Allenbridge

REPORT PREPARED FOR

London Borough of Bromley Pension Fund

February 2018

This quarterly report by your adviser, Alick Stevenson of AllenbridgeEpic Investment Advisers ("Allenbridge"), provides a summary of performance and an analysis of the investments of the London Borough of Bromley Pension Fund for the three months ending 30 December 2017.

Executive Summary for the Quarter ended 31 December 2017

- **The fund value rose to £998.0m at 31 December 2017, up from £955.9m at 30 September 2017. The corresponding figure for 31 December 2016 was £893.8m.**
- **The total fund had an investment return of 4.4% for the quarter, slightly ahead of the benchmark of 3.9%. For the twelve months the fund was also ahead with a return of 15.5% v 10.6%. Over the longer and more meaningful periods, the fund returned 14.1%pa (12.0%pa) for the three years and 14.4%pa (12.3%pa) for the rolling five year period.**

- **Once again it was global equity performance that provided the majority of the overall increase in fund value, although both DGF and Fixed income managers had small positive increases in value.**
- **The Fund continues to transition from its 70/20/10 allocations to equities, fixed income and DGF towards its new long term benchmark which now includes real estate and multi asset income funds. As a result the actual asset allocations at year end represent the old benchmark and not the new one and should be considered historic.**
- **The new benchmark and the actual allocations will be shown for the first time in the 31 March 2018 quarterly report.**

Market Commentary for the Quarter ended 31 December 2017

"Keep your ears in the wind and your eyes on the horizon"

Jeremiah Johnson
American Frontiersman 1824-1900

Global stocks have enjoyed their best annual performance since the post crisis recovery, as accelerating economic growth powered several of the more important markets to double digit gains in 2017.

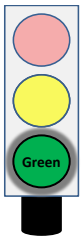
Moving forward in 2018, the quarterly market commentary will now be produced by John Arthur together with the M J Hudson/Allenbridge analytics team. It is an in depth review and will be provided as a separate report to the INVESTREP.

Fund Value as at 31 December 2017

Manager Name	Asset Class	**Value 31-Dec-17**	**Actual % of Fund**		Value **30-Sep-17**	**Actual % of Fund**	Strategic Asset Allocation
		£m			**£m**		%
Baillie Gifford Standard Life	DGF DGF	**51.4** **29.3**	**5.2** **2.9**		**50.7** **28.8**	**5.3** **3.0**	
Sub total DGF		**80.7**	**8.1**		**79.5**	**8.3**	10.0
Baillie Gifford BlackRock MFS	Global E Global E Global E	**383.6** **180.0** **219.6**	**38.4** **18.0** **22.0**		**365.0** **169.1** **210.8**	**38.2** **17.7** **22.0**	
Sub total GE		**783.2**	**78.5**		**744.9**	**77.9**	70.0
Baillie Gifford Fidelity	Fixed Int Fixed Int	**57.8** **76.3**	**5.8** **7.6**		**56.9** **74.6**	**6.0** **7.8**	
Sub total FI		**134.1**	**13.4**		**131.5**	**13.8**	20.0
Fund Totals		**998.0**	**100.0**		**955.9**	**100.0**	100.0

Sourced from investment managers' data

The Fund for the quarter ended 31 December 2017



The last month of the year saw the Fund appoint several new investment managers and begin the transition away from "growth" assets, by liquidating the holdings in Diversified Growth Funds, (the investment returns of which had proved disappointing), and reducing assets held in global equities,.

This liquidation will enable new investment into "income generating" assets in the form of multi asset income funds and real estate and should be completed by the end of the first quarter of 2018.

Fund investment performance for the quarter ended 31 December 2017

The fund returned 4.4% for the quarter which was 0.5% ahead of the benchmark.

For the twelve months the fund was also ahead of the benchmark with a return of 15.5% v 10.6%. Over the longer and more meaningful periods the fund returned 14.1%pa (12.0%pa) for the three years and 14.4%pa (12.3%pa) for the rolling five year period.

Members should bear in mind that the current reallocation of growth assets towards income generating assets funded out of the DGF and equity portfolios will, over time, likely reduce the absolute level of investment performance as cash is paid out and additional growth assets are channelled towards income producing assets.

Market statistics for the quarter and rolling 12 months ended 31 Dec 2017

EQUITIES Total return	3 months %	12 months %
MSCI World	5.0	13.8
MSCI World ex USA	4.2	16.7
S & P 500	5.8	11.3
MSCI UK	4.9	11.8
MSCI Europe ex UK	0.1	16.7
MSCI AsiaPac ex Japan	7.1	25.4
MSCI Japan	7.6	13.6
MSCI All Emerging	4.6	19

FIXED INCOME Total return	3 months %	12 months %
FTSE Index Linked	3.5	2.3
FTSE all Gilts	2.0	1.8
J P Morgan Global Sov	0.2	-2.4
Bofa ML Corp >10yr IG	2.7	5.6
ML HY constrained	-0.1	0.7

Best Performing Sectors	3 months %	12 months %
Financials	5.2	13.3
Materials	7.0	18.4
Information Technology	7.2	29.5
Industrials	4.3	14.4
Consumer Discretionary	6.9	14.3

Inflation Indicators YOY%	As at 30-Nov-17	As at 30-Jun-16
UK RPI	3.9	2.5
UK CPI	3.1	1.6
US Core CPI	1.7	2.2
Euroland CPI	1.5	1.1

Worst Performing Sectors		
Telecom Services	1.1	-1.6
Health Care	0.4	9.7
Utilities	-1.1	4.1
Consumer Staples	5	7.5
Real Estate	3.4	7.4

Other Assets	3 months %	12 months %
LIBOR 1 month	0.4	0.3
LBMA Gold Bullion	1.9	12.6
Brent Crude	17.7	9.9
IPD property Index	2.9	10.5
HFRI Index	-0.2	-0.6

Sources: Datastream and Newton

Fund Governance and Voting

Voting and governance matters are covered in detail within the various Investment Manager reports provided to the members under separate cover.

