MANAGED PORTFOLIO SERVICE (MPS)
MPS INDEX (IDX) STRATEGIES
MARKET & REBALANCE COMMENTARY - Q2 2019

QUILTER CHEVIOT
INVESTMENT MANAGEMENT

EXECUTIVE SUMMARY

- The second quarter of 2019 was another pleasing period for investors, as signs of a breakthrough on the US / China trade impasse and expectations for lower interest rates left many equity markets at or near all-time highs
- Developed stock markets rose strongly for the three months as a whole, despite the resurfacing of trade tensions in May, while for UK investors sterling weakness accentuated gains made across international regions
- Government and corporate bond markets responded favourably to central banks' increasingly accommodative monetary policy rhetoric; the US 10 year yield fell back to 2% while German and Japanese government bonds moved deeper into negative territory
- The IDX strategies delivered positive absolute returns across all risk profiles, building upon the gains made in the first three months of the year
- After such a strong start by stock markets to 2019, we decided to selectively reduce the strategies' European and Japanese equity exposure, retaining the proceeds in cash

The table shows the performance of the IDX strategies for the 3 month, 1, 3 and 5 year periods to 30 June 2019.

Strategy/Benchmark/IA Sector	Q2 2019 (%)	1 Year (%)	3 Year (%)	5 Year (%)
IDX Growth	**4.52**	**4.77**	**31.79**	**50.15**
Strategy Benchmark[1]	4.11	5.18	32.48	51.89
IA Flexible Investment	4.02	2.95	27.50	38.11
IDX Balanced	**3.85**	**4.47**	**27.11**	**45.11**
Strategy Benchmark[2]	3.62	4.98	27.57	46.70
IA Mixed Investment 40-85% Shares	4.21	3.62	26.19	37.34
IDX Income	**3.26**	3.84	**21.94**	**37.90**
Strategy Benchmark[3]	3.31	4.64	23.18	41.46
IA Mixed Investment 20-60% Shares	2.86	2.89	17.91	25.77
IDX Conservative	**2.68**	**3.94**	**16.39**	**33.10**
Strategy Benchmark[4]	2.04	3.39	16.46	35.68
IA Mixed Investment 20-60% Shares	2.86	2.89	17.91	25.77

Source: Quilter Cheviot Limited, Financial Express, 11 July 2019. All figures to 30 June 2019. Strategy performance is shown gross of management fees with all income reinvested, real returns may vary. IA Sector returns are net of the underlying fund manager charges while benchmarks will not include any charges. **Past performance is not a guarantee of future results.**

MARKET COMMENTARY

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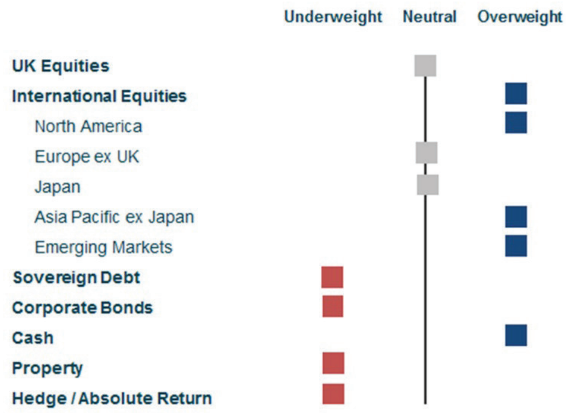
For private clients: https://www.quiltercheviot.com/uk/private-client/insights/

TACTICAL POSITIONING OVERVIEW – 30 JUNE 2019

In the final weeks of the quarter we selectively trimmed the strategies' equity exposure, taking profits after such a strong start to 2019 by reducing the allocations to Europe and Japan. The proceeds of these sales are currently being retained in cash, leaving the weighting slightly elevated for now. Despite this move, the strategies remain modestly tilted towards equity markets within the context of their respective risk profiles.

We remain mildly optimistic on the economic outlook, while financial conditions are supportive of a continuing improvement in corporate profitability. However, equity markets are at the upper end of their recent trading range, and valuations do not look obviously cheap. A period of consolidation would therefore not be surprising, and having reduced the strategies' exposure to equities, we would review any meaningful pullback as an opportunity to deploy some of the 'dry powder' currently held in cash.

IDX BALANCED STRATEGY TACTICAL POSITIONING – 30 JUNE 2019



Q2 2019 MODEL STRATEGY ATTRIBUTION ANALYSIS

All index and fund returns are quoted on a total return basis in sterling terms. Please note that not all strategies may hold the investments detailed below. Further information relating to a particular strategy and its current allocations can be obtained from your usual Quilter Cheviot representative.

