IMPERIUM CAPITAL

momentum

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Newsflash

A new month and the 151st issue of Viewpoint from **Imperium Capital**.

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Market Commentary

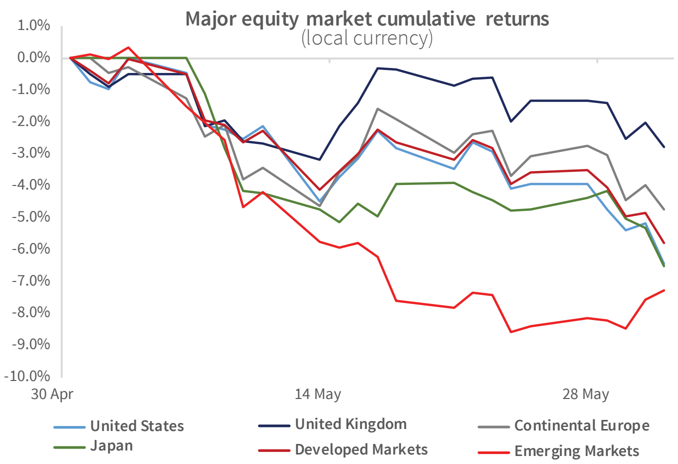
To say we are living through extraordinary times is beyond dispute. The current economic expansion in the US is soon set to become the longest in history, employment growth in the US and elsewhere has been very strong, monetary policy across the developed world remains ultra-loose by any historical standard and yet inflation is still remarkably subdued. Indeed, recent falls in core inflation measures especially in the US have rattled investors and raised fears of weaker growth and tougher conditions for the corporate sector ahead, and in Europe and Japan of prolonged deflation. US inflation as measured by core PCE deflator has fallen to 1.6%, well below the Fed's target of 2%, which has hardly been breached throughout the post crisis decade.

It was the (perhaps entirely predictable) unpredictability of the US President which dominated the market narrative and unnerved investors in May. In early May, President Trump tweeted that tariffs of 10% on $200bn of Chinese goods would rise to 25%, signalling a near collapse in the trade talks and completely over-turning the perception given in preceding months that trade talks were leading to a satisfactory conclusion. Then at the end of the month came the tweet imposing, again without warning, tariffs of 5%, rising to 25% by October in monthly stages, on all imports from Mexico unless the flow of illegal immigrants coming through Mexico is stopped. In between these announcements the US added Huawei to a list of companies that US companies cannot trade with unless they have a licence, citing security issues, and thereby raising the stakes further with China. At a stroke the President has escalated fears of an all out trade war with global ramifications and taken the issue beyond trade into politics, heightening the unpredictability and uncertainty for investors.

Markets reacted accordingly in May, with a sharp shift out of risk assets, notably equities and junk bonds, into safe havens. All equity markets suffered, with the MSCI World index down 5.8% and, unsurprisingly in an environment of rising fears about global trade and growth, emerging markets weakened even more, with the Global Emerging Markets index declining 7.3%. Within emerging markets the Chinese equity market was the notable underperformer, declining 8.9% in US dollar terms. In contrast, government bond yields fell sharply, with 10 year yields on US Treasuries falling by 38bps in the month while German 10 year yields fell to new all-time low of -0.20%. Yields on German government bonds are now negative out to 13 year maturities. This resulted in a return of 2.5% for US Treasuries in May, and 1.5% for Global bonds. As recessionary fears surfaced credit spreads widened, and investment grade bonds underperformed government bonds, returning 1.4% while high yield bonds suffered negative returns, down 1.2%. The flight to safe havens was reflected in a rise of 2.9% in the Japanese yen and 1.7% in gold.

The sudden deterioration of the US-China trade war and the escalation beyond trade into intellectual property theft, cyber security, FX intervention etc combined with the real fear that the US will become increasingly aggressive with other trading partners has heightened the risks of serious damage being inflicted on the global economy. To date the impact has been reflected in weak manufacturing activity, especially in China, its Asian trading partners and big exporting countries such as Germany. While the consumer and service sector has been resilient, recent data releases have been disappointing and raise concerns that the slowdown in global growth this year could become more than a soft patch.

