Appendix 5

MJ HUDSON Allenbridge

# LONDON BOROUGH OF BROMLEY PENSION FUND

## Quarterly review

Q2 2018

# Performance Summary

The recovery in most developed equity markets in Q2 helped push the London Borough of Bromley Pension Fund (the Fund) over the £1bn mark by quarter end, this compares to a valuation of £800m just two years ago and is a return far in excess of the assumptions used in the last triannual actuarial revaluation of 31st March 2016.

The Fund returned 4.95% during the quarter which was ahead of the Fund benchmark by 0.52% for the period. Over the medium and longer term, performance of the Fund has been very strong, returning 12.7% per annum over 5 years and outperforming the Fund's strategic benchmark over 1, 3 and 5 year periods significantly.

The Fund continued to move towards the updated Strategic Asset Allocation with a new investment into the Schroders Multi Asset Income Fund (£120m) financed by divestments from the Blackrock Global Equity Fund. The purchase of the two Multi Asset Income (MAI) funds managed by Schroders and Fidelity is now complete. Post quarter end a further £20m was invested into the Fidelity UK Property Fund, again financed by the sale of part of the Blackrock Global Equity Fund. Fidelity expect to call the remaining money (£16m) for this fund by year end which is in line with expectations at the time of subscription. These new allocations will help to generate the income required to cover the predicted cash outflows from the Fund over the next few years.

With equity markets rising from end March to end May, the timing of the switch from the Blackrock Global Equity Fund into the Schroders MAI Fund at the end of May was fortuitous as equity markets declined slightly thereafter. This will have aided performance during the quarter because the new Strategic Benchmark was adopted in March whilst the switch out into the Schroders MAI fund was only completed in May.

The table below shows the old and new Strategic Benchmark for the Fund as well as the current and targeted position. The actual weightings will change as markets move going forward.

| Asset Class | Old Strategic Benchmark | New Strategic Benchmark (31/3/18) | Current position (30/6/18) | Post final property investments |
|---|---|---|---|---|
| Global Equities | 70% | 60% | 65.8% | 62.4% |
| Multi Asset Income | - | 20% | 19.5% | 19.5% |
| Fixed Interest | 20% | 15% | 13.1% | 13.1% |
| UK Property | | 5% | 1.6% | 5.0% |
| Diversified Growth Fund | 10% | - | - | - |

This shows that the Fund enters the second half of 2018 slightly overweight global equities and underweight Fixed Interest and Multi Asset income. This has been driven by the performance of global equity markets during the transition phase. The scale of these deviations from the new Strategic Benchmark are minor but will be enough to impact slightly on the relative performance of the Fund against its benchmark going forward.

# Executive Summary

- The global economy recovered from its stumble in the first quarter of the year as growth picked up in most developed markets, although volatility remained heightened relative to 2017.

- Global equity markets had a mixed quarter, with developed markets recovering from the correction in Q1 to various degrees; in contrast, emerging markets suffered considerable losses.

- Global bond markets experienced significant bouts of volatility: US 10-year Treasury yields reached a seven-year high, then fell back significantly due to growing risk aversion. Corporate bond spreads continued to widen reflecting the greater uncertainty and prospect of further interest rate hikes.

- In June, the US Federal Reserve increased interest rates by 25 basis points, to a range of 1.75%-2.0%, with two further increases expected this year. This aided a turn in the US dollar which strengthened throughout the quarter.

- Corporate earnings remained robust in the US, still bolstered by the effects of President Trump's tax reforms.

- Uncertainty over Brexit continued to act as a drag on the UK economy and, despite a slight pick-up in growth predicted for Q2, the Bank of England revised its predictions for growth in 2018 downwards.

- UK equities, having been relative underperformers, experience a stronger quarter as interest rates remained unchanged and sterling weakened.

- Italian bond yields shot up at the end of May, as a coalition government formed by two populist parties on either side of the political spectrum took power. Concerns grew over the coalition's plans to cut taxes and boost spending, in a country where government debt is over 130% of GDP.

