Appendix 5

MJ HUDSON Allenbridge

London Borough of Bromley Pension Fund

Quarterly Report

Q3 2018

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Performance Summary

The Fund reached a value of £1.047bn and returned 2.8% in the third quarter of 2018, this was driven by 5% plus returns from developed equity markets led by the US and Japan. UK and Emerging Market equities finished the quarter lower along with Investment Grade Bonds. Returns from the latter are now flat over the last year and slightly down year to date as interest rates have started to rise in the US and UK. The Multi Asset Income Funds produced small positive returns over the quarter (in line with expectations) whilst Property was slightly down.

The Fund underperformed its benchmark by 0.5% in Q3. This was driven by underperformance from the Baillie Gifford Global Equity portfolio which accounts for over 40% of the Fund's assets and underperformed its benchmark by -2.4%, returning 3.4% over the quarter. Over the long term this portfolio has performed very well and continues to hit its long term performance target despite the poor quarter. The Funds other Global Equity portfolio, managed by MFS, invests in a very different manner to Baillie Gifford and was selected because of this diversification of investment philosophy and approach, it is therefore pleasing to see the MFS Global Equity portfolio outperform its benchmark over the third quarter following a period of poorer performance.

Globally, equity markets ended Q3 on a weaker note as US interest rates continued to rise and worries about the US economy overheating increased, this has continued into the fourth quarter with some commentators predicting a global economic recession as early as next year. This is not my central expectation and whilst returns are likely to stay low going forward, I do not expect this to be the start of a major market fall.

During the quarter a further £20m was invested into the Fidelity UK Property Fund with the money taken from the Blackrock Global Equity Fund. A further £16m is expected to be invested into this Property Fund by year-end with the money again taken from the Blackrock Global Equity Fund.

Asset Class	Strategic Benchmark (31/3/18)	Current position (30/9/18)	Post final property investment of £16m
Global Equities	60%	65.0%	63.5%
Multi Asset Income	20%	19.0%	19.0%
Investment Grade Bonds	15%	12.6%	12.6%
UK Property	5%	3.4%	4.9%

This shows the Fund slightly overweight Global Equities and underweight Investment Grade Bonds.

Executive Summary

- The global economy remains resilient albeit less synchronised and growing at a slightly slower pace than previously as many major economies are advancing towards the later stages of the business cycle.
- The US-China trade tensions continued to escalate, with ramifications for emerging markets. This could have a more major influence on global growth if the situation escalates further.
- In September, the Federal Reserve increased rates by 25 basis points, to a range of 2.0%-2.25%, with one further increase expected later this year and a further 2 or 3 rises predicted for 2019. The Bank of England also increased interest rates in the period to 0.75% - the highest level since 2009!
- Global equities posted positive gains as the MSCI World returned 5.1% over the quarter, driven mainly by US economy growth and boosted by the Trump tax cuts driving a strong corporate earnings season.
- UK equities continued to underperform as uncertainty surrounding Brexit acts as a drag on the market. Despite this, GDP growth was revised slightly upwards, underpinned by consumer spending and tourism, with the economy recovering from its weather related drop in Q1.
- Treasury and Investment Grade Bond prices fell and yields rose mainly due to the strength of the US economy. This lead the US Fed and Bank of England to raise interest rates. High yield bonds continued to perform better than the rest of the fixed income markets, but rising interest rates and high levels of corporate debt are concerns.
- Italian bond yields increased further as concerns grew that the new populist coalition government planned to cut taxes and boost spending undermining a previous commitment to the EU to run a balanced budget and reduce government debt, which is already over 130% of GDP and the highest in the EU. This balance between the authority of domestically elected politicians to set a budget and the rights of the EU to manage the Eurozones finances will define the EU going forward making it an important development to watch.
- The dollar strengthened in the beginning of the quarter due to the strong US economic data. Sterling remains volatile in light of ongoing Brexit negotiations. It is the strength of the dollar which causes problems for some emerging economies as often much of their debt is borrowed in dollars.
- The UK property market returned mixed results, particularly in the residential sector, as house price growth slipped. Commercial property values returned their weakest quarterly performance of 2018, while in the retail sector values remained subdued and pressure on lease terms increased.
- The price of oil continued to rise, reaching $82 per barrel due to strong demand, as disruptions in the Middle East and Venezuela hindered supply. Metal prices fell over the quarter as the dollar strengthened and the Fed increased interest rates. Industrial and precious metals were most affected as the US-China trade tensions waged on. Gold prices continued to fall from Q2.
- Q3 saw lower levels of volatility compared to the beginning of the year; however, with central banks tightening monetary policy and escalating trade tensions between the US and China, and, as we move through the business cycle, more analysts are forecasting a likely market correction and a flight to quality on the horizon.