Figure 1.1: The end result in markets during May was a uniform risk-off move



Source: Bloomberg, Momentum GIM. Returns in local currency terms

Events in Europe have not helped the outlook. The announcement of Prime Minister May's resignation has done nothing to lift the uncertainty overhanging the UK. Theresa May is almost certain to be replaced by a Brexiteer as new Tory party leader and Prime Minister, and with it the heightened risk of a no deal exit when the UK's current membership of the EU is due, the 31st October. With the disastrous results of the European Parliament elections for the governing Tory party, which polled its lowest ever result in a national poll, and the impasse in Parliament around the UK's exit from the EU, the risks of an early general election and further lengthy uncertainty have increased materially. Sterling had been one of the best performing currencies in the early months of the year but lost all of that in May with a fall of 3.2% vs the US dollar. Until there is greater clarity about the terms of the UK's exit from the EU and the rapidly evolving political landscape, there appears to be little prospect of a meaningful rally for sterling, even though the currency appears undervalued.

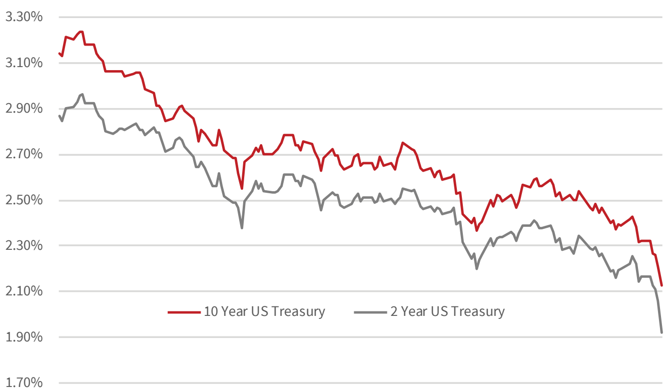
Elsewhere in Europe the unfolding battle between Italy's populist government and the EU Commission unsettled investors. The EU threatened Italy with heavy fines for exceeding its debt limits while the Italian government pressed on with plans for tax cuts and stimulus measures to pull the economy out of its long stagnation. Italy's cause was undeniably aided by the resounding success of Salvini's populist League party in the European Parliamentary elections, taking 34% of the vote, up from the 6.2% secured in the last EU ballot 5 years ago. Together with other populist, anti-establishment, anti-EU parties, the Europe wide election resulted in the two dominant pro-EU centrist parties losing their majority for the first time ever, a shift which will almost certainly make Macron's plans for greater EU integration impossible to implement.

Events have moved rapidly and worryingly over the past month. The Fed's policy pivot to a dovish stance was the key driving force behind the sharp rise in markets over the first four months of the year but has now been fully discounted – to such an extent that the market is now pricing in up to two interest rate cuts this year. The full-blown escalation of the US-China trade war to much broader issues than trade alone, and beyond China to the closest allies and trading partners of the US, poses a serious threat to global stability and the global economy. It changes the dynamics in financial markets and heightens the risk of recession, or at the very least a further sharp slowdown in growth with negative implications for the corporate sector.

Some caution is therefore warranted in the short term, with recent moves vindicating the more cautious stance that we have been advocating since the end of March.

However, while recent leading indicators globally of trade, manufacturing and industrial production have generally been weak, the key service sector has remained buoyant and employment has been strong, pointing to sufficient momentum to keep the economic expansion intact, albeit at relatively subdued levels. With inflation subdued central banks have considerable flexibility in keeping policy ultra loose, and even looser should current low levels of inflation prove intractable. Furthermore, the extent of the falls in government bond yields and the impact on financial conditions and valuations of other markets should not be under-estimated: US bond yields have fallen by a full one percentage point over the past 7 months. This provides a strong underpinning to equities and other risk assets, offsetting the more challenging conditions faced by the corporate sector after last year's benign backdrop.

Figure 1.2: The 10 Year Treasury yield has fallen one percentage point over the past 7 months



Source: Bloomberg, Momentum GIM.

Risks abound and have been highlighted with dramatic effect in the past month. The period of consolidation in markets that we have been calling for is well underway and could continue in the short term, particularly bearing in mind that most markets are still well ahead so far this year. However, any sign of a thawing of relations between the US and China and a resolution to the current impasse would be quickly reflected in markets; predicting the actions of unpredictable leaders is unlikely to make a sustainable investment policy but it seems to us that both Trump and Xi recognise that a resolution rather than further escalation is in both their interests and common ground will ultimately be found. We therefore take the view that the cycle has further to run and if falls in markets continue interesting valuation opportunities will arise.