    - Following the proposed appointment of a Eurosceptic finance minister and news of the possible introduction of a parallel currency for some government transactions, markets panicked and fears grew that Italy might leave the euro. However, this candidate was vetoed by the Italian President and the plans for a parallel currency cancelled. The government subsequently reaffirmed its commitment to staying in the euro and bond yields subsided as government policies proved less radical than feared.

- Following a period of weakness, the dollar strengthened significantly as the Fed increased interest rates while other major central banks maintained very loose monetary policy and a widely anticipated Bank of England rate rise failed to materialise.

- Activity in the UK property market and particularly in the residential sector, remained subdued in the second quarter of the year. This was in part due to the continuing effect of flat wages and concerns over the ability of households to service debt in an environment of increasing interest rates.

- Commodity prices had a mixed quarter, but overall ended the quarter up. Fears of a trade war remained the key influence over performance, with soybean prices, in particular, suffering from the tensions.

- The price of oil continued to rise due to strong demand along with supply disruptions in the Middle East, while gold prices fell as a result of a stronger dollar.

- The first quarter of 2018 saw substantial turbulence with the return of volatility and tighter monetary policy, indicating that 2018 as a whole would not be as smooth sailing as 2017; Q2 provided further support for this theory. Despite strong fundamentals, escalating trade tensions between the US and China, as well as concerns over the late stage of expansion in the US, mean that there may be clouds on the horizon.

# Outlook

In the tenth year of a bull market, with US growth rebounding and strong earnings reported, it is both the best and worst of times for market participants. There is room for both an optimistic picture and a bearish case: to invest in a market which, while demonstrating more volatility than earlier in the year, can still as often as not surprise to the upside, or to get out while the going is good before the market turns decisively downwards. Certainly one can look to facts to buttress either case, but our consensus position is that while a correction will come, it is probably not imminent, with no obvious trigger set to decisively turn market sentiment on the immediate horizon, although dangers remain.

In the US, growth has rebounded strongly while Trump's expansionary fiscal policy has not yet led to significantly higher inflation, nor has growth been choked off by tighter monetary policy; indeed, offsetting higher rates from the Fed with bigger deficits might allow the economy to keep going despite monetary headwinds, as corporate balance sheets are strengthened through lower corporate tax rates. Wage growth has also started to come through, boosting Trump ahead of the mid-term elections later on this year, giving the economy a demand-side fillip to match Trump's largely supply-side reforms of tax cuts and deregulation. Fed Chairman Powell, in remarks to Congress, sets the scene of a generally strong US economy over the next couple of years which should accommodate an unwinding of the past 10 years' experiment in unconventional monetary policies and record low rates towards a more normal interest rate regime.

Despite continuing near-chaos politically as Britain attempts to negotiate its exit from the European Union, the optimists' economic case that the UK's poor GDP growth in Q1 was due to poor weather was supported by slightly stronger data in Q2 although the Bank of England further reduced its longer term growth forecasts, while lower inflation should help reduce the squeeze on UK consumers in the third quarter. Meanwhile, the election of a new populist government in Italy, which spelled doom for the euro according to some more apocalyptic critics, has instead seen no moves to radically change the euro's governing rules.

However, despite positive indications, it is possible to point to storm clouds on the horizon. Trump's brinkmanship over trade with China, the EU, and Canada has brought up comparisons to the global protectionism following the Smoot-Hawley Tariff Act in 1930 and the Great Power rivalry that it subsequently spawned, while markets, so often moved by liquidity as much as fundamentals, will have to navigate monetary tightening in the US (most prominently), but also in the Eurozone, by the Bank of England and, possibly even in Japan over the coming quarters.

Many indicators associated with a late cycle are flashing: while the yield curve is not yet inverted- an empirical regularity before previous downturns - it is getting very close to being so; Bank of America Merrill Lynch comment that 14 out of 19 indicators that they watch to signal a bear market have now been triggered; and analysts at Citigroup state that we are currently in the third phase of four periods that are standard for market cycles. It's not a question of "if" but "when" the next downturn comes, although the consensus seems to be that the markets will remain resilient for a while yet. Whether to ride the markets, transition to defensive stocks, or exit the market entirely, is still a decision that many are weighing up. We would look to diversification and a defensive strategy but this period could run for a number of years yet.

