February 2017

Market & Economic Update

Market Commentary

January was a month of two halves for developed equity markets. Improved economic sentiment, sterling weakness and positive fourth quarter results from a number of companies had driven UK and US equity markets to record highs around the middle of January. However, after enjoying a calmer start to the year than twelve months ago, the unpredictable geopolitical backdrop, particularly after Donald Trump's inauguration, was a key factor in the sell-off in markets later in the month.

Elsewhere, Asia and emerging market equities had a positive month overall, with a weaker US dollar and firmer materials prices supportive. In fixed income, sovereign bond yields continued to rise, as the reflation trade continued for the majority of the month and European growth prospects showed signs of improvement. In commodity markets, oil prices were weaker on the prospect of further US supply, while the positive performance of gold and the other precious metals in January reflected dollar weakness and rising geopolitical uncertainty.

Gareth Lewis
Chief Investment Officer

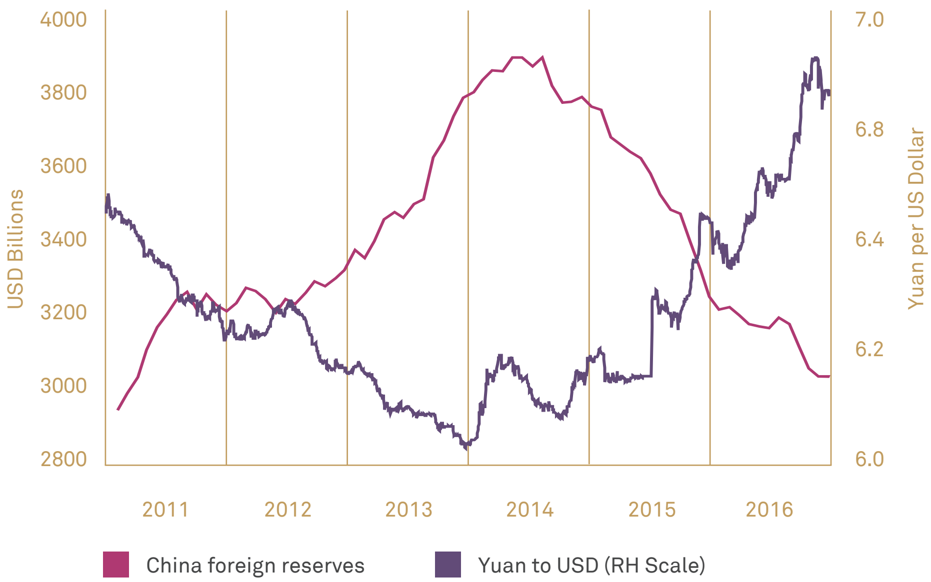
Louie French
Senior Research Analyst

In this month's Chart of the Month we have highlighted the fall in China's foreign reserves as it battles to manage the depreciation of its currency and stabilisation of its economy.

Reports in the month highlighted that China's reserves have fallen to their lowest level since February 2011 at US$3.01 trillion. While this is still a sizable figure, the depletion of reserves and Beijing's latest crackdown on capital outflows highlight the extensive efforts of the Chinese authorities to try to stimulate the domestic economy in the face of significant debt issues. In 2016 the Chinese authorities attempted to tackle banking sector solvency and non-performing loans by setting up policies which included a debt for equity swap programme, allowing banks to reclassify non-performing loans and swapping impaired local government loans for government debt. While these policies helped accelerate bank lending and refinanced some of the debt, there is little sign of the measures adding economic value.

2017 is an important year in Chinese politics, with the Communist Party conference in the autumn expected to see some significant reshuffling of the top leadership committee, the Politburo Standing Committee. With markets and the global economy now focusing on reflation, the possibility of a China hard landing still has the potential to send a wave of deflation across the global economy.

China foreign exchange reserves



Source: Thomson Reuters Datastream / Tilney

Our view – asset allocation summary

General summary

- At its November meeting the Asset Allocation Committee decided to reduce exposure to US Treasuries in the centralised models, with an increase in the allocation of absolute return and short-dated investment grade credit.
- Our view remains that global economic growth remains weak and is hampered by secular stagnation. The Brexit vote and the Trump presidency mark significant change that will see fiscal spending temporarily benefit the wider economy.
- Following the US presidential elections, an accelerated fiscal stimulus package is now expected, which is likely to put pressure on US Treasuries. As a result, we have taken profits from US Treasuries and looked to redistribute the proceeds into areas which match our house view of caution and mitigate downside risks.
- Following fresh falls in sterling and under-appreciated risks to the euro, we are also now seeking to hedge out euro currency exposure.