INVESTMENT MANAGER REVIEWS

Global Equity Portfolios

Baillie Gifford Global Alpha (segregated)

This portfolio was funded as at 20 December 2013 with a performance objective to outperform the MSCI ("ACWI") All Country World Index by 2-3% pa (before fees) over rolling five year periods. This measurement commenced from 31 December 2013).

(The Fund was closed to prospective investors at the beginning of 2015 but remains open for additional funding from existing clients). Baillie Gifford is one of several investment managers that have been appointed to the London CIV and are currently appointed, with other managers, for both Global Equity and DGF mandates.

Rolling one year turnover was slightly higher than the previous quarter, at 13.0% (110%), implying an average holding period of around six years, a recognition that Baillie Gifford continues to focus on the long term and prefer to look through the short term gyrations except when they see stock purchasing opportunities.

Baillie Gifford operate a long term growth investment strategy which aims to overcome short term political statements by buying and holding stocks across the world which exhibit long term fundamental strengths.

The portfolio statistics were little changed from the previous quarter. The fund was invested across 23 (24) countries and held 101 (100) different investments. These investments were spread over 10 (10) sectors and encompassed 38 (38) differing industries, thus providing a broadly diversified set of assets. It is worth noting that the active money within this portfolio is continuing to run at a very high level of around 91% (92%). This "active money" ratio confirms that the fund is not holding benchmark or index weightings relating to stocks making up the index and reflects the active stock picking philosophy of the manager and its long term nature. During the quarter the manager added four new stocks and sold out of five, Brambles, Carlsberg, Colgate, Rolls Royce and Tripadvisor.

For the quarter, the fund had a net investment return of 4.9%, just 0.1% behind the benchmark. Since the portfolio reorganisation in December 2013, the fund has returned 16.6%pa against a benchmark of 14.2*%pa. (All returns shown are net of fees).*

The portfolio remains ahead on 3 and 5 year measures, and since inception in December 1999 has returned a net 8.3%pa against the benchmark of 7.1%pa.

The "active money" style (stock picking) is clearly demonstrated with the top ten holdings continuing to account for slightly over 28% of the total portfolio, in line with the previous quarter (29%). Naspers with 4.6% (3.8%), Amazon 3.8% (3.8%), and Prudential Corp 3.3% (3.3%) hold the top three positions, with Royal Caribbean Cruises at 2.5% (3.3%) dropping back to fifth position.,

SAP, Alibaba, and Moody's take the eighth, ninth and tenth positions with 2.4%, 2.3% and 2.1% respectively.

BlackRock Ascent Life Enhanced Global Equity Fund (pooled)

This portfolio was funded as at 20 December 2013 and has a performance objective: to outperform the MSCI ACWI by 1-2% per annum whilst managing risk relative to the benchmark.

The manager can invest across the whole of the MSCI ACW Index and, as a result, held 703 stocks (653) at the end of the quarter and delivered a net investment return for the quarter of 6.1% against 4.9% for the index. For the rolling twelve months the manager has moved ahead of the benchmark at18.5*% (benchmark 13.2%).* Over the three year rolling period the fund is slightly ahead at 15.4%pa versus the benchmark of 14.6%pa, and since inception, has a positive net return of 15.4%pa

In terms of country allocations, the manager has maintained a near neutral position in most major markets, and remains slightly underweight in the UK, but has moved to a small overweight in the USA..

Sectorally, the fund has remained overweight InfoTech, stayed underweight in Financials, and has increased its underweight position in Healthcare. During the quarter the fund remained slightly (significant) underweight position in Consumer Staples, and maintained its neutral position in Consumer Discretionary).

The top ten stocks have again changed significantly since last quarter. Apple has moved into first place with 2.3% with Facebook next with 1.6%, with the next four stocks all holding 1.2% and the remaining four, each holding just 1.1%. Thus, there is little spread between 1st and 10th place. The top ten stocks now account for some 13.2% (11.6%) of the overall BlackRock portfolio.

MFS Global Equity Fund (segregated)

This portfolio was funded as at 18 December 2013 and has a performance objective to outperform the MSCI world index (net dividends reinvested) over full market cycles.

MFS is currently invested in 14 (13) countries and has 116 (106) holdings. This contrasts with the benchmark of 1,653 (1,652 holdings spread across 23 countries.

For the quarter the fund returned 4.1% net against its benchmark of 4.6% for an underperformance of 0.5%. Over the rolling twelve months the fund was also behind its benchmark by 0.9% with a net return of 10.9% against a benchmark of 11.8%. These shorter measures confirm the difficulties managers with a value bias to the portfolio have had over recent periods, in markets which have favoured growth rather than value stocks. Over the three year rolling measure the fund is ahead by 1.3%pa (15.9%pa v 14.6%pa). Since inception the fund has returned 15.6%pa (net) against the benchmark of 14.3% pa.