# Performance report

| Asset Class/ Manager | Global Equities/ Baillie Gifford |
|---|---|
| Fund AuM | £408m Segregated Fund; 40.1% of the Fund |
| Benchmark/ Target | MSCI All Countries World Index +2-3% p.a over a rolling 5 years |
| Adviser opinion | Manager continues to exceed their performance target |
| Last meeting with manager | No meeting this quarter |
| Fees | 0.65% on first £30m; 0.5% on next £30m; 0.35% thereafter |

The manager continues to deliver outperformance within the global equities portfolio driven by a strong research agenda. One of their themes for this year has been the need for diversification across the portfolio as we enter more uncertain times and this has resulted in a trimming of some of the stronger performers of recent quarters like Amazon and Google parent Alphabet along with some semiconductor manufacturers which are highly economically sensitive. The money has been reinvested into a broader range of holdings and average holding size has been reduced although Active Share[1] remains high at 91%. Turnover within the portfolio has ticked up slightly suggesting an element of portfolio repositioning which makes sense after the strong recent outperformance but the focus remains resolutely on companies capable of delivering sustainable long term growth. This Baillie Gifford global equity fund can be accessed via the London CIV.

| Asset Class/ Manager | Global Equities/MFS |
|---|---|
| Fund AuM | £218m Segregated Fund; 21.4% of the Fund |
| Benchmark/ Target | MSCI All Countries World Index |
| Adviser opinion | Short term underperformance quite marked |
| Last meeting with manager | No meeting this quarter |
| Fees | 0.6% on first £25m; 0.45% on next £25m; 0.4% thereafter |

MFS have an investment philosophy which concentrates on high quality stocks on attractive valuations, this acts as a good balance to the Baillie Gifford, growth orientate, portfolio covered above. Value as an investment style has been out of favour for a number of years and the MSCI index of Value stocks has underperformed the sister index of Growth stocks markedly with the gap between the two indices at the widest in a decade.

The portfolio returned by 5.4% during the quarter, underperforming its benchmark by 1.5%. Over 1 year the portfolio has underperformed the benchmark markedly returning 3.6% against the benchmark's 8.9%. Over 3 years the portfolio is ahead of its benchmark but is not reaching its performance target.

MFS are positioned away from technology companies and underweight the US market in general believing both to be expensive, this was detrimental to performance in Q2 as it has been for over a year now. Interestingly, value as an investment strategy has only performed this poorly against the broader index in four other annual periods, all of which occurred near an equity market peak (1980, 1998, 1999, 2007). The manager continues to pursue their investment philosophy and strategy, the question is whether the speed of technological change and business disruption it is causing is transitory or likely to persist. In the event of the latter, the strategy may struggle further but any weakening of equity markets particularly driven by an unwinding of the high valuations of some of the US

[1] Active Share measures the difference between the weight of a stock in a portfolio and its weighting in the index. A passive, index tracking, portfolio will have an active share of 0%; A portfolio holding only off benchmark stocks will have an active share of 100%.

technology companies which now form such a large part of the benchmark will see a rapid recovery in this portfolios relative performance.

| Asset Class/Manager | Global Equity/ Blackrock |
|---|---|
| Fund AuM | £44m Pooled Fund; 4.3% of the Fund |
| Benchmark/ Target | MSCI All Countries World Index |
| Adviser opinion | Decision on remaining monies in the fund needs to be made |
| Last meeting with manager | No meeting this quarter |
| Fees | 0.3% of fund value |

The manager underperformed their benchmark in Q2 returning 5.6% against the benchmark return of 7.0%, over the year it outperformed the benchmark by 1.2%. Over 3 years performance has been in line with the benchmark. This portfolio has been used as the source of funds for the investment into Schroders Multi Asset Income Fund (£120m) during the quarter and following the £20m invested into the Fidelity UK Property Fund post quarter end this portfolio now stands at approximately £24m. A further £16m should be invested into the property fund during the second half of the year post which a decision will need to be taken regarding the remaining monies in this portfolio. It has performed acceptably since inception on 1/12/2013 but has not reached its performance target over the longer term.