Equities

- There were no changes to equities in November's asset allocation meeting. Geographically, we remain underweight Asia Pacific, Emerging Markets and North America, overweight Europe and neutral on Japan and the UK.

Fixed income

- As highlighted already there were a couple of changes within fixed income at November's asset allocation meeting. The asset models remain underweight to fixed income at the asset level, but are now underweight high yield bonds and Sovereigns, while investment grade credit is neutral.

Commercial property

- A small reduction was made to the property allocation in July and we remain neutral on the asset class. Property is a long-term investment and although there is uncertainty, UK property does benefit from a relatively stable and attractive yield.

Commodities

- A small weighting to physical gold was initiated in October 2015 and was increased at July's meeting. Gold is often viewed as a form of insurance amid a potential growth shock and in an environment where we may see further rounds of competitive global currency devaluation.

UK, US and Europe

- January was a mixed month for developed market equities. US equities were the notable outperformers in the month, with markets reaching new highs and the Dow Jones passing 20,000 for the first time before the late sell-off. Overall, the S&P 500 returned +1.9% in local currency terms and +0.1% for sterling investors. In Europe, various political risks weighed on peripheral equity markets, but stronger returns from banks and the core markets helped the MSCI Europe ex UK index finish flat overall in local currency terms and up +0.6% for sterling investors. In the UK, the second half sell-off in UK large caps resulted in the MSCI UK Total Return index returning -0.5% in January.

- Taking a closer look at the UK market, January was a better month for the more domestically focused UK small (+1.4%) and mid-caps (+0.5%). On the sector level, basic materials was the strongest performing sector in the month (+11.8%), while health care (-3.9%) and oil & gas (-5.3%) were the laggards.

- Meanwhile on the economic and political front speculation over the Government's position on Brexit continued to dominate headlines in January. Prime Minister Theresa May's 12-point plan for Brexit signalled that the UK was likely to leave the single market, while Parliament would now have a vote on negotiations following the Supreme Court's ruling on a legal case brought against the Government. The second week of March appears set to be eventful. The Government has reportedly informed the House of Lords that it wants the European Union (Notification of Withdrawal) Bill approved by the 7 March, the day before Chancellor Philip Hammond presents his first Budget on the 8 March and the Prime Minister invokes the Brexit clause at the EU summit on 9 or 10 March. The UK economy has continued to show signs of resilience despite the uncertainty. The first estimate of fourth quarter GDP was ahead of forecasts at +0.6%, which would make the UK the fastest growing economy in the G7 for 2016. While revisions are possible, the Office for National Statistics highlighted that growth continued to be dominated by services, with strong contributions from consumer-focused industries such as retail, travel and leisure. While sterling weakness is likely to be helpful for the UK's trade deficit, rising inflation is set to be a headwind for consumer spending in 2017. CPI inflation was up to +1.6% in December, its highest level since 2014, while December's producer price inflation data indicated that even higher inflation is on its way.

- In the US, political and social tensions were elevated in January following the official inauguration of President Trump and the first clues of what is likely to follow from a policy perspective. What impact Trump's campaign pledges on fiscal policy and trade, if delivered, will have on the US economy has certainly caught the attention of the US Federal Reserve (Fed) and markets. The latest Fed committee minutes highlighted the uncertainty of future fiscal policy and what impact that would have on monetary policy. However,