Outlook

The 10-year anniversary of the collapse of Lehman Brothers and the significance of reaching the longest bull market run in modern times makes clear that we are closer to the end of an economic cycle than to the beginning. Market participants can still point to contrasting economic data to make their case on whether

investors should look more to the short or to the medium term for market conditions to turn and for the cycle to truly end.

While geopolitics continued to make its mark on the third quarter – with a crisis in Turkey and continuing fallout from Argentina's economic troubles joining longer-running issues like US-China trade tensions and the mismatch between Eurozone economics and political pressures – worst-case scenarios like widespread emerging market contagion or a Eurozone confrontation and unravelling failed to materialise. In the fourth quarter of 2018 policymakers will hope for a similar outcome from managing events, given the likelihood of further high-profile political developments before the end of the year, with a US-China trade meeting planned, UK Brexit negotiations hanging in the balance, and midterm elections in the US all likely to see robust political differences on display.

While geopolitics hogs all of the headlines, turbulence may well be more likely to come from a combination of the weakening effects of fiscal policy and central banks' efforts at monetary normalisation. Moves to unwind QE and raise rates are designed to give central bankers more ammunition for the next downturn and also to encourage the debt deleveraging that has only partially taken place in the low interest rate environment of the last ten years. Fears of missteps from policymakers are likely to rile markets, but going too far too fast may well spark off the very end of the cycle that Central Banks are trying to prepare for.

While policymakers face questions of how quickly to normalise policy, indicators point in differing directions. While government spending during recessions is designed to socialise debts onto the public balance sheet from companies and households, historically low interest rates have instead enabled companies around the world to take on cheap debt. In the ten years since the global financial crisis, the debt held by nonfinancial corporations has grown by $29 trillion – almost as much as government debt – according to new research by the McKinsey Global Institute[1]. However, this rise in debt has largely been driven by companies in emerging economies: Turkey's corporate debt has doubled in the past ten years, with many loans denominated in US dollars. Chile and Vietnam have also seen large increases in corporate borrowing. Rising US rates may well pose a threat to these companies' ability to pay or rollover these debts. Over the next five years, a record $1.5 trillion worth of nonfinancial corporate bonds will mature each year and as some companies struggle to repay, defaults will most likely rise. However, rather than a simpler story of emerging economies with dollar-denominated debts, it has actually been China who has been the biggest driver of this growth. At 163 percent of GDP, China now has one of the highest corporate-debt ratios in the world.

In light of this data on corporate debt levels, while some analysts argue that rising US rates might start an emerging market crisis that could spread globally, some argue that the Dollar is overvalued and fears are overblown, while others forecast a likely recession in 2019 due to a global dollar shortage.

Unemployment and participation rates indicate developed economies might be close to overheating yet median real wages across the OECD remain stubbornly flat while households have done better than corporates in paying down pre-2008 debt levels.

Thus, the continued navigation towards "normality" ten years after the need for extraordinary measures is fraught with contrasting signals and fragilities are still endemic in the global economic system. Market participants will hope that policymakers can navigate a course that does not tip too far in any one direction. We may well be late cycle, but investors continuing economic growth will drive markets higher yet.

[1] Lund, S., Mehta, A., Manyika, J. and Goldshtein, D. (2018). A decade after the global financial crisis: What has (and hasn't) changed?. [online] McKinsey & Company. Available at: https://www.mckinsey.com/industries/financial-services/our-insights/a-decade-after-the-global-financial-crisis-what-has-and-hasnt-changed [Accessed 26 Oct. 2018].