Market Performance - Global (Local returns)

Asset Class/Region	Index	To 30 April 2019				
		Currency	1 Month	3 Months	Year to date	12 Months
Developed markets equities						
United States	S&P 500 NR	**USD**	-6.4%	-0.8%	10.4%	3.2%
United Kingdom	MSCI UK NR	**GBP**	-2.8%	2.5%	8.7%	-2.5%
Continental Europe	MSCI Europe ex UK NR	**EUR**	-4.7%	1.2%	11.7%	0.3%
Japan	Topix TR	**JPY**	-6.5%*	-4.9%	2.4%	-11.4%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	**USD**	-7.0%	-3.8%	5.5%	-8.8%
Global	MSCI World NR	**USD**	-5.8%	-1.1%	9.7%	-0.3%
Emerging Market Equities						
Emerging Europe	MSCI EM Europe NR	**USD**	1.3%	2.4%	11.7%	6.8%
Emerging Asia	MSCI EM Asia NR	**USD**	-8.8%	-5.5%	3.2%	-12.4%
Emerging Latin America	MSCI EM Latin America NR	**USD**	-2.0%	-4.1%	6.1%	8.2%
BRICs	MSCI BRIC NR	**USD**	-7.6%	-3.8%	7.0%	-7.2%
Global emerging markets	MSCI Emerging Markets NR	**USD**	-7.3%	-4.5%	4.1%	-8.7%
Bonds						
US Treasuries	JP Morgan United States Government Bond TR	**USD**	2.5%	4.3%	4.4%	6.5%
US Treasuries (inflation protected)	BBgBarc US Government Inflation Linked TR	**USD**	1.8%	4.1%	5.5%	4.5%
US Corporate (investment grade)	BBgBarc US Corporate Investment Grade TR	**USD**	1.4%	4.5%	7.2%	7.4%
US High Yield	BBgBarc US High Yield 2% Issuer Cap TR	**USD**	-1.2%	1.2%	7.5%	5.5%
UK Gilts	JP Morgan UK Government Bond TR	**GBP**	2.9%	4.8%	4.8%	4.4%
UK Corporate (investment grade)	ICE BofAML Sterling Non-Gilt TR	**GBP**	1.0%	3.3%	5.1%	4.3%
Euro Government Bonds	ICE BofAML Euro Government TR	**EUR**	1.1%	2.9%	3.6%	4.9%
Euro Corporate (investment grade)	BBgBarc Euro Aggregate Corporate TR	**EUR**	-0.2%	2.0%	3.8%	3.1%
Euro High Yield	BBgBarc European High Yield 3% Constrained TR	**EUR**	-1.4%	1.0%	5.2%	2.6%
Japanese Government	JP Morgan Japan Government Bond TR	**JPY**	0.8%	1.3%	2.1%	2.6%
Australian Government	JP Morgan Australia GBI TR	**AUD**	2.2%	4.7%	6.6%	10.7%
Global Government Bonds	JP Morgan Global GBI	**USD**	1.9%	2.7%	3.2%	3.1%
Global Bonds	ICE BofAML Global Broad Market	**USD**	1.5%	2.6%	3.5%	3.4%
Global Convertible Bonds	ICE BofAML Global Convertibles	**USD**	-2.8%	-0.9%	6.8%	-0.3%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	**USD**	1.0%	1.4%	6.5%	6.2%

Source: Bloomberg | ***Past performance is not indicative of future returns.*** | **) denotes estimate*

Market Performance - Global (Local returns)

