Appendix 5

MJ HUDSON Allenbridge

London Borough of Bromley Pension Fund

Quarterly Report

Q1 2019

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Performance Summary

Yet again the first quarter of 2019 was a period of rapid sentiment change with markets this time turning positive across the board. Equity markets led the charge with the developed world equity index up 12.7%. Government Bond yields fell in all developed economies, giving a positive return for this asset class of between 2.0%-3.5% depending on country, whilst UK Index-Linked Bonds returned a strong 6.3% as UK inflationary fears receded.

Given the rapid turnaround in markets it is perhaps unsurprising that the Fund performed well this quarter and recovered all of the 2% underperformance against the Strategic Benchmark delivered in the final quarter last year. The Fund finished the quarter at a value of £1,041m, returning 8.68% against a return of 6.60% for the Strategic Benchmark over the period. The Fund is now only marginally behind the Strategic Benchmark over 1 year (+8.0% v +8.3%) and has outperformed this benchmark by 1.8% over 3 years and 1.4% over 5 years as well as over the long term.

Long term the performance of the Fund has been strong not only against its Strategic Benchmark but also in absolute terms. Over 5 years the Fund has returned 11.6% per annum and over 15 years, 8.9% per annum. These returns will be above the assumptions used in past Strategic Asset Allocation Reviews and have helped the Fund reach a Funding level around 100%.

ASSET ALLOCATION

Asset Class	Fund weight (30/3/19)	Strategic B/M weight	Difference
Equities	63.4%	60%	+3.4%
Fixed Interest	13.3%	15%	-1.7%
Property	4.7%	5%	+0.3%
Multi Asset Income	18.7%	20%	-1.3%

Last quarter I explained the sources of the Fund's 2% underperformance against its Strategic Benchmark, attributing it to three factors, this quarter it is the same factors which have driven the outperformance.

1. Asset Allocation: The overweight in equities against the Strategic Benchmark and corresponding underweights in other asset classes cost the Fund approximately -0.5% in performance terms at the Total Fund level in the fourth quarter of 2018. In this quarter the Fund's asset allocation added approximately 0.4% as equities produced the highest return in the quarter.

2. Both Multi Asset Income portfolios have an absolute return target set against LIBOR (a measure of short term interest rates). Fidelity target a return of LIBOR +4% and Schroders a return of LIBOR +5% per annum, both over the long term. By having the slightly higher return target you can assume that the Schroders portfolio takes slightly more investment risk to achieve its target than Fidelity.

   The LIBOR based targets reflect the desired return of the portfolios over the longer term but will not reflect the performance of specific asset classes in any individual quarter. With short term interest rates currently set by the Bank of England at 0.75% per annum, both the Fidelity and Schroders benchmark will show a return of just over 1% irrespective of market returns. In a quarter where the vast majority of assets rose in value both portfolios will reflect this and thereby outperform their benchmark for the quarter. It is important, therefore, to look at the performance of these managers against their benchmark only over the longer term. This does not remove the fact that their performance against the benchmark in any specific quarter will affect the performance of the Total Fund against its Strategic Benchmark for that quarter. The effect of this on the performance of the Total Fund was approximately -1.0% in 4Q2018 but added 0.4% in 1Q2019.

3. The Baillie Gifford global equity portfolio outperformed its benchmark by over 3% in the quarter. This accounted for almost 1.2% of the outperformance at the total Fund level. The Fund has employed this manager for almost 20 years and they have performed exceptionally well over the long term having outperformed their benchmark by over 2.4% per annum over 5 years and by 1% per annum since inception in 1999. Baillie Gifford now manage 40% of the Fund's assets and this outperformance has added significant value to the Fund over the long term. The scale of the outperformance in the quarter is not out of line with the level of investment risk in the portfolio against its benchmark. I would continue to back this manager to add value over the long term.

As can be seen from the comments above, the three factors which caused the Fund to underperform against its Strategic Benchmark in 4Q2018 are the same factors which added value during the market rally in 1Q2019. These three factors are likely to continue to be the main determinants of relative performance going forward unless the structure of the Fund changes.

What the first quarter has shown is that we continue to be in a market driven by the hope of further Central Bank largess. The collapse in Q4 2018 was driven by a concern that the US Central Bank (the Fed) would continue to raise interest rates, even as the US economy slowed, increasing the likelihood of a recession. As the Fed changed its view and removed the threat of further interest rate rises, so markets recovered. This creates a dilemma in the medium term; we need a healthy global economy for markets to flourish and continue to produce investment gains, yet any perceived improvement in the underlying economy will lead central banks to again withdraw liquidity from the markets which is likely to herald a market fall. Conversely, any further slowing of the economy will raise concerns over the central banks' ability to avert a recession. It feels to me like markets are going to struggle either way.