Performance report

Asset Class/ Manager	Global Equities/ Baillie Gifford
Fund AuM	£423m Segregated Fund; 40.4% 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 underperformed their benchmark by 2.4% in the third quarter as a number of high profile growth names in the technology sector retraced some of the very strong performance of the past year, this was driven more by concern over the high valuations of a number of these stocks rather than a real deterioration in the underlying businesses. The manager had sensed the strong rally in high growth stocks coming to an end and noted last quarter that they were selling some of the strong performers and broadening out the portfolio slightly. Turnover within the portfolio is at the higher end of historic ranges with the average holding period of stocks in the portfolio coming down from 7 towards 5 years. With equity markets remaining weak into the fourth quarter this portfolio may underperform further in the short term but I remain impressed by the investment philosophy and focus of the manager and the portfolio continues to hit its performance target over 1, 3 and 5 years and has outperformed since inception in 1999.

Asset Class/ Manager	Global Equities/MFS
Fund AuM	£231m Segregated Fund; 22.1% of the Fund
Benchmark/ Target	MSCI All Countries World Index
Adviser opinion	underperformance over the last year is quite marked
Last meeting with manager	2/10/18 John Arthur / Rob Almeida; David Holding
Fees	0.6% on first £25m; 0.45% on next £25m; 0.4% thereafter

The MFS Global Equity portfolio returned 5.9% in the third quarter, outperforming its benchmark by 0.3%. This was a welcome improvement in the relative performance of the recent past. MFS have an investment philosophy which concentrates on companies with defendable business models on attractive stock market valuations and this acts as a good balance to the Baillie Gifford, growth orientate, portfolio covered above. The poor performance of the last 12 months has come as many companies have seen their business models undermined by new technology and the opportunities enabled by the internet. MFS seem to have struggled to fully understand the impact of some of these changes and recent meetings I have had with the Fund Manager have made me wonder about the Investment Manager's ability to analyse this level of change when they do not monitor the high growth technology companies themselves as they rarely fit the valuation criteria of the investment process.

I intend to meet again with the manager post year end and will continue to monitor the portfolio closely. The portfolio should prove defensive if equity markets fall further and defendable valuations become more of a positive. The manager remains focused on the long term and has not altered their investment process or focus following the poor performance of the last 12 months. The manager has outperformed since inception in 2013 but has underperformed their benchmark over 1, 3 and 5 years.

Asset Class/Manager	Global Equity/ Blackrock
Fund AuM	£27m Pooled Fund; 2.5% of the Fund
Benchmark/ Target	MSCI All Countries World Index
Adviser opinion	Further sales expected to finance the investment into UK Property
Last meeting with manager	No meeting this quarter
Fees	0.3% of fund value

This portfolio is being realised to finance the Fund's investment into UK Property. A further £20m was realised from this portfolio during the quarter and the final allocation of £16m to the Property Fund should be made by year end which will lead to a further sale from this portfolio. Any monies remaining after this will be realised and the cash reinvested into the Funds Fixed Interest mandates. The portfolio performed in-line with its benchmark over the quarter and has marginally outperformed its benchmark since inception.

Asset Class/Manager	Fixed Interest/ Baillie Gifford
Fund AuM	£57m Pooled Fund; 5.4% 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 9.0 years and is currently yielding 3.2%.

There is some discrepancy between the return calculated by the Fund's Custodian and the manager this quarter, this is not uncommon in the Fixed Interest and it most likely stems from the differing pricing sources used. Taking the Custodian's figures, the portfolio underperformed over the quarter returning -1.8% against the benchmark return of -0.9%. The portfolio has now underperformed its benchmark over 1 and 3 years, albeit marginally. The manager's calculation of performance figures show marginal outperformance over the longer term.

The portfolio is positioned close to the benchmark at present reflecting the manager's cautious view given the uncertainties over the final Brexit terms. They believe global growth remains reasonably robust and whilst the US may be nearing the end of the current economic cycle, other world economies are relatively early in the cycle and, therefore, there should be room for reasonable economic growth for some time from here.