A look through the country and sector weights shows that the fund continued to remain underweight North America (58.4% v 62.8%) and Asia Pacific ex Japan (0.8% v 4.5%), and has maintained its overweight positions in Europe ex UK at +3.4% (+3.1%),. In Japan the manager has brought the position back to neutral, and maintained its' neutral position in the UK. The fund continues to run a small +1.7% overweight in emerging markets.

Sectorally, the fund has maintained its significant overweight position in Consumer Staples (16.7% v 9.0%), with smaller over-weights in Industrials at+5.2% (+5.5%) and Financials +4.1% (+3.6%). These over weights are being "funded" by underweight positions in Consumer Discretionary -5.6% (-6.1%), Utilities, where the manager has a 0.8 weighting (-3.0%) and Energy -2.9%(-2.8%).

In terms of top ten holdings, Nestle (2.6%), Johnson & Johnson at 2.4% and JP Morgan Chase with 2.5% are the three largest, with, Honeywell, KAO Corp with 1.8% each and Lockheed Martin with 1.7% in eighth, ninth and tenth positions.

Global Equity Crossholdings

There are no crossholdings within the aggregated top ten holdings of the three global equity managers this quarter.

Diversified Growth Funds

Baillie Gifford

This mandate was funded on 8 December 2012 and has a performance objective to outperform UK base rate by at least 3.5% pa (net of fees) over rolling five year periods and with an annualised volatility of less than 10%.

For the 12 month period the portfolio has returned 7.2% against the benchmark of 3.8%. For this quarter, the fund had a positive return of 1.3% versus the benchmark of 1.0%. Since inception, the fund has delivered a return of 5.5%pa **(net of fees)** against its performance target of 3.9%pa.

The 4th Quarter 2017 is effectively, the last full reporting quarter for this fund, as the total holding will be liquidated in the first quarter 2018 to fund new investment in multi asset income funds.

Standard Life Global Absolute Return Fund

This mandate was funded on 7 December 2012 and has a performance objective to achieve +5% per year (gross) over 6 month LIBOR over rolling three year periods with expected volatility in the range of 4% to 8%pa.

The manager has reported a positive performance for the quarter of 1.9% against its benchmark of 0.1%. For the rolling twelve months the fund remains in positive territory with a return of 3.1% against its benchmark of 0.5% but well below the performance objective. Since inception, the fund has generated a positive return (net of fees) of 3.14% pa, although this return remains significantly behind the Bromley Pension Fund actuarial target return of 5.6%pa.

The 4th Quarter 2017 is effectively, the last full reporting quarter for this fund, as the total holding will be liquidated in the first quarter 2018 to fund new investment in multi asset income funds.

Fixed Income

Baillie Gifford Fixed Income Alpha Plus

This mandate was reorganised on 1 June 2015 and now has a reference benchmark comprising 44% Gilts, 44% Sterling non gilts, 6% global corporate bonds and 6% emerging market bonds. The manager's objective is to outperform this benchmark over rolling three year periods.

For the quarter, the fund had a small positive return of 1.6%, just ahead of the benchmark of 1.5%. Since the original inception date of 9 December 2013, the fund has generated a return of 6.9% pa exceeding the benchmark of 6.6% pa. Since the reorganisation in June 2015 the fund has delivered benchmark performance with a return of 5.3%pa versus 5.0%pa.

From a credit rating perspective the fund remained marginally overweight benchmark levels with AAA rated bonds (9.8% v 9.0%), with a total of 89.5% against the benchmark weighting of 98.5% invested in investment grade bonds.
High yield bonds, (below investment grade), have a significant overweight position of 7.7% against 1.7% for the index and are comprised largely of bonds rated BB which have lost their "BBB" rating, but in the opinion of the manager have the ability to regain that rating. The manager does not invest in "C" rated bonds. The manager remains significantly underweight AA rated bonds at 39.0% versus 53.8%

Regionally, the fund has remained underweight the UK at -9.0% (-12.8%) and over-weight the US at +8.25 (10.3)%. Looked at by sector, the fund has moved less underweight sovereign debt -5.4% (-6.5%) and remained marginally underweight Utilities -0.7% (-0.8%) with corresponding over-weights in Financials 2.0% and Industrials +2.4% (+2.0%). The manager has maintained its overweight position in Securitised loans +1.4% (+4.2%).

In terms of active money ie those positions larger than the benchmark allocation, the manager continues to hold +2.1% in, 2.7% in KFW 5.0% 2036 bonds and Vonorovia at 1.6

Overall, the fund's duration has moved marginally shorter than the benchmark of 9.2 years at 9.0years. The fund has a redemption yield of 2.58% (benchmark 2.0%) and a running yield of 3.8% (3.4%).

Fidelity Global Aggregate Fixed Income Portfolio

This portfolio was funded in April 1998 and has a performance objective to outperform the IBoxx composite benchmark of 50% Gilts and 50% £ Non Gilts by. 0.75% pa (gross of fees over rolling three year periods

The fund outperformed the benchmark during the quarter with a return of 2.3% (gross of fees) against the benchmark of 1.9%. Over the rolling three years, the fund is ahead of the benchmark by 1.1% pa (5.8%pa v 4.7%pa). Since inception (30 April 1998) the manager has outperformed the benchmark by 1.0% pa with a return of 6.9% pa.