Continue reading

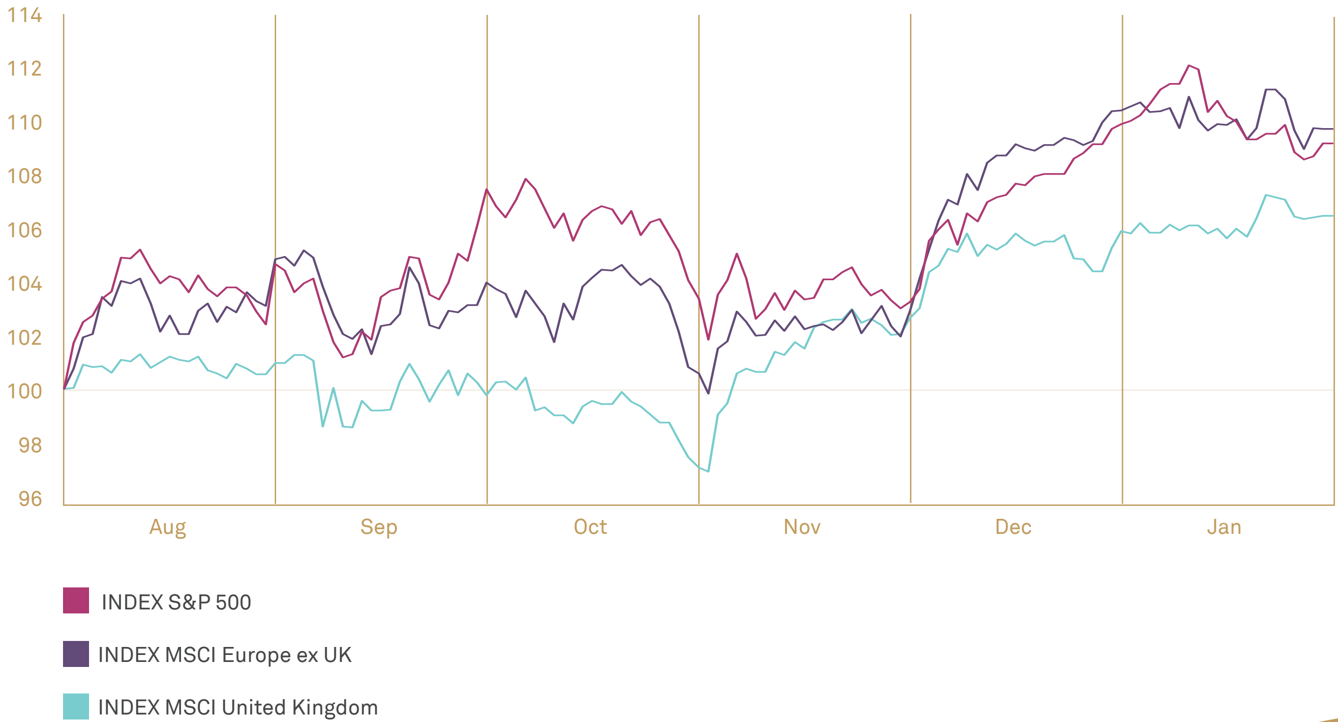
UK, US and Europe

hawkish comments in January from Chairwoman Janet Yellen suggested that the data-dependent Fed would gradually reduce its level of monetary policy support. Given the concerns over US dollar strength, including from President Trump, the Fed appears likely to gradually unwind its balance sheet as well as increase rates. Key data releases in January saw headline inflation up to +2.1% in December, while the latest employment data showed earnings reaching their highest year-on-year growth rate since 2009. The first estimate of annualised fourth quarter GDP was below forecasts at +1.9%, while the forward-looking PMIs for both manufacturing and services remain in expansionary territory.

- In Europe, January saw the Greek debt issues resurface, with the Greek government, European creditors and the IMF all struggling to agree on the terms and conditions of the latest bailout review. This is evidently an unwanted distraction ahead of key national elections across continental Europe and Brexit negotiations with the UK. 2017's headlines appear set to be dominated by political uncertainty. On the economic front, data releases in the month were mainly positive. The European Commission's economic sentiment index is now at its highest level since 2011, while the composite Euro area PMI for December was also at its highest level since 2011.

January also saw the first estimate of fourth quarter GDP, which was in line with forecasts at +0.5%. However, rising inflation (headline CPI +1.8% in January) is likely to extend calls from Germany for tighter ECB monetary policy. President Mario Draghi commented that the ECB will look through short-term inflation if judged to have no implications for medium-term price stability, which given the apparent weakness in core inflation appears sensible.