A greater issue perhaps is the expected rate of return from this portfolio going forward. With Bond yields at historic lows, the global economy growing, (albeit with a US bias) and Central Banks looking to unwind the monetary stimulus of the last decade, returns are likely to be little different from the current portfolio yield of 3% going forward. The portfolio provides a good level of diversification from the Funds equity holdings so the challenge is to retain this diversification whilst targeting a higher level of return.

Asset Class/Manager	Fixed Interest/ Fidelity
Fund AuM	£76m Unit Trust; 7.4% of the Fund
Performance target	50% Sterling Gilts; 50% Sterling Non-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 Fund has a current duration of 9.7 years and a yield of 2.3% both of which are close to the benchmark. The uncertainties around an eventual Brexit deal have caused the manager to move very close to the benchmark in terms of yield, duration and credit quality.

A Brexit deal which gives access to tariff free trade with the EU (The UK's biggest trading partner) will likely see a short term improvement in the economy and hence give the Bank of England the opportunity to raise rates further into this stronger growth outlook, under this scenario UK Bond yields would be expected to rise reflecting the stronger economy (Bond prices fall). A 'harder' Brexit could create some short term impedance to trade and weigh on economic growth in the short term which will likely see bond yields fall (Bond prices rise). Longer term the true impact of Brexit remains a point of strong discussion.

As with the Baillie Gifford Fixed Interest portfolio discussed above, a bigger question is the future level of returns from this portfolio in the current low interest rate environment.

Asset Class/Manager	**Multi Asset Income/ Fidelity**
Fund AuM	£80m Pooled Fund of Funds; 7.6% 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 help cover the cash flow requirements of the Fund into the future.

The manager returned 1.1% in Q3 matching the benchmark return of 1.1%. 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 except that the yield requirement of 4% is being achieved and the portfolio is now invested across a sufficiently diverse range of assets.

The manager has maintained their cautious stance over the quarter and has reduced the equity holding marginally in favour of Emerging Market Hard Currency (USD) Bonds and Asian High Yield Bonds. The portfolio contains a high level of diversification and targets generating the income requirement whilst protecting capital and where possible generating investment returns.

Asset Class/Manager	Multi Asset Income / Schroders
Fund AuM	£119m Pooled Fund; 11.4% 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 second quarter of 2018 and, as such, it is too early to comment on performance at the current time. The portfolio is generating the required level of yield and returned 1.3% over the quarter which was very marginally ahead of the equivalent Fidelity portfolio. The new Manager, Remi Olu-Pitan is looking to make greater use of the broad range of expertise available within Schroders, developing more of a true multi-asset approach perhaps than her predecessor. They are gently increasing the portfolio's exposure to equities during the current market pullback believing that the global economy has further to run despite the short term

political headwinds. At the margin I would expect this portfolio to be slightly more volatile than the corresponding Fidelity Multi-Asset portfolio

Asset Class/Manager	**UK Property/ Fidelity**
Fund AuM	£34m Pooled Fund; 3.4% 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

There was limited change from the previous quarter. 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 investment 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.

Global Economy

While global expansion continues, albeit less synchronised than last year and at a slightly reduced pace from the summer, many major economies are now heading towards more advanced stages of the business cycle. The US Fed's less accommodative monetary policy stance, the US-China trade tensions and China's economic slowdown as it shifts towards consumption rather than investment, are putting pressures on the global economy.

Table 1: Quarterly GDP Growth Rate

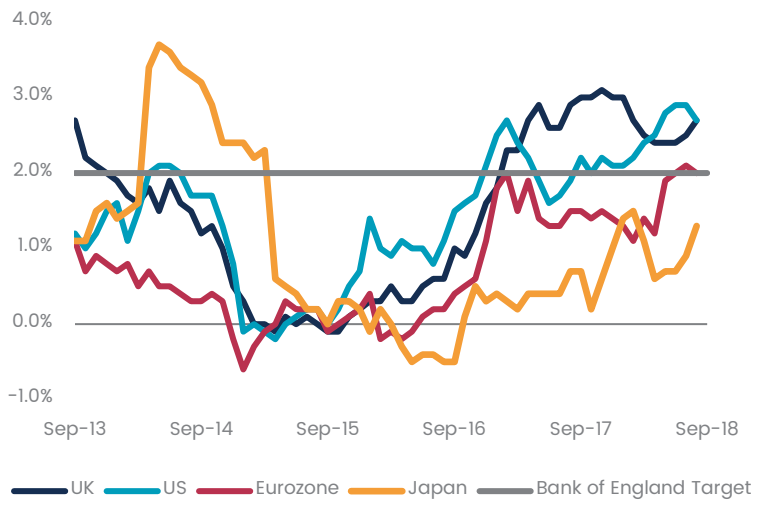
	US GDP	UK GDP	Eurozone GDP	Japan GDP
Q3 2018	3.50%	0.40%*	0.40%*	0.70%*
Q2 2018	4.20%	0.40%	0.40%	3.00%
Q1 2018	2.20%	0.10%	0.40%	-0.90%
Q4 2017	2.30%	0.40%	0.70%	0.90%