Fixed Interest: Bond yields fell steadily as prices rose over the second quarter of 2019, ensuring that sovereign debt (particularly longer-dated conventional and index-linked gilts) produced positive returns. The US 10-year yield moved back down to 2%, while the prospect of more quantitative easing pushed German and Japanese government bonds deeper into negative territory. Closer to home, the 10-year gilt yield dipped below 1% again, with the **iShares UK Gilts All Stocks Index** fund reflecting this move with a total return of 1.5%. The **Legal & General All Stocks Index Linked Gilt Index** fund fared even better, returning 2.3% to take year-to-date gains to over 8%.

Credit markets also performed strongly over the quarter, with the strategies' holdings in the **Vanguard Global Corporate Bond Index** and **Vanguard UK Investment Grade Bond Index** funds returning 3.3% and 2.0% respectively.

The strategies remain 'underweight' fixed interest from a tactical asset allocation perspective.

Equities – UK: The FTSE All-Share returned 3.3% over the second quarter, with larger companies marginally outperforming mid-cap names and smaller companies trailing behind. From a sector perspective Technology and Industrials performed strongly, while Telecoms and Utilities lagged.

The strategies remain neutrally weighted to the country from a tactical asset allocation perspective.

Equities – North America: The FTSE North America index returned 6.8% in sterling terms over the quarter, with the strength of the US dollar relative to the pound boosting gains for a UK-based investor. The sell-off seen in May was reversed by the end of June as trade tensions receded and the Fed provided further comfort to markets, ensuring a positive, albeit volatile period. Once again "growth" stocks outperformed during the quarter, while from a sector perspective Technology was the biggest contributor to headline returns, with Microsoft, Adobe and payment companies (Visa, MasterCard and PayPal) performing well. Financials were also strong, led primarily by AIG, CME Group, Amex, Citigroup and JPMorgan. Conversely, the Healthcare sector struggled, influenced principally by looming elections and the potential of political strains on companies, while the Energy sector was yet again the worst performing area of the market.

The strategies remain modestly 'overweight' the region from a tactical asset allocation perspective.

Equities – Europe ex UK: The FTSE Developed Europe ex UK index returned 8.2% in sterling terms over the period, with the euro appreciating sharply against the pound. Trade concerns helped fuel volatility in much the same way as across other regions, while eurozone exporters continue to suffer disproportionately from the slowdown in China, weaker global trade, threatened US tariffs and a disruptive Brexit. However, the resilience of the domestic economy should still support 1% GDP growth in 2019.

During the quarter we reduced the strategies' allocation to the region, moving from an 'overweight' to a 'neutral' weighting from a tactical asset allocation perspective.

Equities – Japan: The FTSE Japan index returned 2.9% in sterling terms, with the yen strengthening materially against the pound to ensure a positive return for sterling investors in an otherwise disappointing period for Japanese equities. Large companies generally outperformed smaller counterparts in a repeat of the recent trend, while 'growth' names continued to outperform unloved 'value' stocks. 2019 has so far also been notable for the surge in share buybacks, up over 100% vs 2018 and which have typically come with meaningful share price uplifts.

During the quarter we reduced the strategies' allocation to the country, moving from an 'overweight' to a 'neutral' weighting from a tactical asset allocation perspective.

Equities – Asia Pacific ex Japan: The FTSE Developed Asia Pacific ex Japan index returned 5.9% in Q2, with Australia and Singapore performing strongly amidst ongoing trade uncertainty.

The strategies remain 'overweight' the region from a tactical asset allocation perspective.

Equities – Emerging Markets: The FTSE Emerging Index returned 3.8% during the second quarter, as major markets – with the exception of China – posted a positive return in sterling terms. Russia led the way as oil prices remained supportive, while the growing perception that political risk has softened within the country helped bolster investor sentiment. In Brazil, the market has continued to rise since last year's election, hitting historic highs of late. In contrast, the FTSE China index was the worst performing country in the region during the second quarter, despite being the best performing market in the first three months of 2019. Turning to India, and at the end of May Narendra Modi and his ruling BJP increased their majority in India by winning 303 seats in the lower house of parliament. Following a dip in markets in the lead up to the results, the Indian stock market posted modest gains for the quarter as a whole.

The strategies remain 'overweight' emerging markets from a tactical asset allocation perspective.