In terms of credit quality, the fund remains over benchmark at 92.8%% (90.0%) invested in investment grade bonds, albeit underweight the index in A rated bonds (fund 11.1% v 15.1%), and has 22.8% (22.6%) invested in BBB rated bonds, overweight the index by 4.4%. The manager's holdings in high yield bonds has settled around the 4.8% (4.6%).

There have been some changes during the quarter, with the sectoral allocation to US treasury assets increasing to 46.0% (39.9%) of the portfolio. Reductions in the overweight positions in the Financial Services (+3.3%), Insurance (+1.7%) and the Basic Industry (+0.9%) sectors funded the increase in Treasuries now just 4% underweight its benchmark. Other small overweight positions are "funded" by underweights in Supranationals and Sovereign Assets (-4.6%) and Consumer non cyclicals at (-2.1%).

The portfolio has moved long of duration at 9.9 years versus the benchmark duration of 9.8 years and has a running yield of just 2.2% (1.7%)

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Market Review

Quarterly Report

Q4 2017

MJ HUDSON

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Executive Summary

- The global economic picture at the end of 2017 was positive, with strong GDP data, falling unemployment, low volatility and a synchronised global expansion supporting asset market valuations. However, investors remain concerned about high equity market valuations and tight credit spreads, and continue to worry that the cycle is about to turn. In the background, geopolitical tensions threaten to potentially impede further growth.

- The exception to this positive story was the UK, which saw its long-term growth forecasts revised downwards and inflation remain 1 percentage point above the target, as sterling's weakness after Brexit continued to be felt.

- Global equity markets maintained their upward trajectory to end the year at or near record highs, underpinned by broadly positive economic data across the world.

- UK equities performed better in the final quarter of the year than in previous quarters, but for the year they were underperformers relative to other major markets as uncertainty over Brexit continued and the recovery of sterling especially against the US dollar dampened overall equity market performance.

- The fixed income market trends seen since early 2017 continued into Q4, with government bond yields moving sideways. The favourable backdrop helped narrow the spread on investment grade and high yield corporate bonds; in the UK gilt yields fell following a sell-off in September and Corporate bond spreads fell to their lowest levels since before the financial crisis.

- The US dollar continued to decline, but at a slower rate, as investors favoured the Euro, with political concerns continuing to ease and better economic data surfacing in the Eurozone. Select emerging market currencies were also stronger. Sterling strengthened over the period against a weaker US dollar following the Bank of England's November interest rate rise, but not against the Euro or the Japanese yen.

- Activity in the UK property market remained buoyant in the quarter, with low interest rates contributing to returns on investment, although residential house price growth slowed considerably compared to 2016.

- The oil price, which had declined in the first half of the year, recovered further in Q4 to US$67 a barrel after OPEC agreed to output cuts.

- 2018 potentially represents a turning point for investors, the easy money of the last 10 years and the distortions created by Quantitative Easing (QE) may be about to begin to be unwound. While the markets remain in good spirits it is probaly worth investors looking at their portfolios and condisering taking profits and diversifying their portfolios in preparation for the next 10 years.

With the exception of the UK, the global economy continued to show strong synchronised growth. The Manufacturing PMI Surveys (a lead indicator of growth) of the UK and the Eurozone were modestly positive, suggesting that the current recovery can continue for some time. Again outside of the UK, inflation has so far proved to be benign. Despite this, central banks have indicated that they plan to reduce monetary accommodation; in the US, this means raising rates further and in Europe and Japan, reducing the rate of QE.

Table 1: Quarterly GDP Growth Rate

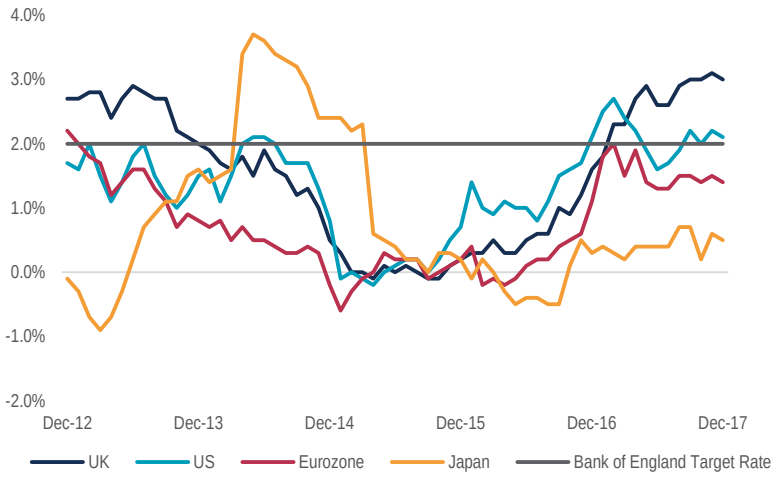
	US GDP	UK GDP	Eurozone GDP	Japan GDP
Q4 2017*	2.7%	0.4%	0.7%	0.7%
Q3 2017	3.2%	0.4%	0.6%	2.5%
Q2 2017	3.1%	0.3%	0.7%	2.9%
Q1 2017	1.2%	0.3%	0.6%	1.5%

Source: Bloomberg. *Forecast based on leading indicators.
Notes: UK Real GDP (Ticker: UKGRABIQ Index), US Real GDP (Ticker: EHGDUS Index), Eurozone Real GDP (Ticker: EUGNEMUQ Index), Japan Real GDP (Ticker: EHGDJP Index)

GDP: Global growth in the fourth quarter remained strong, with the US, Eurozone and Japan all releasing positive indicative GDP data which surprised to the upside.