This raises the question as to whether the Fund should be overweight Equities at the present time, my answer would ideally be no but Fixed Interest offers the potential for very meagre returns at current levels unless we really are about to enter a global recession. I cover this in more depth in a separate report.

Executive Summary

- The global economy continued to show signs of a slowdown as many major economies advance towards the latter stages of their economic cycle. Central banks recognised this somewhat belatedly and moved to a more accommodative monetary stance as 2018 came to a close.

- Driven by the change in central bank policy, all asset classes showed a positive return in Q1 2019 as the year end sell off into thin Christmas volumes abated. The first quarter saw a bumper start to the year, global equities rallied, recovering all of the losses seen in the previous year. The S&P 500 rose by 13.7% over the quarter as the US-China trade tensions looked set to be resolved with a possible agreement on the horizon and major central banks titled towards a more accommodative stance.

- European and UK stocks also rose given this backdrop, despite concerns over economic growth in Germany and Italy and with Brexit uncertainties persisting in the UK. The FTSE All-Share rose by 9.4% over the quarter.

- The US Federal Reserve kept interest rates in the range of 2.25%-2.50% over the quarter. During 2018 the Fed increased interest rates four times but, given the softening economic data persistent across the globe, has scrapped its planned rate hikes in 2019. It also pledged to end its balance sheet reduction programme (Quantitative Tightening) by September. The European Central Bank hinted it would keep rates flat this year as it downgraded growth forecasts across the region. The Bank of England kept interest rates at 0.75% - the highest level since 2009. China moved to stimulate its economy to counter their economic slowdown.

- Given this environment Government Bond prices rose as yields fell across the developed economies with German Bunds moving into negative territory, reaching a yield of -0.1% at longer maturities. US Treasury yields also fell with the US treasury yield curve (3-month minus 10-year) inverting. This has been the harbinger of a global recession in the past. 10-year UK government yields fell from 1.28% to 1.00% over the same period, as the flight-to-quality increased amidst Brexit uncertainty.

- Credit markets also recovered in Q1. Credit yields declined (prices rose), in line with the slowing outlook for global growth and the central bank's more accommodative monetary policy stance. US Investment Grade (IG) corporate bond spreads narrowed against Government Treasuries with the Bloomberg Barclays US Corporate TR Index returning 5.1% over the quarter. However, corporate debt levels remain a worry as its share of GDP continues to move higher than in the 2008 financial crisis levels.

- High yield bonds made significant gains over the quarter as they outperformed both corporate investment grade and Government bonds. The US Fed's softening tone meant investors poured capital into riskier assets, and high yield bond funds saw the biggest weekly inflows since December 2016.[1]

- The dollar weakened over the quarter as the Fed scrapped its planned interest rate hikes and hinted the next interest rate change may be downwards. Softness in Sterling continued as unease over the potential Brexit withdrawal agreement persisted. The Yen fell in Q1, as investors looked for higher yielding currencies.

- UK commercial property grew by 0.7% in Q1 2019. The retail sector continued to struggle but the industrial sector rose by 1.9%, and the office sector posted returns of 1.8% for the quarter.

- The price of Brent crude oil rose from $54 in December to $69 per barrel at the end of March, as production cuts drove prices up. Gold was flat, returning 0.9% over the quarter as investors turned away from safe havens.

- The improving market sentiment in the quarter led the VIX index (indicator of equity market volatility) to drop.

[1] https://www.bloomberg.com/news/articles/2019-01-17/high-yield-funds-see-biggest-inflow-of-cash-since-December-2016

Global Outlook

The first quarter of 2019 started off on a very strong note for risk assets, with the notably dovish tone from the US Fed and the ECB helping support positive market sentiment. In addition the optimism over the possible resolution of the US-China trade dispute eased investors' nerves and increased the appetite for risk assets across the board.

Although markets made up for the losses seen in the fourth quarter of last year, the economic situation has not drastically altered and economic indicators have remained weak globally. The optimism has, by and large, been driven by central banks who are back to stimulating the economy. A change in tone from Fed Chairman Jay Powell, coupled with a hint of possible interest rate cuts quickly changed the market mood and gave investors the hope that benign market conditions could continue for a while longer. President Trump's unrelenting criticism of Fed Chair Powell continues, as the President is desperate for falling interest rates so he can maintain his promise to the electorate of keeping the US economy growing and hence bolster his chances of re-election in 2020. However, we mustn't forget the much promised wall along the Mexican border, political arguments over the funding for this resulted in the declaration of a national emergency and the longest US government shutdown in history. As the political turmoil rambled on, the US economy continued to show signs of weakness. With the Fed guarding against excessive low inflation and having undershot its own inflation targets, it remains to be seen what action the Fed will, or most likely won't, take on interest rates in the run up to the 2020 election.