UK, US & Europe Markets, Percentage Growth, Total Return

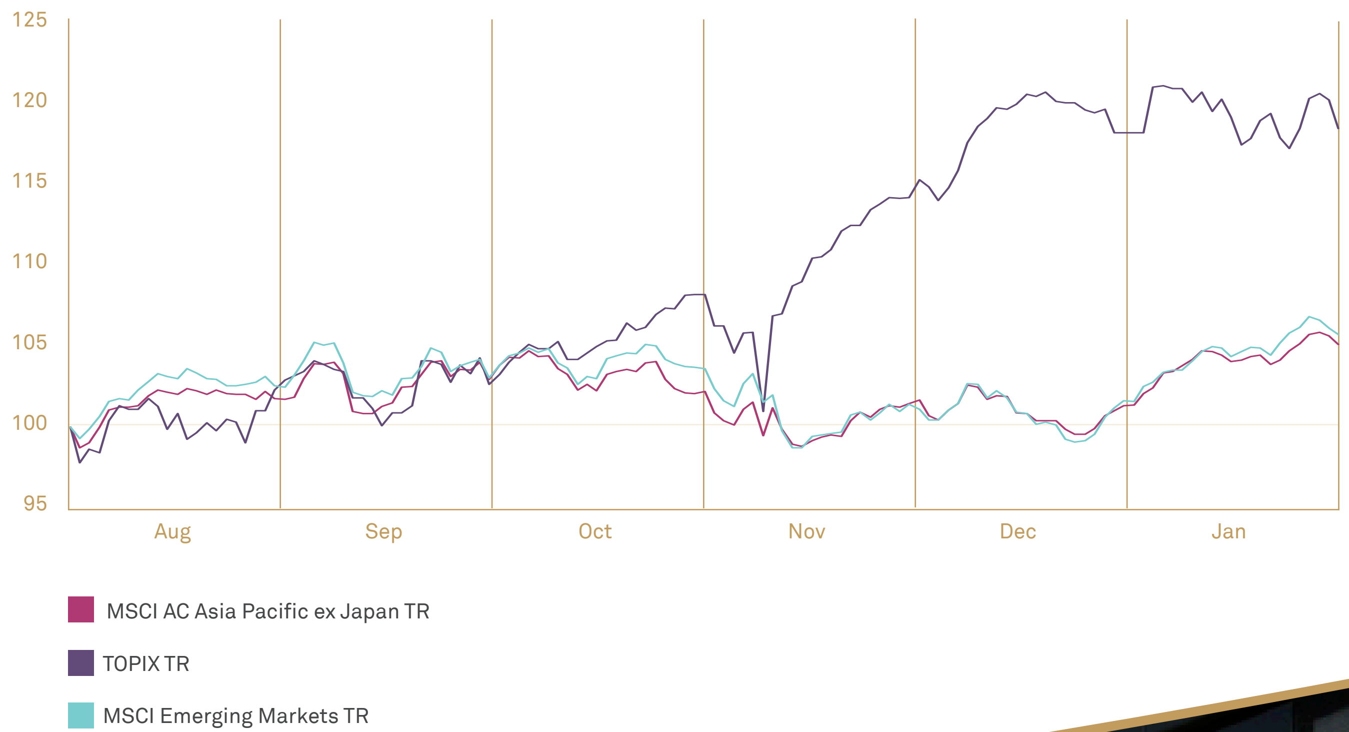


Source: FactSet

Asia, Japan & the Emerging Markets

- January was a positive month for Asia Pacific and Emerging Market equities. The MSCI Asia Pacific excluding Japan and MSCI Emerging Markets indices generated total returns of +5.8% and +5.5% respectively in local currency terms. For sterling investors this resulted in returns of +3.9% and +3.6% respectively.
- The key drivers of the positive returns in the emerging markets were Brazilian and Indian equities, which were up +7.4% and +4.6% respectively on a local currency basis over the month. Chinese equities were also positive in January and had a dramatically better start to the year than they did twelve month ago. The mainland Shanghai Composite index returned +1.8% in local currency terms, while Hong Kong's Hang Seng index was up +6.2%.
- Meanwhile, Japanese equities managed modest gains in January, despite some intra-month volatility and a stronger month for the yen. The TOPIX TR generated total returns of +0.2% in local currency terms and +2.0% for sterling investors.