Asset Class/Region	Index	To 30 April 2019				
		Currency	1 Month	3 Months	Year to date	12 Months
Property						
US Property Securities	MSCI US REIT NR	**USD**	2.5%	3.2%	0.4%*	7.7%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	**AUD**	2.5%	5.9%	13.8%	11.5%
Asia Property Securities	S&P Asia Property 40 Index NR	**USD**	-3.2%	-0.7%	7.9%	1.3%
Global Property Securities	S&P Global Property USD TR	**USD**	-0.8%	1.9%	12.3%	5.6%
Currencies						
Euro		**USD**	-0.4%	-1.8%	-2.6%	-4.5%
UK Pound Sterling		**USD**	-3.1%	-4.8%	-1.0%	-5.0%
Japanese Yen		**USD**	2.9%	2.9%	1.2%	0.5%
Australian Dollar		**USD**	-1.6%	-2.2%	-1.6%	-8.3%
South African Rand		**USD**	-1.9%	-3.4%	-1.4%	-12.9%
Commodities & Alternatives						
Commodities	RICI TR	**USD**	-4.8%	-4.2%	4.7%	-11.4%
Agricultural Commodities	RICI Agriculture TR	**USD**	4.1%	0.1%	-0.7%	-12.5%
Oil	Brent Crude Oil	**USD**	-11.4%	-2.3%	19.9%	-16.9%
Gold	Gold Spot	**USD**	1.7%	-0.6%	1.8%	0.5%
Hedge funds	HFRX Global Hedge Fund	**USD**	-1.0%	-0.5%	2.2%	-4.0%
Interest rates						
United States			2.50%			
United Kingdom			0.75%			
Eurozone			0.00%			
Japan			0.10%			
Australia			1.25%			
South Africa			6.75%			

Source: Bloomberg | ***Past performance is not indicative of future returns.*** | ** denotes estimate*

Market Performance - UK (All returns in GBP)

Asset Class/Region	Index	To 30 April 2019				
		Currency	1 Month	3 Months	Year to date	12 Months
Developed markets equities						
UK - All Cap	MSCI UK NR	**GBP**	-2.8%	2.5%	8.7%	-2.5%
UK - Large Cap	MSCI UK Large Cap NR	**GBP**	-2.4%	3.1%	8.7%	-0.8%
UK - Mid Cap	MSCI UK Mid Cap NR	**GBP**	-4.9%	-1.5%	6.4%	-11.9%
UK - Small Cap	MSCI Small Cap NR	**GBP**	-3.7%	2.4%	13.2%	-7.0%
United States	S&P 500 NR	**USD**	-3.4%	4.2%	11.5%	8.6%
Continental Europe	MSCI Europe ex UK NR	**EUR**	-2.1%	4.2%	9.9%	1.0%
Japan	Topix TR	**JPY**	-1.6%*	2.5%	4.7%*	-6.5%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	**USD**	-3.9%	1.0%	6.5%	-4.0%
Global developed markets	MSCI World NR	**USD**	-2.7%	3.8%	10.8%	5.0%
Global emerging markets	MSCI Emerging Markets NR	**USD**	-4.2%	0.3%	5.1%	-3.9%
Bonds						
Gilts - All	ICE BofAML UK Gilt TR	**GBP**	2.9%	4.6%	4.8%	4.4%
Gilts - Under 5 years	ICE BofAML UK Gilt TR 0-5 years	**GBP**	0.5%	0.8%	0.8%	1.1%
Gilts - 5 to 15 years	ICE BofAML UK Gilt TR 5-15 years	**GBP**	2.2%	3.4%	3.4%	4.6%
Gilts - Over 15 years	ICE BofAML UK Gilt TR 15+ years	**GBP**	4.4%	7.4%	7.9%	6.0%
Index Linked Gilts - All	ICE BofAML UK Gilt Inflation-Linked TR	**GBP**	4.2%	9.2%	8.9%	8.9%
Index Linked Gilts - 5 to 15 years	ICE BofAML UK Gilt Inflation-Linked TR 5-15 years	**GBP**	2.8%	4.5%	3.6%	6.3%
Index Linked Gilts - Over 15 years	ICE BofAML UK Gilt Inflation-Linked TR 15+ years	**GBP**	5.1%	11.6%	11.6%	10.4%
UK Corporate (investment grade)	ICE BofAML Sterling Non-Gilt TR	**GBP**	1.0%	3.3%	5.1%	4.3%
US Treasuries	JP Morgan US Government Bond TR	**USD**	5.9%	9.5%	5.4%	12.1%
US Corporate (investment grade)	BBgBarc US Corporate Investment Grade TR	**USD**	1.4%	4.5%	7.2%	7.4%
US High Yield	BBgBarc US High Yield 2% Issuer Cap TR	**USD**	-1.2%	1.2%	7.5%	5.5%
Euro Government Bonds	ICE BofAML Euro Government TR	**EUR**	1.1%	2.9%	3.6%	4.9%
Euro Corporate (investment grade)	BBgBarc Euro Aggregate Corporate TR	**EUR**	-0.2%	2.0%	3.8%	3.1%
Euro High Yield	*BBgBarc European High Yield 3% Constrained TR*	**EUR**	-1.4%	1.0%	5.2%	2.6%
Global Government Bonds	JP Morgan Global GBI	**GBP**	5.2%	7.9%	4.1%	8.6%
Global Bonds	ICE BofAML Global Broad Market	**GBP**	1.5%	2.6%	3.5%	3.4%
Global Convertible Bonds	ICE BofAML Global Convertibles	**GBP**	-2.8%	-0.9%	6.8%	-0.3%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	**GBP**	4.4%	6.5%	7.5%	11.8%

