MANAGED PORTFOLIO SERVICE
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 MPS 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 MPS strategies for the 3 month, 1, 3 and 5 year periods to 30 June 2019.

Strategy/Benchmark/IA Sector	Q2 2019 (%)	1 Year (%)	3 Years (%)	5 Years (%)
MPS Global Growth	**6.02**	**6.18**	**42.22**	**61.77**
Strategy Benchmark(1)	6.05	9.62	48.13	86.17
IA Global	6.40	7.50	45.10	67.80
MPS Growth	**4.18**	**2.70**	**29.24**	**39.10**
Strategy Benchmark(2)	4.11	5.18	32.48	51.89
IA Flexible Investment	4.02	2.95	27.50	38.11
MPS Balanced	**3.63**	**2.77**	**25.11**	**35.43**
Strategy Benchmark(3)	3.62	4.98	27.57	46.70
IA Mixed Investment 40-85% Shares	4.21	3.62	26.19	37.34
MPS Global Income	**3.97**	**4.60**	**25.19**	**38.07**
MPS Global Income Composite Index	4.52	8.04	34.03	62.88
IA Mixed Investment 40-85% Shares	4.21	3.62	26.19	37.34
MPS Income	**3.16**	**2.57**	**20.74**	**30.43**
Strategy Benchmark(4)	3.31	4.64	23.18	41.46
IA Mixed Investment 20-60% Shares	2.86	2.89	17.91	25.77
MPS Conservative	**2.68**	**3.16**	**15.78**	**25.79**
Strategy Benchmark(5)	2.04	3.39	16.46	35.68
IA Mixed Investment 20-60% Shares	2.86	2.89	17.91	25.77
MPS Cautious	**1.55**	**1.95**	**10.84**	**20.37**
MPS Cautious Composite Index	1.18	2.37	7.73	29.62
IA UK Gilt	1.61	4.86	6.58	31.60

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.**

INVESTMENT INSIGHTS

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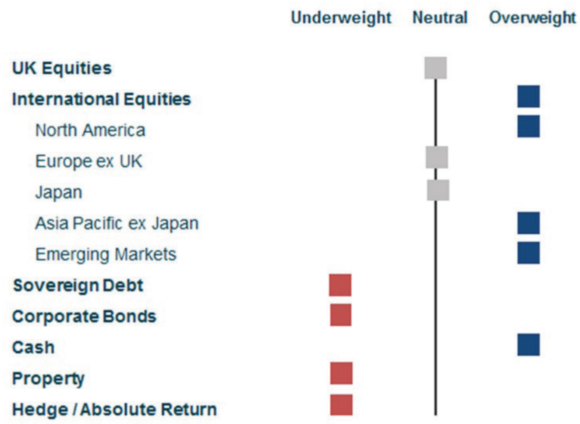
TACTICAL POSITIONING OVERVIEW – 30 JUNE 2019

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.

MPS 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 **Allianz Gilt Yield** fund reflecting this move with a total return of 1.9%. The **Allianz Index-Linked Gilt** fund fared even better, returning 2.4% to take year-to-date gains to over 8%.

Credit markets also performed strongly over the quarter, with the core strategies' holdings delivering a positive return and helping the allocation outperform. Notable highlights included the internationally-focused **PIMCO Global Investment Grade Credit** and **Royal London Sterling Credit** funds, which rose 3.1% and 2.6% respectively.

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 core strategies' exposure finished marginally behind the market over the quarter. In a similar fashion to the first three months of 2019, strong relative returns from the strategies' holdings in the **Merian UK Alpha**, **Investec UK Alpha** and **Artemis Income** funds were offset by the underperformance of the **Majedie UK Equity** fund, which returned 0.6% during the period – a result of its more defensive, domestically-orientated approach. The fund's key detractors were holdings in Saga, Centrica and M&S, while positives included the fund's exposure to gold companies and an underweight position to poorly-performing tobacco stocks. We have been engaging closely with the team this year as the fund has struggled on a relative basis, and continue to like its process and long-term alignment of interests with its investors. It is our view that they are taking the necessary action to address the recent underperformance, with changes to the underlying management structure of the fund evidence of this resolve. In the meantime, we made a small reduction to the strategies' holdings during the quarter as we monitor the effectiveness of these changes, reallocating the proceeds across existing holdings.