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: In the US, GDP numbers came in strong at 3.5%, slightly higher than expected as consumer spending underpinned growth, offsetting weak business investment and a drop in exports which widened the US trade deficit. The latter rose to a five-month high in July, as a result of the administration's protectionist trade policy - although towards the end of Q3, the trade deal between the US, Mexico, and Canada had been agreed.

In the UK, GDP figures were revised upwards as the economy grew faster than expected over the summer. However, there was still cause for concern as economic growth flat-lined in August.

Chart 1: 5-year CPI to September 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

CPI: US inflation fears calmed in Q3, as consumer prices rose less than expected. Inflation figures reached 2.3%, slowing down from 2.9% in Q2 2018. Slower increases in rental costs and energy prices contributed to the decline. However, low unemployment and wage increases in the US, which helped to boost consumer spending, also contributed to the Fed's decision to tightening its monetary policy stance.

In the UK, inflation generated by the fall in sterling following the EU referendum abated; however, households were squeezed further as CPI inflation unexpectedly rose to 2.7% in August - up from 2.4% in the second quarter. The inflation rate still remained above the Bank of England's 2% target, leading to an increase in interest rates to 0.75% – the second rate rise in 2018.

Central Banks: Central banks took further steps to slow or reverse their monetary stimulus programmes. The Bank of England increased rates due to the strengthening economy, underpinned by low unemployment levels, increasing consumer spending, and wage inflation. The Federal Reserve raised rates again in September by 25 basis points, to a range of 2.0%-2.25%, with a further rate rise expected later this year. In the Eurozone, the ECB is looking to keep rates constant at least through the summer of 2019 as its programme of quantitative easing comes to an end.

Political Headlines: Political turmoil continued to trouble markets as trade tensions between the US and China escalated. The Italian government set next year's budget deficit to 2.4%, which was more than expected by the market. In Mexico, the socialist candidate won the election by a landslide but seemed eager for better relations with the United States and Trump administration regarding NAFTA issues.