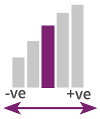
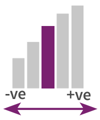
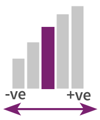
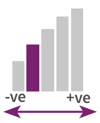
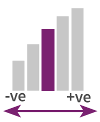
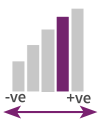
Source: Bloomberg | ***Past performance is not indicative of future returns.*** | ** denotes estimate*

Market Performance - UK (All returns in GBP)

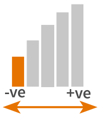
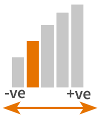
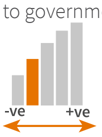
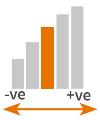
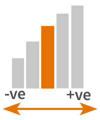
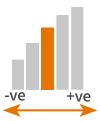
Asset Class/Region	Index	To 30 April 2019				
		Currency	1 Month	3 Months	Year to date	12 Months
Property						
Global Property Securities	S&P Global Property TR	**GBP**	2.5%	7.1%	13.3%	11.2%
Currencies						
Euro		**GBP**	2.8%	3.1%	-1.6%	0.5%
US Dollar		**GBP**	3.2%	5.0%	1.0%	5.3%
Japanese Yen		**GBP**	6.2%	8.0%	2.3%	5.8%
Commodities & Alternatives						
Commodities	RICI TR	**GBP**	-1.7%	0.7%	5.7%	-6.7%
Agricultural Commodities	RICI Agriculture TR	**GBP**	7.5%	5.2%	0.2%	-7.9%
Oil	Brent Crude Oil	**GBP**	-8.5%	2.6%	21.0%	-12.5%
Gold	Gold Spot	**GBP**	5.0%	4.4%	2.7%	5.8%
Interest rates						
United Kingdom			0.75%			
United States			2.50%			
Eurozone			0.00%			
Japan			0.10%			

Source: Bloomberg | ***Past performance is not indicative of future returns.*** | *e denotes estimate*