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 overall. 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 core strategies' active holdings marginally lagged the index over the quarter, but remain comfortably ahead in aggregate year-to-date. The **Iridian US Equity** fund was the main culprit, trailing over the period with a return of 3.0% and giving back some relative outperformance from earlier in 2019. Elsewhere, a strong June boosted the returns seen from the **Vulcan Value Equity** fund, which finished the quarter with a gain of 7.2%. Strong contributions came from names including Hilton, Teradyne, McKesson and Everest Re, as well as both MasterCard and Visa. We continue to believe the portfolio provides an attractive balance between more traditionally-defined 'value' companies and those offering underappreciated structural growth.

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.

The strategies' exposure to the **Janus Henderson European Selected Opportunities** fund outperformed over the period with a return of 9.2%. In contrast, we saw the **JOHCM Continental European** fund lag prior to its disposal in June. We introduced a new holding to the strategies in its place, while at the same time trimming our exposure to the region, with further detail included in the *Model Strategy Changes* section overleaf.

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% versus 2018 and which have typically come with meaningful share price uplifts. The strategies' exposure outperformed in aggregate, driven principally by the **Baillie Gifford Japanese Income Growth** fund, which returned 6.2% to continue its fine track record since its launch in 2016.

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. Turning to the strategies' exposure, and pleasing stock selection by the manager of the **Veritas Asian** fund led to a total return of 6.7% from the holding, with the fund's Consumer Staples, Health Care and Communication Services exposure the key contributors to outperformance. Conversely, the **BlackRock Asian Growth Leaders** lagged with a total return of 0.6%, with the majority of the fund's underperformance arising from the lack of exposure to developed Asian markets, as well as stock selection across the Indian holdings. There were no changes to the strategies' exposure during the period.

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.

Against this backdrop, the strategies' exposure delivered a positive return over the quarter, outperforming the broader market. The **Lazard Emerging Markets** fund returned 6.1%, with the overweight allocations to Latin America and Russia both key drivers of relative performance. The **Janus Henderson Emerging Markets Opportunities** fund also performed well prior to its disposal in June. Again, further detail on the rationale behind this activity is included within the *Model Strategy Changes* section.

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 returns within a diversified basket of alternative investments. Please see the *Model Strategy Changes* section for more detail on the current composition of the allocation.

Lastly, the strategies' commercial property exposure – now achieved solely through the **BMO Property Growth & Income** fund – posted a small loss of -0.8%.

Q2 2019 MODEL STRATEGY CHANGES

Please note that the activity detailed below many not apply to each MPS 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 MPS strategies, taking profits across existing equity positions while introducing a number of new fund ideas. 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**

From a **fund selection** perspective we also made a number of changes to the strategies' underlying holdings. Starting in the UK, we reduced exposure to the **Majedie UK Equity** fund, allocating the proceeds to the existing holdings in the **Investec UK Alpha** and **Artemis Income** funds. As mentioned earlier, we remain happy holders of the fund, albeit at a lower weighting.

In Europe, we exited the strategies' allocation to the **JOHCM Continental European** fund, replacing it with the **Alliance Bernstein Europe ex UK** fund, a higher conviction recommendation from our analyst. The strategy seeks to invest in attractively priced companies displaying a competitive advantage that are in the midst of positive change and / or within industries demonstrating strong dynamics. Overseen by two portfolio managers who are supported by a well-respected (and resourced) team of analysts, the fund offers attractive 'core' exposure to European equity markets and, importantly, does so with a very appealing charging structure.

Moving further afield we introduced the **JPM Emerging Markets** fund in place of clients' exposure to the **Janus Henderson Emerging Markets Opportunities** fund. The JPM strategy, overseen by lead manager Leon Eidelman, seeks to identify quality companies with sustainable growth characteristics, and has a current focus on stocks exposed to the increasingly influential emerging markets consumer. In summary, we like the team, the process, and the structural opportunities that we believe the fund provides access to.

Finally, within the strategies' alternatives allocation we trimmed the exposure to the **Aspect Diversified Trends** 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 the Global Growth Composite from strategy launch to the beginning of July 2011 changing to 100% FTSE UK Private Investor Global Growth Index to 3 April 2018 and then 100% MSCI WMA Private Investor Global Growth Index thereafter.

(2) 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.

(3) 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.

(4) 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.

(5) The strategy benchmark was the Conservative Composite up to the beginning of July 2011 changing to 100% FTSE UK Private Investor Conservative Index to 3 April 2018 and then 100% MSCI WMA Private Investor Conservative Index. The Conservative strategy 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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Investors should remember that the value of investments, and the income from them, can go down as well as up and that past performance is no guarantee of future returns. You may not recover what you invest.