| Asset Class/Manager | Fixed Interest/ Baillie Gifford |
|---|---|
| Fund AuM | £57m Pooled Fund; 5.7% of the Fund |
| Benchmark/ Target | Tailored benchmark |
| Adviser opinion | Benchmark performance over the medium term |
| Last meeting with manager | No meeting this quarter |
| Fees | 0.3% of fund value |

The portfolio has a composite benchmark weighted 44% UK Government Bonds (GILTS) and 44% Non-Government Investment Grade Bonds with a 6% allocation to both Emerging Market Bonds and to High yield Bonds. The portfolio has an average credit rating of single A, a duration of 9 years and is currently yielding 2.6%.

The fund returned -0.5% in Q2 underperforming the benchmark by -0.2%. It has performed close to benchmark over time and is 0.1% ahead over 3 years. Given the investment grade nature of the portfolio and the current low level of yields I would expect returns to be low and the performance target hard to beat for this fund.

The portfolio continues to yield above the benchmark through taking marginally higher credit risk and this will have been detrimental to performance this quarter as credit spreads widened slightly on concerns that the speed of economic growth in the US could lead to faster than expected US interest rate rises.

| Asset Class/Manager | Fixed Interest/ Fidelity |
|---|---|
| Fund AuM | £76m Unit Trust; 7.4% of the Fund |
| Performance target | 50% Sterling Gilts; 50% Non-Sterling Gilts; +0.75 p.a rolling 3 year |
| Adviser opinion | Manager continues to meet long term performance targets |
| Last meeting with manager | 30/8/18 John Arthur / Paul Harris, Ian Fishwick |
| Fees | 0.35% on first £10m; 0.3% on next £10m; 0.21% on next £30m; 0.18% thereafter |

The manager marginally outperformed the benchmark in the second quarter 2018 by 0.2%. Longer term performance remains above benchmark and the manager is achieving the performance target over 3 and 5 years but it is noticeable that levels of absolute returns are falling due to the current low level of yields available.

The portfolio consists of almost entirely Investment Grade bonds with an average duration of 9.9 years and a current yield of 2.0%. The manager has bought the portfolio closely in-line with the benchmark in both duration and yield as they become more cautious of the direction of interest rates. Their concern is that the US continues to grow above trend and increasingly above capacity and that the current market assumption of US rates rising to no more than 3% over the next 12-18 months may be too sanguine. Any reappraisal of this by the market will likely cause US and global bonds to fall to some extent.

In the absence of a strong view on duration or credit within the portfolio, the performance target will be harder to meet in the short term but the mandate gives the manager sufficient flexibility to invest outside the index into non UK markets and higher yielding bonds such that it should remain achievable over the longer term.

| **Asset Class/Manager** | **Multi Asset Income/ Fidelity** |
|---|---|
| Fund AuM | £80m Pooled Fund of Fund; 8.2% of the Fund |
| Performance target | LIBOR +4% p.a. |
| Adviser opinion | |
| Last meeting with manager | 30/8/18 John Arthur /Paul Harris, Eugene Philalithis, Chris Forgan |
| Fees | 0.4% on first £20m; 0.3% on next £30m; 0.25% on next £100m; 0.18% thereafter |

This mandate was funded on 20th February 2018. It invests across multiple asset classes including Alternatives e.g. property, infrastructure, leasing and direct lending via a Fund of Funds approach. It has a target yield of 4% over time and is designed to cover the cash flow requirements of the Fund into the future.

The manager returned 1.2% in Q2 against an index return of 1.0%. Remember the index return is based on LIBOR and as such will not move with the main asset markets of equities and bonds. The investment performance of the two Multi Asset Income managers can only be properly assessed over the long term and it is too early to comment on this element at present.