On a brighter note, job creation continues to rise in the US and the tight labour market has accelerated wage growth. Whilst this is positive for the economy and the electorate it will be a hindrance for companies as the increasing costs will negatively affect corporate profitability which is at historically high levels.

A welcome respite came when Trump stalled the trade war against China pending further negotiations. With the US economy slowing and comment about the negative effects of the trade tariffs from many US based companies, Trump's hand in these negotiations was weakening and his decision to stand back politically was rational. Every coin has two sides and China's own problems of a slowing economy also bought it to the negotiating table. In response to its economic slowdown, Beijing has once again stepped up its fiscal stimulus by boosted infrastructure spending and cutting taxes to businesses, it has so far managed to beat GDP expectations, but the country's high debt problem persists.

The US treasury yield curve inverting this quarter adds another conundrum for investors as this indicator suggests that a recession will hit soon. The yield curve has inverted every time before a recession in the past 50 years and only offered one false signal[2]. However, this could be another false signal as we are living in unprecedented times with unconventional policy from Central Banks and a low inflationary and low yield environment. The question remains how sustainable is the state of the global economy? For investors, this year may continue to be profitable with support from central banks but after that the future looks very uncertain.

In reality, we need economic growth to increase slightly, for this to trigger a slight rise in inflation and hence allow central banks to raise interest rates. However, this scenario is likely to drain liquidity from markets and lead to price falls, as we saw in Q4 2018. The alternative is a weak underlying economic environment and continuation of central bank support which again does not sound positive for markets and too sharp a slowdown could undermine investors' confidence quite rapidly, again leading to market falls. The only thing pushing markets higher from here is the weight of money and investors' desire not to hold cash while short term interest rates are below inflation. We, therefore, expect volatility to continue and for more quarters to be like the last few of high volatility and rapid price movements both upward and downward.

UK Outlook: Sterling's movements continue to be volatile, as Brexit uncertainty continues to dominate the national agenda. By June, it will have been three years since the UK voted to leave the EU, but progress remains slow and

[2] https://uk.reuters.com/article/us-usa-economy-yieldcurve-explainer/explainer-what-is-an-inverted-yield-curve-and-why-is-it-so-ominous-idUKKCN1RS2DB

often fraught. The divisive referendum has left Parliament gridlocked, as indicative voting showed that no potential Brexit scenario commanded a majority amongst MP's.

Theresa May's EU withdrawal agreement has been rejected three times in Parliament and left her with no choice but to plead for cross party help and with the EU for an extension to the Brexit timetable, which may now run till October 31st. With the politicians unable to make progress it looks likely the UK will have to participate in the European elections in May, this will no doubt prove even more divisive than the referendum itself. But with another deadline drawing near again, the EU has put it clearly to the UK that it must not waste this time or it will again teeter towards the legal default – crashing out of the EU without a deal.

Performance report

Asset Class/ Manager	Global Equities/ Baillie Gifford
Fund AuM	£418m 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 meet their performance target
Last meeting with manager	28/2 John Arthur/Global Alpha Team
Fees	0.65% on first £30m; 0.5% on next £30m; 0.35% thereafter

The manager outperformed their benchmark by 3.1% in the first quarter and although the portfolio is slightly behind the benchmark on a 1 year view (-1.4%), over the longer term the manager has added significant value and continues to hit their performance target of outperforming the MSCI All Countries index by 2-3% per annum over a rolling five year period and is ahead of their benchmark since the inception of this portfolio 19 years ago.

Part of what drives this long term success of this portfolio is the manager's focus on doing their own research, this is not just meeting companies on an ongoing basis but includes working with academia in fields such as Artificial Intelligence and the use of new technology. This commitment to research and driving their thinking forward only works if they invest on a timescale which allows their understanding of the future to become the present and hence discounted by markets too fixated on the short term and quarterly updates from companies. To have the strength of mind to invest on this basis and to be different is the key to their success. I see no reason for their approach to alter radically going forward.

Asset Class/ Manager	Global Equities/MFS
Fund AuM	£231m Segregated Fund; 22.2% of the Fund
Benchmark/ Target	MSCI All Countries World Index
Adviser opinion	
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 9.7% in the first quarter, in line with its benchmark. The manager has outperformed over the last 1 and 5 year periods but has underperformed the benchmark over 3 years. The longer term outperformance is over 1% which is a creditable performance.