Asset Allocation Dashboard

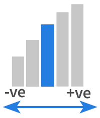
Asset class	View
Equities	
Developed equities  	» We retain our broadly neutral allocation to global equities today. Valuations look reasonable and thus global equities remain attractive, particularly versus sovereign and some corporate bonds. Month to date performance has partially recouped the torrid May performance, across all regions » 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 ongoing US-China trade war remains a pivotal factor in risk pricing today, as does the nascent concerns on slowing global growth. + The increasingly dovish policy pivot remains favourable for global equities, though we remain cognisant of weakening data across an increasing number of regions + Equities are better placed than most asset classes to perform in a moderately pro inflationary environment – The trade war back drop remains unresolved and remains a key risk for global equities
UK equities (relative to developed)  	» UK equities continue to look cheap today but caution is warranted given the now extended Brexit timeline and continued political jockeying, now in the throes of a leadership race to Downing Street. While the UK market's larger cap 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. » With October as the new timeline we should expect to see continued volatility in Sterling and UK assets as that date approaches (and likely beyond). + 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. The economy has fared better than many expected. – Today the chief worries lie within the political sphere - the protracted Brexit timeline and the Tory party leadership contest. The UK high street continues to face major challenges.
European equities (relative to developed)  	» European equity valuations remain favourable when viewed against corporate and sovereign European bond markets. The ECB's new TLTRO program goes some way to replacing the stimulus lost when the bond purchase program ended, but inflationary pressures have all but evaporated and it is difficult to identify a catalyst for meaningful earnings growth + Any renewed ECB asset purchases or policy stimulus will likely provide a fillip to risk assets in the region. – Manufacturing, a mainstay of the German economy in particular, remains under pressure from shifting consumer and industrial trends. This poses headwinds for the broader German economy and the health of the region as a whole – Episodic risk off events, such as the volatility in the Italian bond market or social unrest in France, should be expected.
US equities (relative to developed)  	» The US remains the most expensive of the major developed markets, but the narrow market that has led indexes higher also offers selective value for the stockpicker. The US economy remains in reasonably good health and arguably warrants a premium, but the tighter valuation opportunity today means we continue to 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 recent concerns about slowing growth has led the Fed to reappraise their expectations for 2019 hikes, with rates expectations going into reverse and helping to buoy riskier assets. + The economy remains in reasonably good health with several leading indicators remaining positive, albeit weakening Following the Fed's recent policy pivot, broader measures of financial conditions have loosened, which coupled with the current fiscal stance may help support earnings going forward. – US equity valuations remain elevated vs other regions today which may prove to be an obstacle to further index gains from current levels. Additionally, 2019 earnings growth could disappoint at the same time that margins potentially peak out. – Trade war rhetoric has again turned more sour, leading to the sharp May repricing of US (and global) equity risk.
Japan equities (relative to developed)  	» Japanese equities continues to attractive today. We acknowledge government policy desigend to improve working practices and governance. The direction of the Yen is an important driver of returns with Yen weakness supporting Japanese equities and vice versa; recent Yen strength and relative underperformance of equities provides some cushion going forward » Japanese assets should remain well buoyed by the Bank of Japan, which is the sole major central bank still buying assets today, for now at least. + Japanese equities' relative underperformance leaves some scope for equity upside in the absence of broader based market volatility + Cash rich Japanese corporates are increasingly returning more cash to shareholders through dividends. – In a protracted risk off scenario Yen strength resulting from its safe haven status would hurt Japanese equities.
Emerging market equities  	» We remain in favour of EM assets more generally over DM as the longer term relative growth dynamics remain favourable, which coupled with steady inflation should support EM equity returns over time. Some caution is warranted as further bouts of volatility are inevitable. + EM currencies remain somewhat cheap and provide additional cushion to local EM equity returns through potential earnings enhancement over time. – Emerging markets remain prone to bouts of volatility and flow reversal at times of heightened perceived risk – Despite some encouraging trade talks recently the Sino-US trade war backdrop remains unresolved and remains a key risk for emerging markets as a whole

Past performance is not indicative of future returns.