Asian & Emerging Markets, Percentage Growth, Total Return

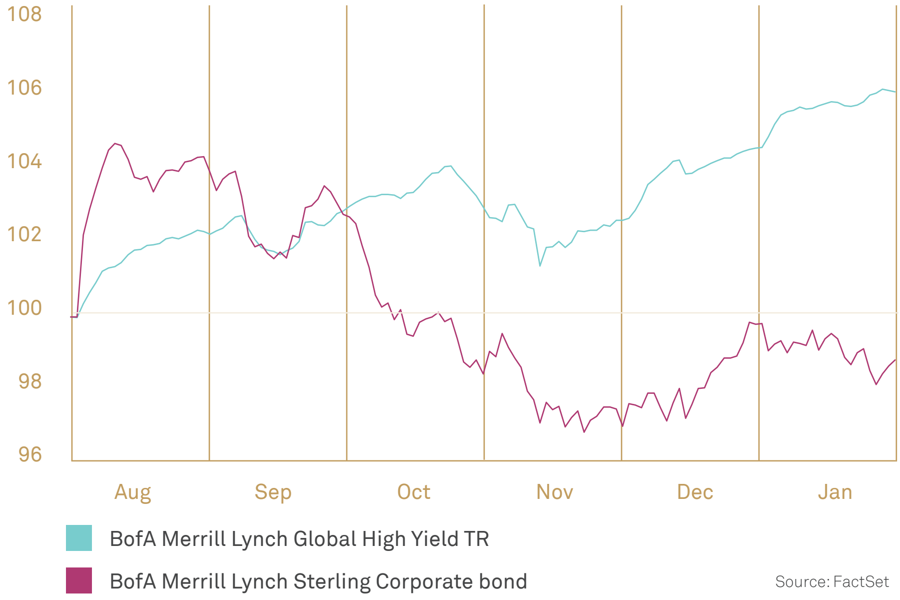


Source: FactSet

Fixed income

- January was another weaker month for global bond markets. Yields continued to rise as the reflation trade continued and European growth prospects showed signs of improvement. In sovereign markets UK Gilts returned -1.8%, German Bunds -2.1% and US Treasuries +0.3%.
- Credit markets also had a weaker month. The BofA Merrill Lynch Sterling Corporate Bond index returned -0.9%, while the BofA Merrill Lynch Global High Yield index was flat in sterling terms and up +1.9% in local currency terms (USD).

Fixed Income Markets, Percentage Growth

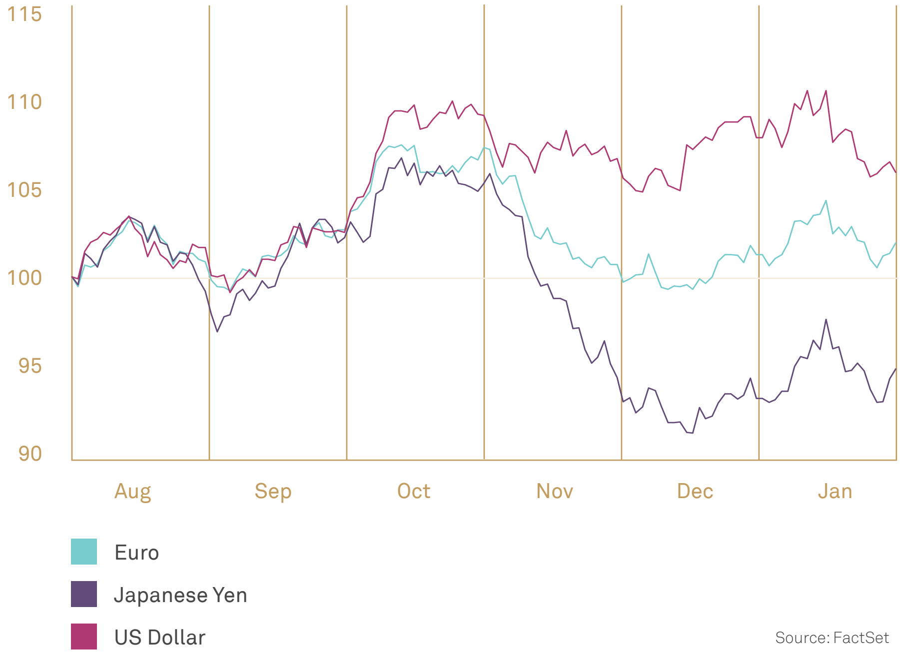


Source: FactSet

Currencies

- After a strong 2016, the US dollar was notably weaker in January as markets reacted to President Trump's inauguration and the first clues as to his policies. The dollar was down -1.8% against sterling, while the broader dollar index fell -2.6% to its lowest level since November.
- Sterling was volatile in the month as markets digested the latest Brexit announcements and economic data releases. The euro and yen both appreciated in sterling terms, rising +0.6% and +1.8% respectively.
- Elsewhere, markets continued to focus on the People's Bank of China and its management of the country's FX reserves. These have fallen to their lowest level since February 2011 at $3.01 trillion. While this is still a sizable figure, their fall and Beijing's heightened crackdown on capital outflows highlight the Chinese authorities' efforts to manage the yuan's depreciation.