The manager continues to develop the portfolio as expected, post the initial funding the manager has increased exposure to the alternative investments segment mainly in infrastructure and direct lending funds, these are investment areas which the Fund does not access directly and so provide a useful element diversification. The fund is cautiously positioned and has met its income requirements over the quarter.

| **Asset Class/Manager** | Multi Asset Income / Schroders |
|---|---|
| Fund AuM | £119m Pooled Fund; 11.7% of the Fund |
| Performance target | LIBOR +5% |
| Adviser opinion | |
| Last meeting with manager | 5/9/18 John Arthur / John Griffiths, Remi Olu-Pitan |
| Fees | 0.35% of fund value |

£120m was invested into this fund during the quarter and, as such, it is too early to comment on performance at the current time. The manager recently announced the departure of the lead portfolio manager with his replacement being promoted within the team. The replacement is experienced and the structure Schroders have put in place to manage this change seems good. I will continue to monitor this and report more fully next quarter.

| Asset Class/Manager | UK Property/ Fidelity |
|---|---|
| Fund AuM | £16m Pooled Fund; 1.6% of the Fund |
| Performance target | IPD UK All Balanced Property Index |
| Adviser opinion | |
| Last meeting with manager | 30/8/18 John Arthur / Paul Harris, Alison Puhar |
| Fees | 0.75% of fund value |

The initial investment was made into this fund on 22nd February 2018. A further investment has been made of £20m on 22nd August 2018 taking the Fund's total investment as at the time of writing to £36m against a commitment of £50m, the remaining £16m is expected to be called by year end and the manager has a couple of properties under active negotiation at the current time. The fund now holds 45 properties spread across the UK and across all major property types. It has a 5% exposure to retail assets which is significantly below the index weighting and whilst it is seeing some pressure on lease terms in this area these are within current expectations. The fund has scope for rents to rise as vacancies are filled and rent free periods expire and although their view of the market is becoming more cautious in the shorter term they do still expect the fund to return 7-8% per annum over the medium term.

# Appendix - Global Economy

Following signs of a slowdown in the synchronized global expansion observed in the first quarter of 2018, growth was stronger in the second quarter, as temporary effects, such as poor weather in the UK and a significant flu outbreak in Germany, dropped out of the figures. Inflation began to pick up globally, and monetary policy tightened further, led by a further rate rise in the US.

Table 1: Quarterly GDP Growth Rate

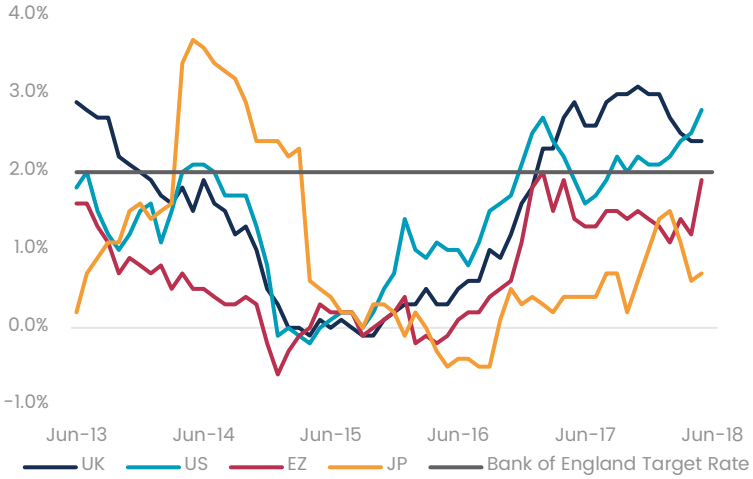
| | US GDP | UK GDP | Eurozone GDP | Japan GDP |
|---|---|---|---|---|
| Q2 2018* | 2.90% | 0.40% | 0.50% | 2.10% |
| Q1 2018 | 2.80% | 0.20% | 0.40% | 0.60% |
| Q4 2017 | 2.90% | 0.40% | 0.70% | 1.60% |
| Q3 2017 | 3.20% | 0.50% | 0.70% | 2.50% |

Source: Bloomberg. *Forecasts 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:** Growth strengthened in Q2, and consumer confidence remained strong in both the US and Europe, bolstered in part by positive unemployment data. However, rising trade war tensions dampened expectations for growth in the longer-term.

In the UK, economic data rebounded somewhat from a lackluster Q1. The Bank of England, however, revised growth forecasts down during the middle of the quarter.