The picture for the UK was mixed: the PMI data showed a higher predicted growth rate of 0.4%, but continued low wage growth and the level of consumer debt is having a negative impact on the domestic economy.

Chart 1: 5-year CPI to December 2017



Notes: UK: UK CPI EU Harmonised YoY NSA (Ticker: UKRPCJYR Index); US: US CPI Urban Consumer YoY NSA (Ticker: CPI YOY Index); Eurozone: Eurostat Eurozone MUICP All Items YoY Flash Estimate NSA (Ticker: ECCPEST Index); Japan: Japan CPI Nationwide YoY (Ticker: JNCPIYOY Index)

CPI: Inflation in all regions ticked up after a dip in October. Higher oil prices contributed to the rise, although inflation still remains subdued and below central bank target rates, at the moment a sudden acceleration seems unlikely. In the UK, inflation continued to outstrip the Bank of England's 2% target, but is expected to start to decline, having peaked at 3.1% in November, as the impact of sterling weakness falls out of the annual calculation.

Central Banks: The continuing strong global economic performance was the backdrop to central banks slowing or reversing their monetary stimulus programmes. In November the Bank of England raised interest rates for the first time in over a decade, to mixed responses. The ECB announced that it would reduce its monthly bond purchases by half from the beginning of 2018. The Federal Reserve began reducing its balance sheet in October, and has raised rates for the third time in 2017, to a range of 1.25-1.5%. This tightening of monetary policy was, in general, anticipated and calmly received by the markets and had little impact on asset prices.

On the political front, news was mixed but broadly positive; Abe's victory in Japan over a divided opposition boosted the chances of sustained fiscal and monetary stimulus. But despite Mrs Merkel's victory in the German Elections, she has failed to form a new government and the repercussions for Spain of the referendum result in Catalonia are yet to be realised. In December, Mr Trump managed to get his tax reform bill passed through Congress.

Global equity markets continued to rise, bringing a year of strong growth to a close. The MSCI World returned 23.0% over the year, and 5.6% over the quarter, compared to 6.5% in Q1, 4.2% in Q2 and 5.0% in Q3.

Equities

UK: Equities performed better in Q4 than in the three previous quarters, boosting 2017 year-on-year returns: the FTSE 100 returned 5.0% and the FTSE All-Share 4.9%, and 12.0% and 13.1% respectively for the year, reaching record highs at year-end. Signs of progress on Brexit negotiations in Q4 helped to provide a boost to markets towards quarter end. Equities also benefited from the global recovery, as around 70% of FTSE 100 companies generate revenue outside the UK, and a backdrop of rising commodity prices helped oil, gas and mining sectors in particular in Q4. However, relative to other major markets, UK equities underperformed in 2017.

Japan: Performance was much stronger in the final quarter of the year. The triumph of Prime Minister Abe in October's snap elections resulted in improved investor sentiment as it ensured the continuation of fiscal and monetary policies. Additionally, the corporate earnings were solid, continued the strong trends seen in the previous quarter. The MSCI Japan returned 8.6% over the quarter, and the Nikkei 225, 12.0%; for the year, they returned 20.1% and 21.3% respectively.

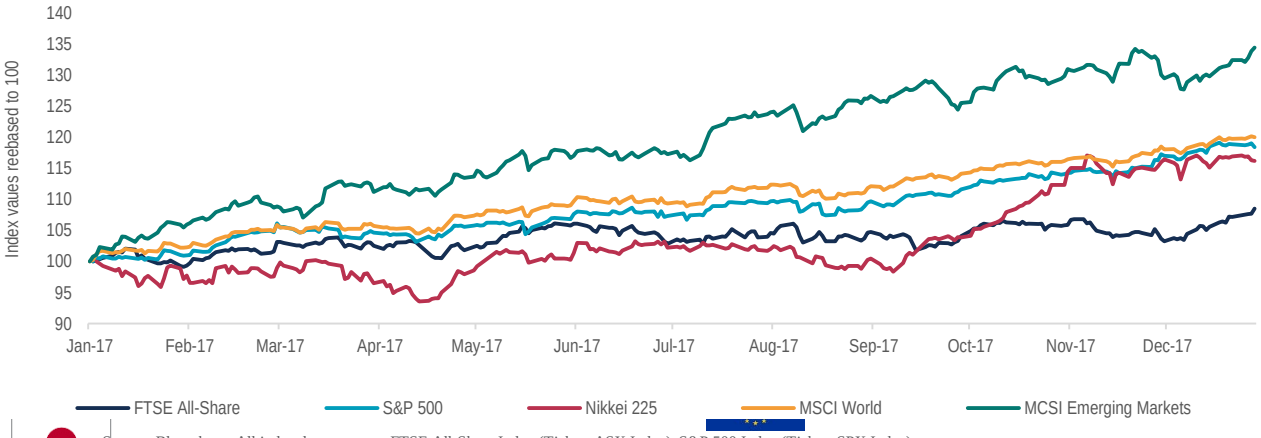
Emerging Markets: Emerging economies posted another quarter of strong growth, as a result the MSCI Emerging Market equity index returned 7.3%. Over the entire year, it was the best performer, with a substantial return of 37.5%. Returns were boosted by the continued recovery in Brazil and Russia, a bank recapitaliation in India and strong growth in Central Europe.