Currency Returns relative to GBP, Percentage Growth

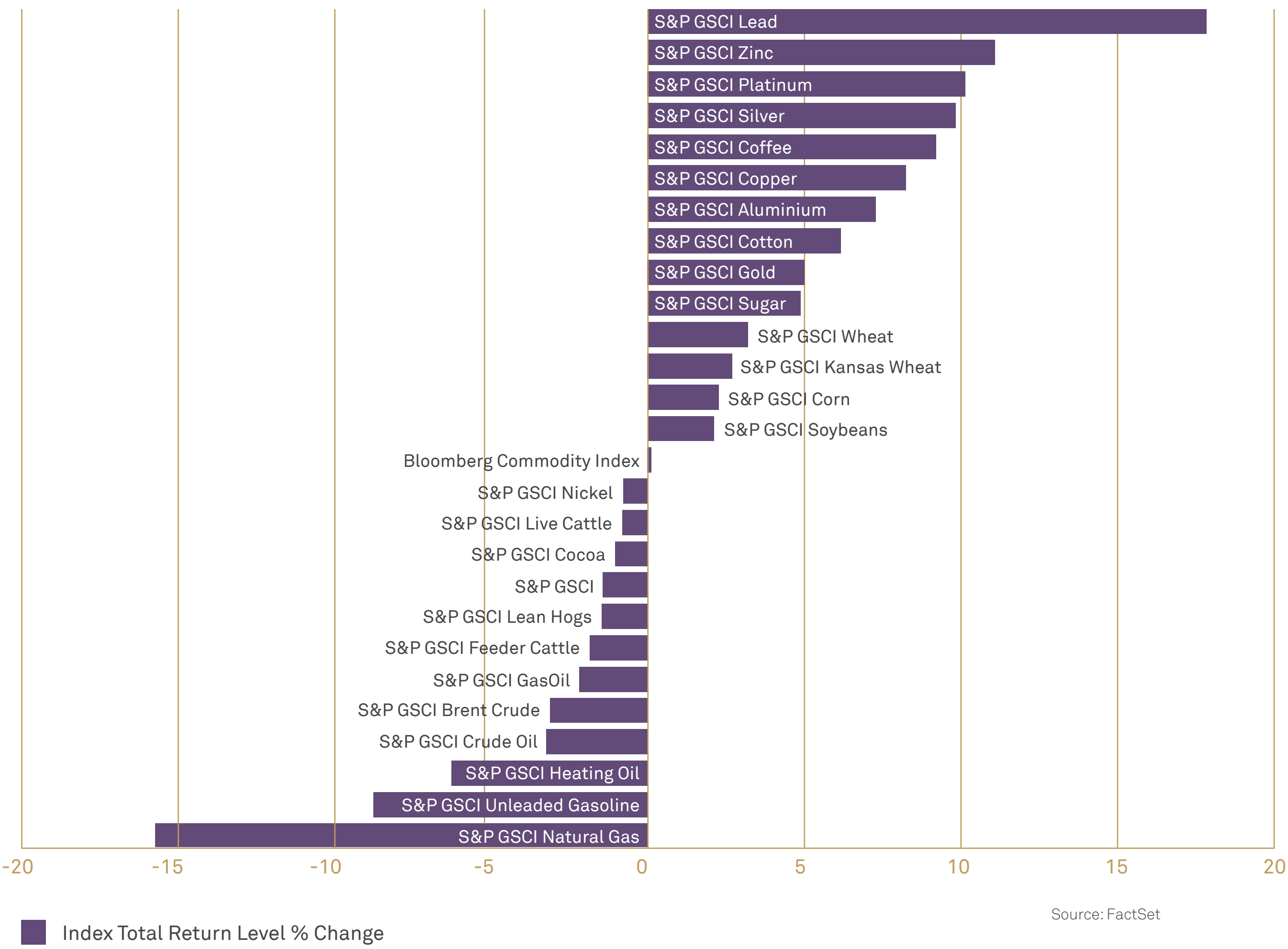


Source: FactSet

Commodities

- January was a weaker month for commodity market returns. The two headline indices, the Bloomberg Commodity Total Return index and the S&P GSCI Total Return index returned +0.1% and -1.4% respectively in US dollar terms over the month. In sterling terms, this resulted in total returns of -1.7% and -3.2% respectively.
- As highlighted in previous months, the performances of the two headline indices tend to differ as a consequence of the S&P GSCI index having a higher weighting to the energy sector. After performing strongly in 2016, the GSCI Energy sub-sector was weaker in January (-3.6%), with concerns about the prospect of further US supply weighing on prices. The number of active US oil rigs was reported as rising to their highest since November 2015 in the month, while executive orders from President Trump gave the green light for the construction of the controversial Keystone and Dakota pipelines.
- Elsewhere, January was a positive month for gold (+5.0%) and the Precious Metals sub-sectors (+5.7%), which reflected dollar weakness and rising geopolitical uncertainty. Industrials Metals were also positive performers in January (+8.5%) and were towards the top of the individual commodities chart, with markets pricing in the potential for further tightening of supply and strong demand from China and the US.