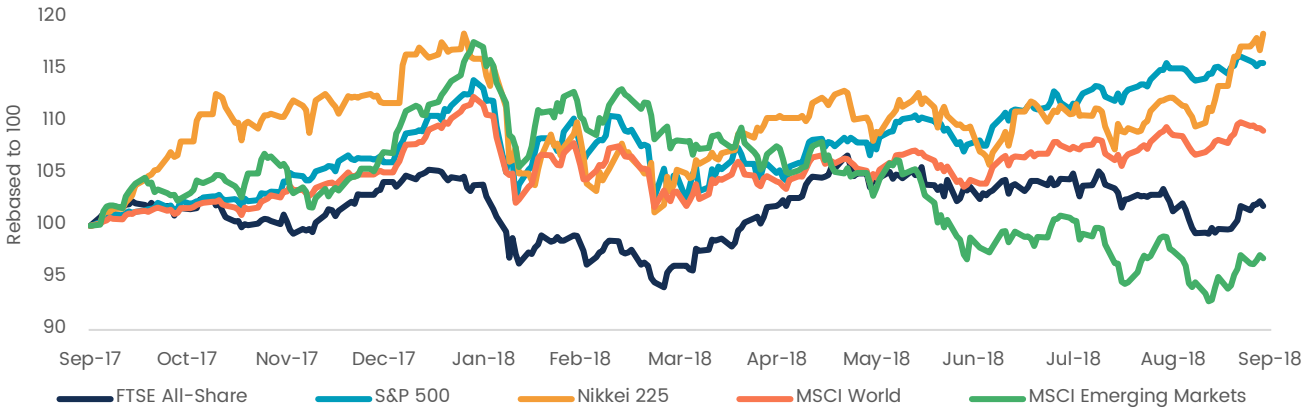
Equities

Global equities registered gains in Q3 partly due to the strength of the US economy; however, political uncertainties and fear of further trade tension escalations still dominated market concerns across the board with emerging markets enduring the most of the volatile conditions. The MSCI World returned 5.6%[2] in Q3, compared to 1.4% in the previous quarter.

UK: In addition to the above, continuing Brexit uncertainty contributed to the negative returns in Q3. UK financial and mining stocks were particularly affected due to their strong exposure to emerging markets. The FTSE 100 fell by -0.7% and FTSE-All share by -0.9%.

US: Performance in US equities remained robust over the period thanks to strong economic growth and corporate earnings. Further trade tariffs were introduced targeting China. Despite this, the US reached the milestone of the longest bull market in history, as the S&P 500 returned 7.7% and the Dow Jones Industrial Index rose by 9.6% over the quarter.

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 posted positive returns of 6.3% and 8.8%, as the Japanese Yen fell against the US Dollar boosting exports. Economic growth rebounded strongly as corporate earnings continued to improve in line with market expectations.

Emerging Markets: Emerging markets had another volatile quarter, due to the strength of the US dollar, global trade tensions, and an increase in risk aversion. South Africa and Turkey underperformed, the latter suffering the most with the sell-off in the Lira, as geopolitical tensions escalated with the US. However, Mexico outperformed following a decisive Presidential election result and an agreement with the US on the renegotiation of NAFTA. Russian equities benefited from strength in crude oil prices. The MSCI EM Index posted a return of -1.0% over the quarter.

EU: Worries over potential US tariffs on EU goods plagued the markets; this later cooled as an agreement to work towards zero tariffs on non-auto industrial goods materialised, while car tariffs were put on hold. Stock market returns were positive but financial stocks, and in particular Italian banks, weighed on performance, as there were worries over the Italian budget.

China: Further trade tensions with the US caused the MSCI China Index to fall by 7.7%. The US implemented tariffs on Chinese goods and, in September, announced a 10% tariff on $200 billion of Chinese goods, which resulted in the Chinese retaliating by enforcing their own tariffs on US imports. The central bank also introduced measures to try to stabilise the currency (Renminbi).

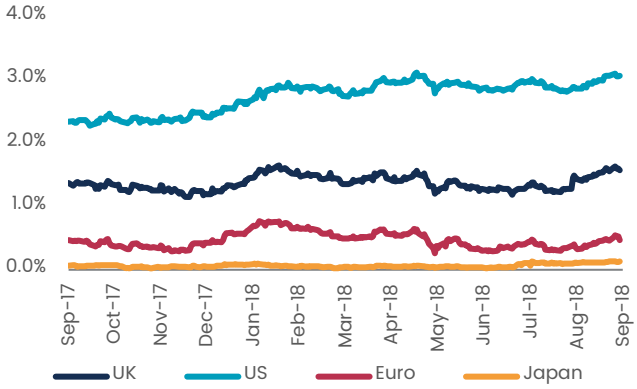
[2] All return figures quoted are Total Return, calculated with gross dividends reinvested. Source: Bloomberg.

Fixed Income

Global bond markets were resilient over Q3: government bond yields rose due to positive macroeconomic data, mainly from the US, and corporate bonds registered positive total returns in local currency. However, the number of geopolitical issues continued to weigh on bond investor sentiment.