US: Strong equity growth continued into Q4, supported by the Republican tax reform and positive economic data, including better-than-expected GDP growth and a recovery in oil prices. The Fed's decision to raise rates again had little impact, in part because the move was expected and priced in. Solid corporate earnings, particularly in the technology sector, underpinned this performance, as well as good performance in cyclical areas such as consumer discretionary and financials. The S&P 500 returned 6.6% over the quarter, and the Dow Jones Industrial Average 10.9%; performance for the year stood at 21.8% and 28.1%, respectively.

EU: European equities had a poor quarter; the MSCI EMU[1] Index returned negative 0.5%, down from 4.4% in Q3. Profit-taking, a stronger euro and political uncertainty in Germany and Spain negatively impacted equities, and led to high volatility early in Q4, which subsequently subsided. However, total return for 2017 was 13.3%, compared to 5.3% in 2016, as the economic recvoery gathered momentum. The technology and materials sectors were the best two performing sectors in Q4.

: After strong gains in previous quarters, equities recorded modest gains in Q4, with returns of 7.7%. Economic data met expectations. The People's Bank of China increased interest rates in December, and the 19th National Congress laid out a

Chart 2: Global Equity Markets Performance



Source: Bloomberg. All in local currency. FTSE All-Share Index (Ticker: ASX Index) S&P 500 Index (Ticker: SPX Index) Nikkei 225 Index (Ticker: NKY Index) MSCI World Index (Ticker: MXWO Index) MSCI Emerging Markets (Ticker: MXEF Index)

[1] European Economic and Monetary Union

plan for reducing financial risks while delivering slightly lower, but still substantial, GDP growth with an increasing emphasis on the domestic economy.

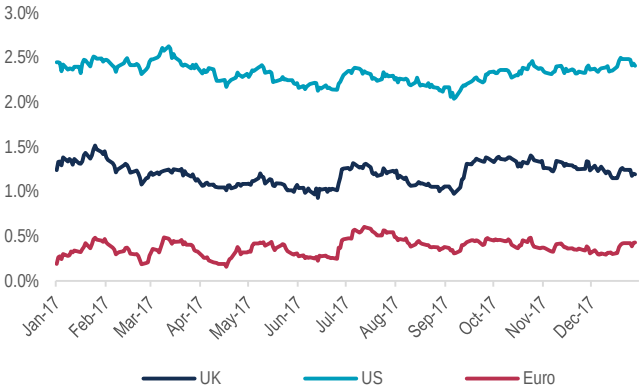
Fixed Income

The fourth quarter followed the key trends that have been driving bond market returns since early 2017. The U.S. economy continued to expand at a robust pace, boosting corporate earnings and increasing global risk appetite. This favourable backdrop, along with the US tax reform provided a tailwind for investment-grade corporate and high-yield bonds in particular. The Fed commenced its balance sheet "shrinking plan" in October, and the ECB announced that it would half the pace of bond purchases from January, both of which put further upward pressure on bond yields.

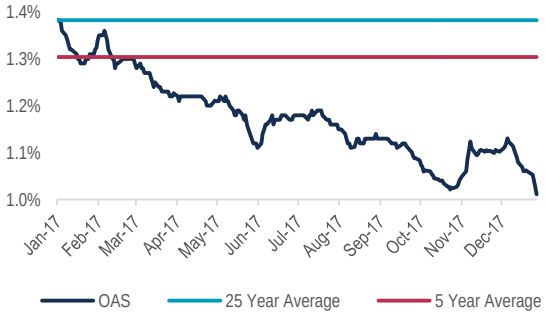
Government Bonds: Following the sharp sell-off of UK bonds in September, yields declined slowly over the quarter as the Bank of England indicated that there were no more interest rate rises on the immediate horizon.

US Treasury yields rose over the period, as tax reform raised the prospect of faster growth, higher inflation, and larger budget deficits in the future, and monetary policy tightened further. Eurozone bonds were broadly flat over the period, but saw a sell-off as the year drew to a close, in part due to the confirmation of an Italian general election in March.

Chart



Source: Bloomberg.
Notes: US Generic Govt 10 Year Yield (Ticker: USGG10YR Index)
UK Govt Bonds 10 Year Note Generic Bid Yield (Ticker: GUKG10 Index)
Euro Generic Govt Bond 10 Year (Ticker: GECU10YR Index)

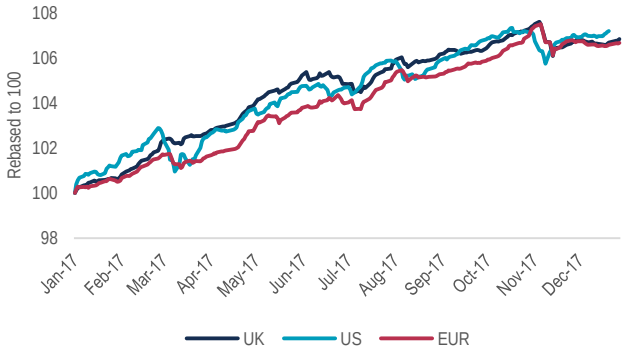


Source: Bloomberg. Notes: Bloomberg Barclays US Corporate Total Return Value Unhedged USD (Ticker: LUACTRUU INDEX)
Option-Adjusted Spreads (OAS) represent the difference between the index yield and the yield of a comparable maturity Treasury.

