Developed Equities



» We retain a neutral allocation to global equities today. Valuations vary across regions and sectors and whilst in aggregate they are not cheap, they do offer the prospect of reasonable returns, both in absolute terms and relative to other classes. The recent volatility has presented an opportunity to add some marginal equity risk, but this seems to us as more of a valuation adjustment which could continue to play out so caution against aggressive risk adding today.

» Monetary policy and cross border politics will remain key drivers of risk appetite and global equity returns, the former being key to the recent repricing.

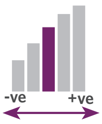
+ The global macro backdrop remains favourable for global equities, though we remain cognisant of slowdowns in some regions.

+ Equities are better placed than most asset classes to perform in a moderately pro inflationary environment.

− Valuations in some areas remain expensive at current levels despite sharp falls recently.

− Continued talk around and implementation of trade tariffs is not constructive for global equities, though a recent agreement to halt new tariffs for 90 days offers some respite.

UK Equities



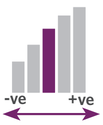
» UK equities look cheap today but caution is warranted given the evolving Brexit negotiations and continued political jockeying. While the larger cap market constituents are more globally focused than they are UK, and have earnings shielded in large part from FX swings, the more domestically oriented names may face bigger challenges.

» December is shaping up to be a turbulent month politically and continued uncertainty over the Brexit outcome means the risk premium on Sterling equities has increased. The currency tends to be the channel for UK risk hedging and in the event of a sharp decline UK equities should be reasonably supported.

+ The UK market remains exposed to global markets and factors and as such is somewhat insulated from the headline Brexit concerns, benefiting from any associated Sterling weakness.

− Today the chief worries lie with the ongoing Brexit negotiations, and recent political developments mean significant challenges remain.

European Equities



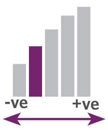
» European equity valuations remain favourable when viewed against corporate and sovereign European bond markets. From a more cyclical point of view the European macro backdrop has wavered of late and political risks remain. The neutral rating reflects that Europe remains something of a recovery laggard. There is scope for a more meaningful recovery in earnings but the region faces some headwinds today, not least the impending ending of the ECB purchase program.

+ European earnings still have scope to recover more meaningfully from their post crisis lows.

− European assets, including equities, may come under pressure should the ECB's bond programme reduction accelerate, or the Euro strengthen if the ECB brings forward their expected date to raise rates.

− Episodic risk off events, such as the recent volatility in the Italian bond market, should be expected.

US Equities



» The US remains the most expensive of the major developed markets, even after factoring in recent volatility in equity prices. However, the US economy remains in good health and arguably warrants a premium valuation. This valuation headwind means we score US equities less highly than ex US bourses today.

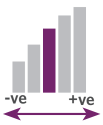
» Monetary policy remains crucial to keeping markets in check and volatility under control. To date the Fed has managed this well, but there remains an outside risk of higher inflation leaving the Fed little alternative to raising rates more quickly than rates markets are pricing.

+ The economy remains in good health with leading indicators remaining firmly positive.

+ Despite the Fed's programme of rate hikes, broader measures of financial conditions remain relatively loose, which coupled with the current fiscal stance can help propel economic growth further and equity prices higher.

− Despite recent market weakness valuations remain somewhat extended and rising yields may be an obstacle to further index gains from current levels. Additionally 2019 earnings growth may become more challenging as one-off tax cut benefits wear off.

Japanese Equities



» Japanese equities look attractive today and we acknowledge the government's policies to improve working practices and governance. Forward estimates of earnings have tailed off recently and equity prices have fallen sharply. The direction of the Yen is an important driver of returns with Yen weakness supporting Japanese equities and vice versa.

» Japanese assets should remain well buoyed by BoJ policy which remains aggressive when compared to the other main DM central banks.

+ Yen weakness will likely boost equities further if the Fed moves in line with their stated intentions and the BoJ maintains their yield curve policy, albeit now within a wider 20bps range around zero.

− In a protracted risk off scenario Yen strength resulting from its safe haven status would hurt Japanese equities, as witnessed recently in October.