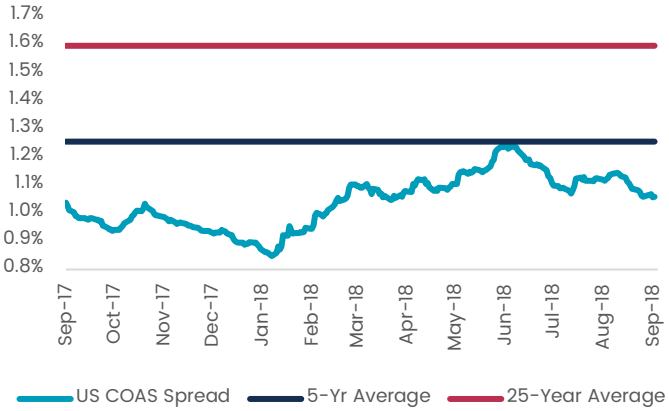
Government Bonds: Government bond yields rose over the quarter: US 10-year yields rose from 2.86% to 3.06%, Bund yields rose from 0.30% to 0.47% and UK Gilt 10-year yields rose from 1.42% to 1.57%. Another rate rise by the US Fed at the end of the year is widely expected while base rates in the UK reached their highest level since 2009. Italian 10-year bond yields rose from 2.68% to 3.06%, as concerns remained with the populist coalition as they announced a target budget deficit higher than market expectations and previous agreements with the EU.

Chart 3: Government Bond Yields



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

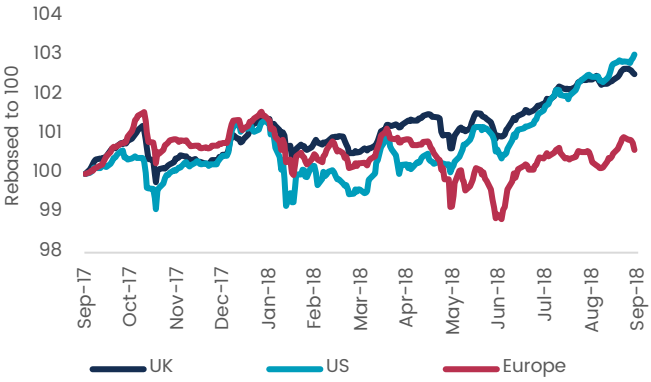


Source: Bloomberg. Notes: Bloomberg Barclays US Corporate Total Return Value Unhedged USD (Ticker: LUACTRUU INDEX)
Option-Adjusted Spreads (OAS) represent the difference between the index yield and the yield of a comparable maturity treasury.

Investment Grade Corporate Bonds: Global Investment Grade (IG) bonds registered positive total returns after two negative quarters, as credit spreads narrowed in response to the improving US macroeconomic data from a strong corporate earnings season. In Q3, the Bloomberg Barclays US Corporate Statistics returned 1.98%, up from -2.15% in Q2. However, the increase in interest rates and the high levels of corporate debt present risks to corporate creditworthiness in the long term.

High Yield Credit: High Yield (HY) credit registered higher positive returns over the quarter outperforming government bonds due to a strong corporate earnings season, rising inflatio, and steady economic growth. In Q3, the Bloomberg Barclays Pan-European High Yield bond index returned 1.56%, up from -2.15% in Q2. High yield bond issuance was low in the quarter which helped returns. The high coupon and relatively short duration gave HY credit opportunities to outperform the market, but volatility could quickly return, particularly with rising interest rates.

Chart 5: High Yield Corporate Bonds



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)

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Currencies

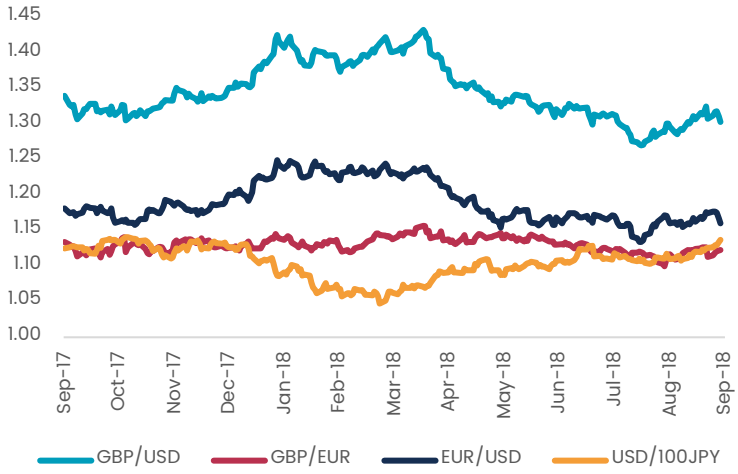
Earlier in the quarter, the dollar strengthened on the back of the strong US economic performance, which exposed frailties in emerging markets (EM), as EM currencies tend to move against the dollar. However, the dollar started to weaken as the Fed raised interest rates, despite ardent criticism from the White House while US trade talks with China did not materialise. Sterling remained volatile as the government continues to negotiate the terms of leaving the European Union and the weaker-than-expected economic data from August remained a concern.