Corporate Bonds: A positive global picture, and the US tax reform, encouraged investor purchases of corporate bonds. Throughout 2017, corporate spreads have steadily narrowed and end the year at their lowest levels since 2007, and well below the 25-year average (1.4%) and 5-year average (1.3%).

High Yield and Investment Grade Credit: Global high yield bonds faced a turbulent final quarter, as high valuations resulted in large scale moves into investment grade bonds at the beginning of November. Over the entire year, both performed strongly, benefiting from high corporate earnings, the US tax reform and the low-inflation global

Chart 5: High Yield Corp



Source: Bloomberg*. Notes: Bloomberg Barclays Pan-European High Yield: Sterling Total Return Unhedged GBP (Ticker: I05892GB Index)
Bloomberg Barclays US Corporate High Yield Total Return Index Value Unhedged US (Ticker: LF98TRUU index)
Bloomberg Barclays Pan-European High Yield (Euro) TR Index Value Unhedged EUR (Ticker: LP02TREU Index)
*The previous indices used have now been discontinued in favour of the Bloomberg

recovery. High yield bond performance in particular was boosted by investors seeking higher yields in a low interest rate environment.

Currencies

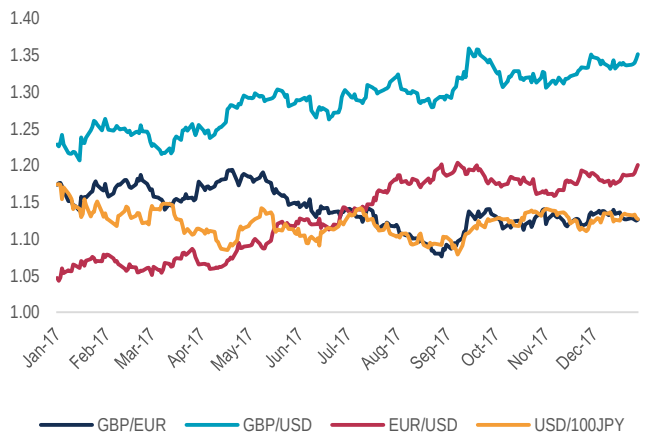
The final quarter of 2017 saw reduced volatility in major currency rates. The decline of sterling at the beginning of the quarter was reversed following the Bank of England's rate rise in November, and overall it was relatively unchanged over the period against both the euro and dollar. Continuing positive economic news from the Eurozone pushed the euro higher over the quarter, closing a strong year. USD/JPY showed very little change.

Table 2: Currency rates as at December 2017

	Quarter-end Value	% Quarter Change
GBP/EUR	1.13	-0.71%
GBP/USD	1.35	0.86%
EUR/USD	1.20	1.62%
USD/100JPY	1.13	0.16%

Source: Bloomberg.
Notes:
GBPEUR Spot Exchange Rate (Ticker: GBPEUR Currency)
GBPUSD Spot Exchange Rate (Ticker: GBPUSD Currency)
EURUSD Spot Exchange Rate (Ticker: EURUSD Currency)
USDJPY Spot Exchange Rate (Ticker: USDJPY Currency)

Chart 6: 1-year Currency Rates of Major Currency Pairs

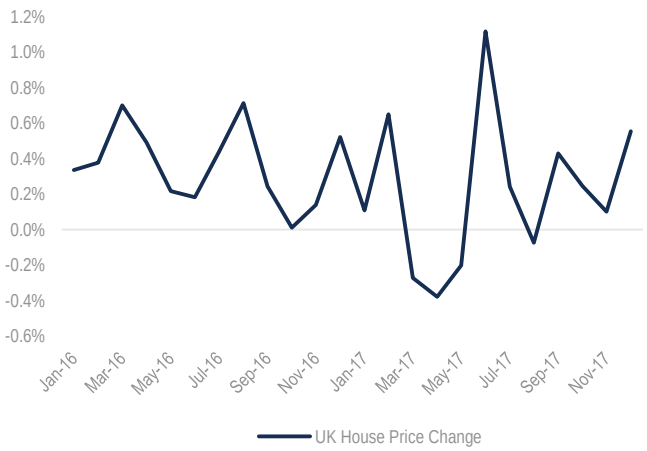


Property

Brexit has had a significant impact on UK property, and continuing lack of clarity is expected to increase volatility in 2018. Overall, 2017 was a poor year for residential property, with UK house prices rising 2.6%, compared with 4.5% in 2016. Commercial property saw increased volumes as markets recovered from the immediate aftermath of Brexit.

Commercial Property: Investment volumes increased, rebounding from the post-Brexit slump. Offices showed considerable activity both in and beyond London. Foreign investment in industrial property also increased over the period. Signs of progress in Brexit negotiations provided a significant boost to real estate equities in December.