Emerging Market Equities

» EM assets remain under pressure as the buoyant Dollar and trade war rhetoric continue to weigh on sentiment to emerging markets. We remain in favour of EM assets more generally over DM as the longer term relative growth dynamics look favourable, which coupled with steady inflation and accommodative policy should support EM equity returns over time. This shorter term price action if anything provides a buying opportunity but some caution is warranted as further bouts of volatility are inevitable.

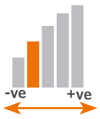
+ EM currencies remain on the back foot which provides some additional cushion to local EM equity returns through potential earnings enhancement over time.

+ Emerging markets at the index level trade at a significant valuation discount to developed markets.

− Emerging markets remain prone to bouts of volatility and flow reversal at times of heightened perceived risk.

Fixed Income

Government

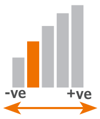


» On a medium term outlook DM government bonds remain largely unattractive today with poor real return prospects in aggregate. US treasuries are the exception though and offer improved value today, though the 10yr yield has fallen below the 3% level. Market expectations for interest rate rises have reduced in recent weeks accompanied by a more dovish Fed. Conversely other markets, such as Italy, are a source of price volatility.

+ Quality government bonds remain one of the best diversifiers in a multi asset portfolio.

− 2018 is likely to mark the year that net central bank bond purchases turns negative. That may prove to be headwind for all rate sensitive debt, particularly in higher quality European bond markets as the ECB steps back from buying already expensive bonds.

Index-linked
Relative to government

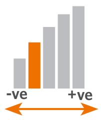


» Index linked bonds offer some selective value but, like their nominal counterparts, they are expensive. US breakevens have fallen quite sharply in recent weeks, but in a longer term context they still appear quite full.

+ Index linked bonds are one of the few ways to meaningfully protect against inflation risk.

− Inflationary forces remain somewhat muted today and on any further slowdowns in global growth they would almost certainly underperform nominal bonds. The oil price has come off significantly since October which will reduce inflationary pressures.

Investment Grade Corporate
Relative to government



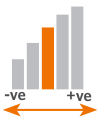
» Investment grade bonds provide some diversification benefit in a multi asset portfolio but valuations still remain quite tight despite recent moves wider in spreads. Fundamentals remain reasonable but we would advocate owning more shorter dated credit at today's levels as rate sensitivity remains near highs, and yields low.

+ A reasonable alternative to owning sovereign bonds with diversifying qualities and some spread.

− With central bank buying slowing the risks are asymmetric.

− Credit quality has drifted lower in recent years, and leverage has moved higher.

High Yield Corporate



» Spreads have widened in recent weeks in leveraged credit markets, but whilst fundamentals remain robust, all in valuations remain somewhat expensive.

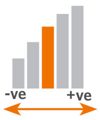
» We favour owning shorter duration credit where the risk return looks more favourable today, with an opportunity to add spread duration at better levels.

+ In the absence of a systemic market shock the running yield of high yield means the asset class will likely trump most of other fixed income.

− Issuance terms are increasingly favouring the issuer, and valuations look somewhat expensive

− Risks are asymmetric today.

Emerging Market Debt



» Emerging market bonds have been under pressure alongside EM equities and EM FX, though bonds have held up in early December volatility. With yields shy of 7% the asset class is attractive today. Spreads are slightly elevated relative to history but idiosyncratic stories, such as Turkey, cause ongoing concern. The recent weakness may yet run further.

+ We believe EM bonds continue to offer some of the best longer term real return opportunities in bond markets today.

− Renewed Dollar strength will weigh on EM assets, with local bonds and FX likely bearing the brunt.

Convertible Bonds

» Convertible bonds are about fairly priced to their constituent parts today, albeit somewhat expensive in absolute terms, driven largely by loftier US valuations. We favour an allocation to convertibles in a multi asset portfolio for the convexity it brings, which remains valuable at a time of elevated valuations, as we are today

» Some caution is warranted given the concentration to the US market and technology names, though some of this steam has recently been released as (US) stocks repriced

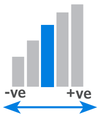
+ The natural convexity provided by convertibles should continue to provide reasonable protection against any protracted equity correction.

− The call optionality embedded into convertibles only really has any value if markets move higher, and the US, the largest regional market, remains well valued today in aggregate.

− If volatility reverts again to the recent multi year lows then the optionality holds limited value.