Fixed Income	
Government 	» On a medium term outlook DM government bonds remain largely unattractive today with poor real return prospects in aggregate following the recent rally. After recent repricing in US rates markets that now price in a cut into 2020, we are more cautious on bonds and look for more diversification to come from cash and gold. Other sovereign markets, such as Italy, are a source of price volatility. + Quality government bonds remain one of the better diversifiers in a multi asset portfolio, even when they are optically expensive. For that reason we advocate having exposure, or owning higher quality investment grade in lieu of pure sovereign. – Net central bank bond purchases have now turned negative and may be a headwind for all rate sensitive debt, arguably more so in higher quality European bond markets as the ECB ends its bond purchase program, though we've not seen this yet to date.
Index-linked (relative to government) 	» Index linked bonds offer some selective value but, like their nominal counterparts, they are expensive, particularly so in the UK. + Index linked bonds are one of the few ways to meaningfully protect against inflation risk. – Inflationary forces remain muted today and on any sustained slowdown in global growth they would almost certainly underperform nominal bonds.
Investment grade Corporate (relative to government) 	» Investment grade bonds provide some diversification benefit in a multi asset portfolio but valuations still remain quite tight. 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 quantitative easing slowing the risks appear more asymmetric Credit quality has drifted lower in recent years, and leverage has moved higher
High Yield Corporate 	» Spreads have recently widened but out to a level that is probably about fair in our opinion, but which is likely to remain somewhat elevated and potentially volatile. » We favour owning shorter duration credit where the risk return looks more favourable today, with an opportunity to add spread duration if credit markets widen further again from here. + 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. – The global credit cycle is at best mid cycle, at worst late cycle, so spread volatility is to be expected going forward. – Defaults are likely to come in higher with recoveries potentially lower than historical levels
Emerging market debt 	» The asset class remains attractive today, with spreads slightly elevated relative to history in spite of lower yields after recent rate moves » The healthy running yield means the asset class remains a preferred credit allocation for us and we continue to prefer hard currency to local exposure at this time. + We believe EM bonds continue to offer some of the best longer term real return opportunities in bond markets today. – Dollar strength would weigh on EM assets, with local bonds and FX likely bearing the brunt
Convertible bonds 	» Convertible bonds played their protective role well through the latter stages of 2018 and enjoyed a decent uplift through Q1. We continue to favour an allocation to convertibles in a multi asset portfolio for the convexity it brings. » Some caution is warranted given the concentration to the US market and technology names, although the Q4 2018 performance has shown the asset class to be quite resilient in a growth stocks led sell off. + The natural convexity provided by convertibles should continue to provide reasonable protection against any renewed equity weakness. – The call optionality embedded into convertibles only really has any value if markets move higher, and the US, the largest regional market, remains one of the more expensive regions today in aggregate – If volatility reverts again to the recent multi year lows then the optionality holds limited value.

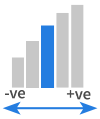
Real Assets /Alternatives

Commodities



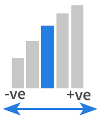
» The prices of some industrial commodities will likely be buffeted by the ongoing trade wars, and tensions in the gulf have impacted oil prices more recently. These geopolitical risks are unlikely to go away any time soon.
» Commodity prices are primarily supply and demand driven, and idiosyncratic factors can be as important as the global economic cycle.
+ With the US Dollar still near cyclical highs, and global growth still positive, 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.

Property (UK)



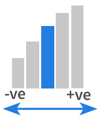
» Property remains an attractive asset class for investors requiring yield.
» Total returns will come mostly from income with limited scope for capital growth with global REIT stocks at somewhat elevated valuations today.
» When viewed against high quality, longer duration Sterling assets and inflation linked bonds, UK property outside London holds some appeal, with industrial and office space having more attractive fundamentals than the under pressure retail sector.
+ Premium 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 make 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 and performance has been strong at the index level through both the market weakness in latter 2018 and the strong gains year to date
» 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 events has hit a handful of stocks hard.

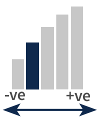
Liquid Alternatives



» 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/systematic strategies 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. Thorough due diligence is vital, and blend is recommended, as idiosyncratic performance can be unpredictable
– Poor 2018 performance has led this sector to be somewhat out of favour.

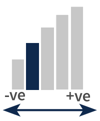
Currencies*

GBP



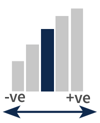
» Politics and the conservative leadership race has replaced headline Brexit risk in the short term. The currency remains out of favour though and whoever emerges the victor is unlikely to have much impact while the Brexit saga rolls on.
» In real terms the currency remains at the lower end of valuations and has room to appreciate over the medium to long term, but politics and rate policy remain a source of volatility and are likely to dominate its nearer term path.

Euro



» The Euro has trended slowly weaker in recent months as data has softened. Whilst any change in explicit rate policy has now been pushed towards the early stages of 2020, this looks overstated today. More recently, expectations for further easing have resurfaced as forward inflation expectations have nosedived. This will not lift the currency
» In real terms the common currency looks about fair value today but with short positioning building there is no obvious and imminent catalyst for an uplift, and on balance the local fundamental backdrop appears to be deteriorating which makes the currency largely unattractive today.

Yen



» Rate differentials continue to offer little reason to buy the Yen. However, in real terms the Yen remains cheap today.
» What sets the Yen apart from Sterling and the Euro is the currency's diversifying qualities at times of risk, as evidenced by its recent mini rally. We retain a neutral rating but there is scope for another leg up if global risk appetite falls from favour again.

*Past performance is not indicative of future returns. *Currencies views are expressed versus the US Dollar*

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