Chart 1: 5-year CPI to June 2018




Source: Bloomberg.
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 continued its upward trend across the quarter, with the US in particular showing price acceleration.

In the US, inflation figures increased to 2.9% in June 2018, the highest rate since 2012. This increase was in part due to the effects of the rising oil and gasoline prices. This resulted in some market turbulence, as fears arose that the Fed would raise rates more quickly than planned. In the UK, the inflation rate was 2.4% in May 2018, down from 2.5% in March. While inflation remained above the Bank of England's 2% target, it dropped to its lowest level for a year in April 2018 as the effect of past sterling weakness dropped out.

**Central Banks:** Central banks took further steps to slow or reverse their monetary stimulus programmes. The Bank of England kept its rates at 0.5% over the quarter, as weaker-than-expected economic data meant that a widely-expected May rate rise failed to materialise. Whether the more recent, stronger economic data will lead to a rate rise at the August meeting has divided opinion. The Federal Reserve raised rates again in June by 25 basis points, to a range of 1.75%-2.0%, with a further two rate rises now expected this year. In the Eurozone, Mario Draghi confirmed that the ECB would not raise rates until after its programme of quantitative easing comes to an end, at least through the summer of 2019.

**Political Headlines:** Political turmoil further troubled markets with trade tensions between the US and China escalating, Italian election results generating panic amongst investors and, in Spain, Mariano Rajoy's scandal-plagued tenure coming to an end with Pedro Sánchez of the left-leaning Spanish Socialist Workers' Party becoming Prime Minister on 2nd June.

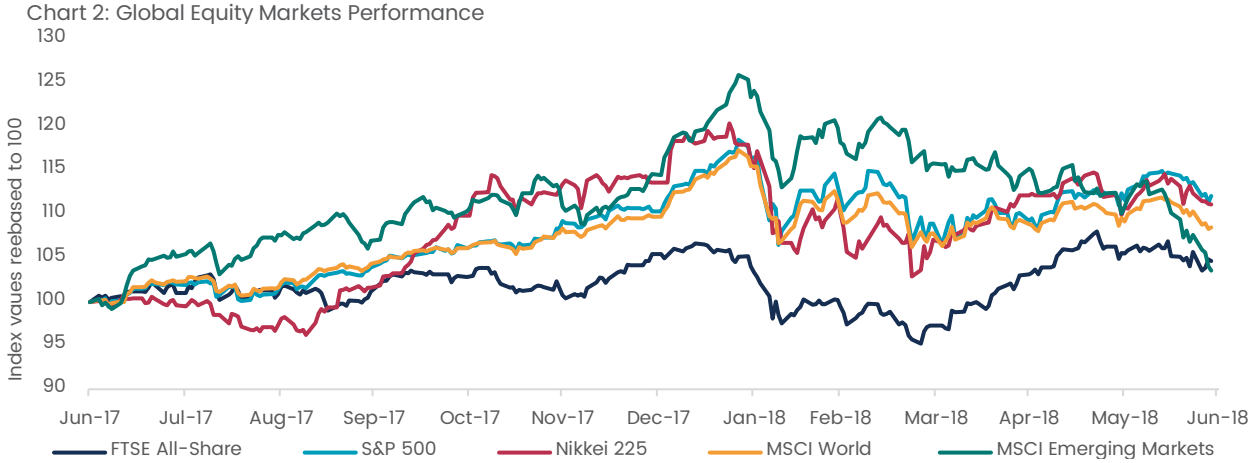
# Equities

Following the first equity market correction and quarterly decline in global equities in two years in Q1, Q2 presented a more mixed picture, with developed equity markets recovering somewhat, whilst emerging markets declined, reversing their strong Q1 performance. The MSCI World returned 1.4%[2] in Q2, compared to -1.3% in the previous quarter.

**UK:** Having struggled earlier in the year, UK equities bounced back in Q2. The FTSE 100 returned 9.4% and the FTSE All-Share 9.0%, following negative returns of 6.6% and 6.4% in the previous quarter. Contributors included the internationally exposed large cap stocks benefiting from the weakness of sterling, with rates remaining unchanged at 0.5%, and the higher oil prices boosting energy companies.