Real Asset / Alternatives

Commodities



» Commodity prices are primarily supply and demand driven, and idiosyncratic factors can be as important as the global economic cycle. Prices are likely to be affected by the trade tariffs being imposed by the US and their trade partners (Europe and China in particular) in retaliation. This dynamic remains in flux and is likely to cause some volatility, with tariffs more likely than not to increase. However, the recently agreed 90 day truce between US and China might ease pressure.

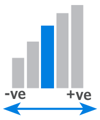
+ With the US Dollar still near cyclical highs, and global growth positive if not on a tear, commodities have scope to generate positive returns.

+ Gold remains a good hedge against risk off outcomes, as witnessed during recent market weakness.

− Trade tensions may continue to weigh on the commodities sector which is particularly exposed to a slowdown in global growth, and China in particular.

− Geopolitics is an important consideration as evidenced by recent oil price gyrations.

Property



» Property remains an attractive asset class for investors requiring yield.

» Total returns will come mostly from income with limited scope for capital growth with global REIT stocks at somewhat elevated valuations today.

» When viewed against high quality, longer duration Sterling assets and inflation linked bonds, UK property outside London holds some appeal, with industrial and office space having more attractive fundamentals than the under pressure retail sector.

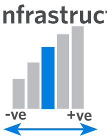
+ Attractive yields should continue to attract capital and provide some floor to prices, as will any sustained Sterling weakness.

+ The longer duration qualities of the asset class makes it a good diversifier within multi asset portfolios.

− As a long duration asset class property remains susceptible to any repricing in long term bond yields.

− UK property remains sensitive to eventual Brexit terms, which continue to evolve.

Infrastructure



» Infrastructure stocks trade at reasonable valuations today - broadly in line with global equities - and performance has held up stronger through recent market weakness.

» Their income generating potential should continue to support the sector and attract buyers of quality infrastructure assets.

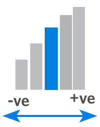
+ In a multi asset portfolio the relatively defensive nature of the asset class and a degree of inflation protection make the asset class appealing.

+ The asset class offers a healthy yield at a reasonable valuation today - both equity and debt flavours.

− As a long duration asset class infrastructure remains susceptible to any repricing in long term bond yields.

− Regulation can work both for and against the underlying investments, and a spate of recent accidents has hit a handful of stocks hard.

Liquid Alternatives



» We define this section as less/non-directional, absolute return type strategies that seek to capture long term risk premia or market mispricings, and includes hedge fund alternatives in predominantly UCITS vehicles.

» We favour an allocation to a basket of liquid strategies today to provide additional diversification as high quality bonds on the whole remain expensive.

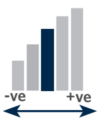
+ These strategies provide additional diversification with reasonable return potential.

− The sector is relatively young and growing. It remains somewhat untested through a protracted risk off period so thorough due diligence is vital, and blend is recommended.

− The hurdle for performance is higher given the more attractive level of treasury yields today.

Currencies*

GBP



» Brexit uncertainty remains high, particularly given recent political developments and Sterling remains volatile. We retain a neutral view until we have a clearer expectation around how the Brexit plan and indeed political situation evolves. With Sterling looking fairly beaten up there is probably more upside than downside risk today at the margin.

» In real terms the currency remains at the lower end of valuations and has room to appreciate over the medium to long term, but politics and rate policy are likely to dominate its nearer term path, and remains a source of volatility. The currency's future path remains a binary outcome at present.

EUR

» The Euro remains somewhat rangebound today and lacks conviction either way. Whilst any change in explicit rate policy has now been pushed towards the latter half of 2019, the reducing quantum of bonds the ECB is purchasing may increase rates volatility.

» In real terms the common currency looks about fair value today but with long market positioning continuing to scale back there is no obvious and imminent catalyst for an uplift.

JPY

» Rate differentials continue to offer little reason to buy the Yen. However, in real terms the Yen remains cheap today and recent weakening accentuates this.

» What sets the Yen apart from Sterling and the Euro is the currency's diversifying qualities at times of risk. Market positioning has recently built up on the short side which when coupled with heightened volatility could see some uplift. As such we favour a modest bias to the Yen today.

*Currencies views are expressed versus the US Dollar