Chart 7: 1-year UK Monthly Residential Property Price % Change



Source: Nationwide.
Notes: UK Monthly Indices

Residential Property: Having improved in Q3, house price growth slowed in Q4, to a quarterly growth rate of 0.8% from 1%, according to Nationwide. A significant contribution to this slowdown was London, where the annual rate of growth declined from 3.7% in 2016 to -0.5%. On a monthly basis, growth accelerated to 0.6% in December from 0.2% and 0.1% in October and November respectively. The November budget more than doubled stamp duty threshold (£125k to £300k) which is

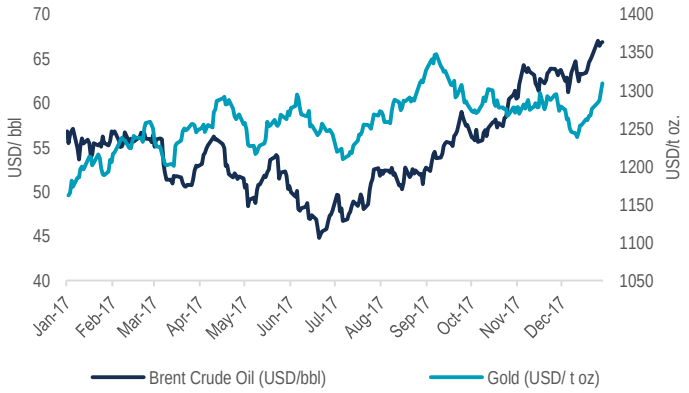
expected to raise prices, although the outlook for 2018 is pessimistic. Residential real estate equities also benefited from the progress in Brexit talks, and the FTSE EPRA/NAREIT UK Residential Index ended the year at levels not seen since 2007.

Commodities

Major commodities rose in Q4 2017, with crude oil making large gains. Industrial metals like Copper (up over 30%) and Zinc, and to a lesser extent Aluminium and Nickel, also recovered over the year on stronger global economic activity.

Oil: Oil prices rose significantly in Q4, as Opec acted to reduce supply and tensions between Saudi Arabia, Iran and Qatar flared. Brent crude started 2017 at US$56.82 a barrel, declining to US$46 by the summer but ended the year at US$66.87, an increase of over 17% for the year.

Chart 8: Gold and Brent Crude Oil prices



Gold: Gold prices ended the fourth quarter higher, despite a slump in December just before the Trump tax changes were passed. However, the gold price is still lower than it was in September, when prices peaked at US$1,351, this has been attributed to a lower than expected outcome for inflation, better growth and continued low volatility in markets. While these benign conditions continue Gold is unlikely to perform strongly. Gold started 2017 at US$ 1,151 and ended the year higher, at $1309, an increase of 13.7%.

Outlook

Market sentiment heading into 2018 is divided into those who believe the current level of valuations is unsustainable and expect a correction is imminent, and those who do not. To be fair, the trend higher in equity markets since Q1 of 2016 has not seen a significant period of consolidation, and while it is true that earnings are now generally outstripping expectations, a lot of that good news is already priced in. At the moment, the majority see these high valuations but remain optimistic that benign economic conditions can continue over the year and sustain the bull market for a bit longer. There are several possible triggers which could spell the end of the cycle: the first is its length, the second ironically is the Trump tax cuts, especially given the fact that the US economy is looking decidedly late cycle, near full capacity and thus prone to higher inflation. Another is Central Bank policy; so far the central banks have been very transparent and measured in their changes, but we are about to embark on the new policy experiment of Quantitative Tightening (QT), and last but by no means least, Credit Spreads for non-government bonds are, relative to the last 10 years, very narrow. Investors would be very wise to keep an eye on these "canaries" as we move through 2018.

The outlook for the global economy is generally considered brighter than it has been in a while: unemployment across the US, UK, and the Eurozone has been falling; inflation remains largely benign and monetary policy normalisation looks set to continue. The Fed is expected to increase rates three times in 2018, and other central banks are feeling confident enough to continue reducing the pace of QE, as growth returns to trend in the developed economies. However, underneath the positive headline figures, old questions about poor productivity and low real wage growth remain. How long an expansion can continue without a wage-led rise in inflation or increased productivity remains to be seen; it will be interesting to see how Trump's largely supply-side tax cuts will impact the US economy.

Political risk remains an issue for markets; 2018 will see the hardest work for the UK political establishment, as it embarks on real Brexit negotiations. Mrs Merkel still needs to form a Government in Germany, and the problems of solving an issue like Catalonia, and for that matter Italy, are going to resurface over the year. The Mueller investigation into Trump has the capability to surprise, as do the revelations of former associates and employees, but the markets seem for now largely immune to the dysfunctional US presidency.

The clearest change we will see as we progress through 2018 and into 2019 is the end of "global easy monetary policy". As stated above, the Fed has already stopped reinvesting coupon and principal from the bonds it has on its balance sheet, as well as increasing interest rates. The impact of tax cuts in the short term is likely to be increased deficit funding from the bond markets. In Europe, Japan and the UK, QE has or is close to an end, even if interest rates do not rise, these actions are a tightening of policy. Fiscal policy, especially in Europe and the UK, remains tight, so it is even more important that the global economy continues to grow at a rate that enables it to cope with tighter monetary conditions. Another outcome of a higher clearing level for "risk-free" rates is spread widening. All assets have a yield with a spread over the risk-free rate, and over the last 10 years we have seen a compression of these spreads. At some point, spreads will once again widen, and asset prices will fall to compensate for the higher yield.

While there is a broad consensus that the global economy will continue to strengthen in 2018, investors must remain wary. The hinge points -the unwinding of QE, China's continuing transition from credit-induced growth to a wage-led economy and interest rates returning to their normal range- will need careful monitoring. In addition, investors must watch to see that the signs that preceded past excesses, including stagnant wages, record household leverage, asset price bubbles and finance-created derivative amplifications, do not take them unawares.

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