Alternatives: The strategies' absolute return / hedge fund exposure delivered a positive return over the quarter, with the **Aspect Diversified Trends** fund continuing its strong rally year-to-date to post a total return of 6.0%. This was driven primarily by its long bond exposure, although equity and commodity exposure also contributed to returns. Holdings in the **LFIS Vision UCITS Premia**, **Invesco Global Targeted Returns** and **Mygale Event Driven UCITS** funds also registered gains for the period. In contrast, the **Merian Global Equity Absolute Return** fund finished in negative territory for the second consecutive period, returning -2.3%. We wrote in more detail about the fund last quarter, and there has been no change to our view of the holding as a long-term source of diversified returns within a basket of alternative investments. Please see the *Model Strategy Changes* section for more detail on the current composition of the allocation.

IDX STRATEGIES – Q2 2019 MODEL STRATEGY CHANGES

Please note that the activity detailed below many not apply to each IDX strategy. Further information relating to a particular strategy and its current allocations can be obtained from your usual Quilter Cheviot representative.

During the quarter we implemented several changes to the IDX strategies, taking profits across existing equity positions while introducing a new fund idea. To summarise, the key changes made to the strategies' **asset allocations** during the quarter were as follows:

- We selectively **reduced** the strategies' exposure to **European equities**
- We selectively **reduced** the strategies' exposure to **Japanese equities**
- We selectively **increased** the strategies' exposure to **cash**

Within the strategies' alternatives allocation we trimmed the exposure to the **Aspect Diversified Trend**s fund following its recent strong performance. We also exited the **Invesco Global Targeted Returns** fund in favour of the **PIMCO Dynamic Multi-Asset** fund. This is a relatively new addition to coverage that combines 'top-down' ideas with 'bottom-up' analysis to produce a portfolio diversified across asset classes and by geographical exposure. Its objective is to generate attractive risk-adjusted returns over the course of a market cycle, by following a philosophy that impresses us with its proactive, tactical nature and approach to risk management.

CONCLUSION

Despite accommodative financial conditions, central banks once again appear to be on the cusp of co-ordinated easing. The Federal Reserve is expected to cut rates by at least 0.25% in July, the ECB is likely to follow and restart quantitative easing later in the year, and the Bank of Japan will extend its guidance by maintaining low rates until late 2020 and may also resume asset purchases.

The good news from the G20 meeting in late June was that the US and China agreed to re-open trade discussions and postpone another round of higher tariffs. The US is to loosen some restrictions on high-tech exports and China will increase purchases of agricultural products. The bad news is the uncertainty continues, and there appears to be little progress on key sticking points including the speed of existing tariff removal, enforcement of transfer restrictions on intellectual property and trade deficit reductions.

Analysts continue to revise down estimates for corporate profits growth, as the spike caused by pre-tariff stockpiling fades and corporate profitability reverts to trend. The revisions are similar in scale to the 2015/16 global growth slowdown, with the largest downgrades concentrated on the US followed by Japan and the eurozone. Energy and information technology have been the most affected sectors.

A meaningful improvement in corporate results will be needed in the second half of the year to meet the current 4% growth estimate. In a low growth environment, companies with above average sales and the ability to generate strong free cash flow to support dividends and share buybacks have consistently outperformed. Many are technology and consumer focused, whereas the laggards have tended to be traditional 'value' companies, typically industrial cyclicals and financials. While the latter are not universally unattractive, it may take more than erratic policy decisions for performance leadership to change.

We remain mildly optimistic on the economic outlook, while financial conditions are supportive of a continuing improvement in corporate profitability. However, equity markets are at the upper end of their recent trading range, and valuations do not look obviously cheap. A period of consolidation would therefore not be surprising, and having trimmed the model strategy's exposure to equities in recent weeks, we would review any meaningful pullback as an opportunity to deploy some of the 'dry powder' currently held in cash.

Source: Quilter Cheviot, Financial Express, July 2019

(1) The strategy benchmark was 100% FTSE UK Private Investor Growth Index to 3 April 2018 and then 100% MSCI WMA Private Investor Growth Index thereafter.

(2) The strategy benchmark was 100% FTSE UK Private Investor Balanced Index to 3 April 2018 and then 100% MSCI WMA Private Investor Balanced Index thereafter.

(3) The strategy benchmark was 100% FTSE UK Private Investor Income Index to 3 April 2018 and then 100% MSCI WMA Private Investor Income Index thereafter.

(4) The strategy benchmark was 100% FTSE UK Private Investor Conservative Index to 3 April 2018 and then 100% MSCI WMA Private Investor Conservative Index thereafter. The Conservative strategy benchmark then changed to a composite on 2 January 2019.

Performance data for the above benchmarks is therefore shown as a combination of both benchmarks over relevant time periods, and may differ from the performance calculated for one of these alone. Full details of the history of the strategy benchmarks are available upon request.

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