**US:** Performance in US equities was driven by strong corporate earnings and economic data, although the growing threat of a trade war between the US and China raised concerns over future performance. The S&P 500 returned 4.8%, and the Dow Jones Industrial Index rose 2.1%.

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)

**Japan:** The MSCI Japan Index and the Nikkei both returned to positive territory in Q2, posting 1.0% and 4.4% respectively, as they were boosted by a weaker yen, following a disappointing Q1. Corporate earnings broadly met expectations, and unemployment declined further.

**Emerging Markets:** Emerging markets had a difficult quarter, due to the strength of the dollar, trade tensions, and an increase in risk aversion. In Brazil, political instability and strikes hit output. Turkey and Argentina also suffered, with the former raising interest rates sharply to shore up the lira, and the latter forced to approach the IMF for assistance. The MSCI EM Index posted a total return of minus 9.8%, a sharp deterioration.

**EU:** Political uncertainty increased significantly in Europe in Q2. The Italian elections resulted in a coalition of two populist parties. However, instability subsequently declined, and support for the euro was steady or increasing across the Eurozone by the end of the quarter. Stock market returns were positive, boosted by more promising economic data, although financial stocks, in particular Italian banks, weighed on overall performance.

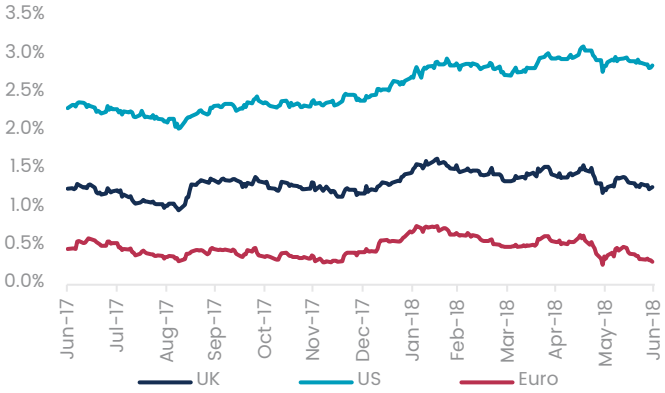
**China:** Trade tensions with the US led to the MSCI China Index returning -5.6%, compared with 2.2% in Q1. Growth slowed somewhat, as expected, but remained solid as the transition from an investment-led model to one based on consumer spending continued.

[2] All return figures quoted are Total Return, calculated with gross dividends reinvested. Source: Bloomberg.

# Fixed Income

Global bond markets suffered from bouts of volatility in Q2 due to a number of impactful political and economic issues and events. These included a greater divergence between a US economy that seemed to be, if anything, on the verge of overheating, and a softening of economic activity elsewhere, the ratcheting of trade tensions between the US and China, and the formation of a populist coalition government in Italy with some radical, expansionary economic plans.

**Government Bonds:** US 10-year Treasury yields touched a seven-year high in May as strong economic data gave rise to future inflationary concerns. This, however, was followed by a significant retracement, and a similar flight to quality with parallel moves into Bunds, as events in the Eurozone made investors take fright. Italian 10-year yields increased from 1.79% to 2.68%, and two-year yields from -0.33% to 0.72% as a new populist coalition took power. Spanish yields also rose on news that Mariano Rajoy had been forced out of office in June. The US yield curve flattened with two-year yields increasing from 2.27% to 2.53%. The spread between two and 10-year yields reached its lowest point since 2007 (long regarded as a potential sign of a coming recession). Despite this, the Fed raised rates at its June meeting.




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)

Chart 4: US Corporate Bond Spreads


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:** Global corporate bonds registered negative total returns with US dollar investment grade and euro high yield leading the declines. Segments of fixed income more vulnerable to trade tensions faced more pressure than more domestically focused areas in the face of trade tensions that spread from the US and China to also encompass Canada and Europe, threatening global corporates' supply chains and overseas earnings. Overall, Investment-grade corporate bonds posted negative excess returns over the second quarter, as credit spreads widened and the prospects for further Fed rate hikes strengthened.