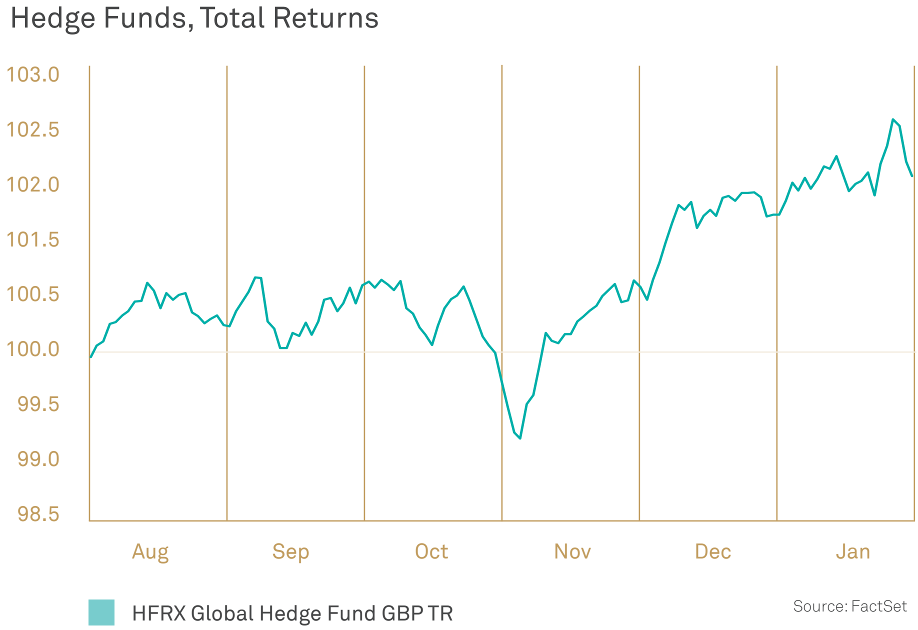
Commodities performance 1-31 January 2016



Commodity monthly performance, January 2016. Data in the above table in US dollars. Source: FactSet

Hedge funds

- Overall January was a generally positive month for the HFRX sub-indices in local currency terms, with returns ranging from +1.1% to -1.0%.
- The best-performing sub-index was the HFRX Market Directional, which returned +1.1%.
- The worst performing sub-index in January was the HFRX Macro/CTA, which returned -1.0%.
- The headline index, the HFRX Global Hedge Fund index, was up +0.4% in local currency terms over the month.