Table 2: Currency Rates as At September 2018

	Quarter-end Value	% Quarter Change
GBP/EUR	1.12	-0.7%
GBP/USD	1.30	-1.3%
EUR/USD	1.16	-0.7%
USD/100JPY	1.14	2.7%

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

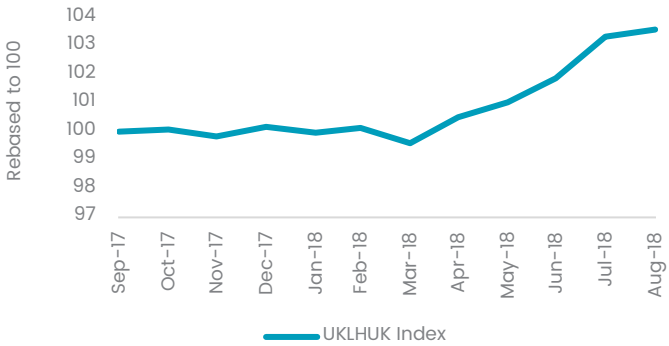


UK Property

Commercial property saw growth of 1.6% in the third quarter but, according to the CBRE, it was the weakest quarterly performance of 2018. Residential property remained flat, with continuing fears over household disposable income and debt servicing if interest rates were to venture higher.

Commercial Property: CBRE reported that UK commercial property values increased by 0.3%, down from the last quarter, with rental growth also lower at 0.1%. CBRE data showed that the industrial sector continued to outperform other sectors with capital values increasing by 0.9% and rental values by 0.4% over the last month of the quarter. The retail sector contracted further in Q3 in terms of both rental values (-0.6%) and capital values (-0.4%).

Chart 7: 1-Year UK House Price Index



Source: Bloomberg.
Notes:
UK House Price Index – Average Price for All Dwellings (Ticker: UKLHUK Index)

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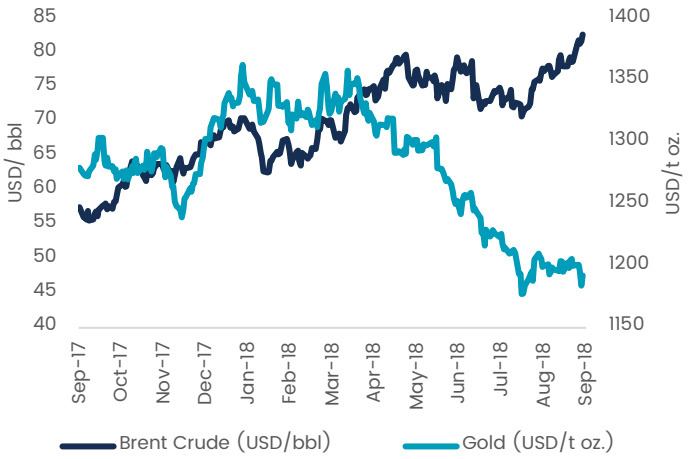
Commodities

Oil: In the second quarter, Brent Crude went above $80 per barrel for the first time since November 2014. Earlier in the quarter, Brent crude prices dipped after the US-China trade war caused volatility in emerging markets. Since then, Brent Crude oil prices have rallied to $82 per barrel due to steady demand and geopolitical tensions. A sharp drop in Venezuelan production, Libyan outages and US sanctions against Iran's oil imports helped to boost crude oil prices.

Gold: The price of gold continued to tumble and declined by 5% in the third quarter. Rising interest rates in the US and the strength of the dollar were the major contributors to the price fall. With the Fed looking to increase interest rates again in 2018 and in 2019, the bearish outlook on gold looks set to continue.

Chart 8: Gold and Brent Crude Oil Prices



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