**High Yield and Investment Grade Credit:** Investment Grade (IG) credit weakened compared to High Yield (HY) over the quarter, partly due to the threat of higher trade tariffs and sensitivity to interest rates. However higher-than-expected issuance was also likely a factor, and may be on the rise due to elevated merger and acquisition activity in the wake of the Trump administration's focus on deregulation along with significant corporate cash stockpiles. This supply can create negative technical pressure and may well have led to higher spreads as a result.


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)

# Currencies

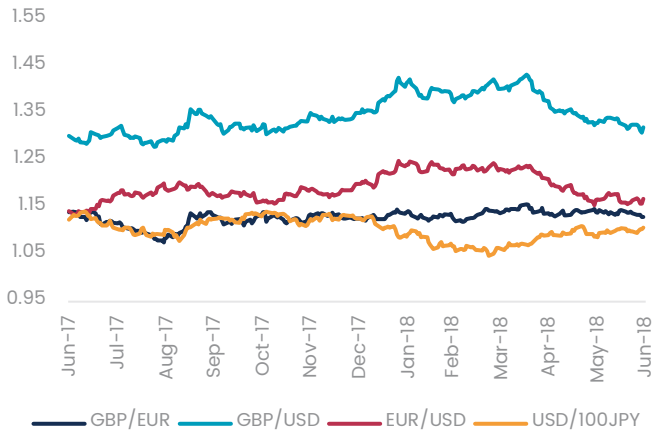
The main theme in Q2 2018 was the strength of the dollar, which saw significant appreciations against sterling, the euro and the yen. This was driven in part by a further rate rise by the Federal Reserve, in contrast with continued ultra-low rates in Europe, the UK and Japan. The weakness of sterling was further heightened by weaker-than-expected economic data from Q1 resulting in the Bank of England deciding against a rate rise in May.

Table 2: Currency Rates as At March 2018

| | Quarter-end Value | % Quarter Change |
|---|---|---|
| GBP/EUR | 1.13 | -0.65% |
| GBP/USD | 1.32 | -5.77% |
| EUR/USD | 1.17 | -5.19% |
| USD/100JPY | 1.11 | 4.22% |

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

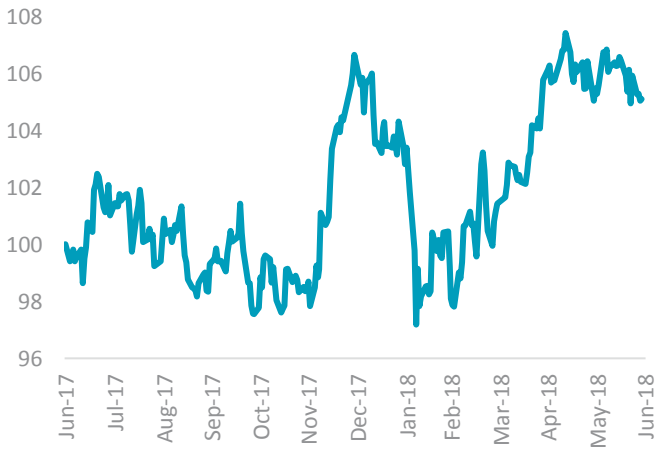



# UK Property

The UK property market recovered slightly in Q2, with the FTSE EPRA/NAREIT UK Index up 3.6% overall in the period. Commercial property continued to see modest growth, but residential property remained flat, with continuing fears over household disposable income and debt servicing if interest rates were to venture higher.

**Commercial Property:** UK commercial property capital values were up 0.2% on average during Q2 2018, down from last quarter, with rental value growth also slower at 0.1%. CBRE data revealed that the industrial sector continued to experience the strongest capital value growth (1.7%). Other sectors showed very weak (or, in the case of retail, negative) growth in terms of both capital value and rental growth. CBRE reported that the capital values in the retail sector decreased by 0.8% in June 2018, the biggest monthly fall since May 2012. At the end of the quarter, total returns for the year to-date stood at 4.2%.

Chart 7: 1-Year UK Commercial Property Investment Index




Source: Bloomberg.
Notes:
FTSE EPRA/NAREIT UK Index (Ticker: ELUK Index)

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