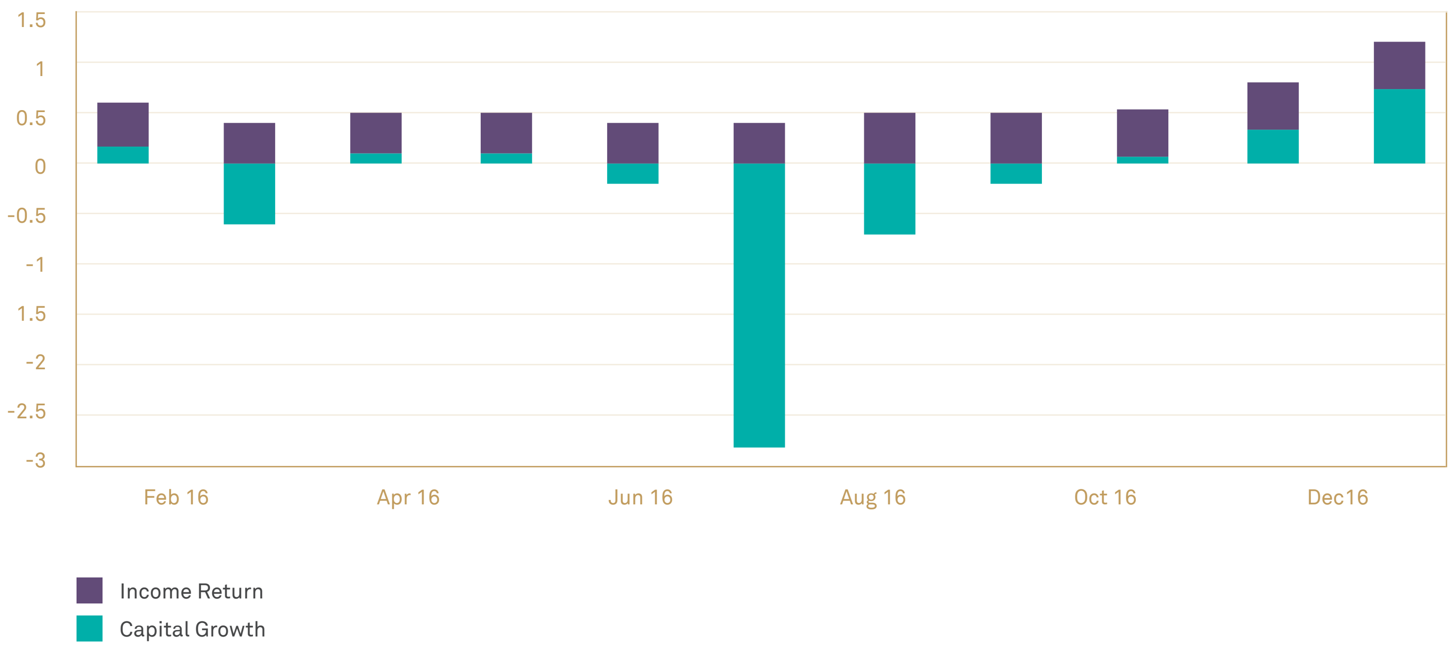
Property

- Returns for the IPD UK Property Monthly Total Return index were at their highest for 2016 in December, with the index producing total returns of +1.2% over the month.

- While income returns remained stable at +0.5%, capital growth was up +0.7% in December – the highest monthly gain in 2016.

- Looking at the property markets overall in 2016, it was a volatile year for UK capital values, particularly in the immediate aftermath of the Brexit vote, with heightened uncertainty regarding the outlook for central London commercial property. However, improvements in investor sentiment in the last quarter and a weaker sterling for foreign buyers has led to a partial rebound in capital values, with the majority of open-ended property funds also removing their emergency fair value adjustments and dealing suspensions. Income returns were a consistent contributor to total returns in 2016 and the IPD UK Property Monthly Total Return index returned +2.6% overall.

Monthly IPD Returns*



*Index data is released mid-month and therefore figures are only available with a one month lag.

Source: FactSet

Datasheet – latest market returns to the 31 January 2016 percentage returns for major asset class indices.

Assets	1 month	3 month	6 month	2016-17	2015-16	2014-15	2013-14	2012-13	3 Year	5 Year
MSCI United Kingdom TR	0.5	2.7	7.2	21.5	-7.0	7.1	7.3	15.1	21.0	49.5
Numis Smaller Companies TR	0.7	6.7	10.4	18.6	3.8	-2.6	31.8	25.6	19.9	98.6
S&P 500 TR	0.1	4.6	11.8	35.3	5.2	25.0	17.2	16.2	77.9	142.4
MSCI Europe ex UK TR	0.6	1.7	9.2	24.3	-1.7	7.4	11.9	23.8	31.2	81.8
Topix TR	2.0	-0.9	11.7	31.7	6.0	12.4	14.2	6.0	56.8	90.0
MSCI AC Asia Pacific ex Japan TR	3.9	-0.7	10.4	38.6	-12.6	20.6	-7.5	13.7	46.0	53.5
MSCI Emerging Markets TR	3.6	-2.1	10.9	41.9	-15.9	15.6	-13.0	7.5	37.9	28.9
S&P GSCI TR	-3.2	2.7	16.6	30.5	-27.1	-31.1	-10.2	1.7	-34.5	-40.1
Bloomberg Commodity TR	-1.7	0.2	9.9	28.3	-18.9	-12.5	-14.5	-1.6	-8.9	-23.3
BofA Merrill Lynch Global High Yield TR	0.0	-0.5	10.8	34.0	0.7	8.2	2.6	16.2	46.0	74.1
BofA Merrill Lynch Sterling Corporates TR	-0.9	0.0	-1.9	9.7	-3.3	15.6	4.8	11.6	22.6	43.4
HFRX Global Hedge Fund GBP	0.4	1.9	1.7	4.8	-6.3	-0.5	4.6	3.7	-2.3	6.0
US Dollar	-1.8	-3.0	5.5	12.7	5.9	9.4	-3.5	-0.5	30.6	25.4
Japanese Yen	1.8	-9.4	-3.9	21.3	2.7	-5.0	-13.7	-16.8	18.3	-15.0
Euro	0.6	-4.3	2.0	12.6	1.5	-8.4	-4.2	3.2	4.7	3.6

1 Year ending 31 January. Source: Lipper (to 31 January in GBP. Currency movements are vs. sterling.

Important information

The value of your investments, and the income derived from them, can go down as well as up, and you can get back less than you originally invested. Any indication of past performance or quoted yields is not an indicator of future returns. Before investing in funds, please check the specific risk factors on the key features document or refer to our risk warning notice, as some funds can be high-risk or complex, or can be susceptible to risks particular to the geographical area or industry sector in which they invest. Gold, technology and other focused funds can suffer as the underlying stocks can be more volatile and less liquid. Prevailing tax rates and relief are dependent on your individual circumstances and are subject to change. The property market can be illiquid; consequently, there can be times when investors will be unable to sell their holdings. Property valuations are subjective and a matter of judgement.

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