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. Like Baillie Gifford they invest over the long term. Their issue over the last 3 years has been the speed with which new technology has undermined the business model of many businesses. This state of rapid change looks set to continue and the manager's challenge is to understand this and predict which companies will see their business models undermined and which will adapt.

Asset Class/Manager	**Global Equity/ Blackrock**
Fund AuM	£11m Pooled Fund; 1.1% of the Fund
Benchmark/ Target	MSCI All Countries World Index
Adviser opinion	A decision needs to be taken with the remaining monies in this portfolio
Last meeting with manager	No meeting this quarter
Fees	0.3% of fund value

The portfolio recovered from a poor Q4 2018 to return 10.5% over the quarter, outperforming the benchmark return of 9.8%. The poor performance in Q4 continues to affect the one year performance but, longer term, including over 3 and 5 years the portfolio has outperformed the benchmark by 0.5-0.8%. This is an acceptable performance record.

The investment philosophy and process used to manage this portfolio rely on analysing vast quantities of data on everything from market sentiment and hedge fund positioning to foot fall in Chinese supermarkets and credit card usage across the world. The technological challenges of achieving this are vast and require constant reinvention as new data sources become available. However, as Q4 showed, the portfolio has a habit of failing to recognise sudden deteriorations in market sentiment and has a performance track record of sustained periods of outperformance followed by occasional performance shocks. The complexity of the modelling makes the investment process difficult to analyse and, whilst the work is impressive, I find it difficult to build high conviction in the manager's ability despite what is a strong long term track record.

Asset Class/Manager	**Fixed Interest/ Baillie Gifford**
Fund AuM	£59m Pooled Fund; 5.7% of the Fund
Benchmark/ Target	Tailored benchmark
Adviser opinion	Benchmark performance over the medium term
Last meeting with manager	2/5/19 John Carnegie; Paul Roberts/John Arthur
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 8.7 years and is currently yielding 3.7%.

The portfolio returned 3.8% in the first quarter against a benchmark return of 3.6% so marginal outperformance. Over the longer term (5 years) the portfolio has matched its benchmark with periods of outperformance mitigated by a poor 2018. Throughout this 5-year period, the manager has been over exposed to High Yield and Emerging Market Bonds compared to its benchmark. The higher yield of these bonds aids portfolio returns in all markets unless the cost of credit is rising when they will underperform Government Bonds. This was the case in 2018.

Whilst the manager may be adept at selecting investments at the individual bond level I see no evidence of skill in allocating between areas of the Bond market and as such regard the manager as competent rather than skilful.

Given the outlook for the UK economy of sluggish growth and flat interest rates, UK Government Gilts are unlikely to provide any return over their yield (sub 2% at present) unless markets endure a prolonged period of global uncertainty and potential recession causing a more major reappraisal of risk appetite. However, exposure to Government Gilts does provide diversification in these circumstances. A further review of the Funds Fixed Interest portfolios in contained in a separate report.

Asset Class/Manager	Fixed Interest/ Fidelity
Fund AuM	£79m Unit Trust; 7.6% 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	7/3/19
Fees	0.35% on first £10m; 0.3% on next £10m; 0.21% on next £30m; 0.18% thereafter

The portfolio returned 3.8% in the first quarter, in line with its benchmark. Over the long term the manager has consistently added value in this mandate including returning 0.8% above the index since inception in 1998, so over a 20 year period. Given the low level of yields now available within this mandate and the lacklustre performance of the UK economy I feel it is unlikely that the manager will add such value over the near future.

The Fund has a current duration of 9.9 years and a yield of 2.1% 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. The manager remains cautious despite the higher yields now on offer in some areas of the market post the sell-off in the fourth quarter of 2018. Despite running a defensive stance within the portfolio during a quarter when investment risk was rewarded, the manager matched the benchmark return by being well positioned in terms of duration (the amount of time until a bond is repaid).

It is this balance between holding low yielding assets such as Government Bonds, as at present, or investing in a broader range of Credit which will provide a higher yield but more volatility and have the potential to correlate with Equities in the event of a major market fall that is the central discussion point for this mandate. Ideally you select a manager who has the ability to switch asset allocation to more defensive Government Debt if they predict a market setback but this is hard to get right and few managers show real skill in predicting such an event. A further comment on the Fund's Fixed Interest mandates is made in a separate report.

Asset Class/Manager	Multi Asset Income/ Fidelity
Fund AuM	£79m Pooled Fund of Funds; 7.6% of the Fund
Performance target	LIBOR +4% p.a.
Adviser opinion	Too early to make any assessment
Last meeting with manager	7/3/19
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% per annum and is designed to help cover the cash flow requirements of the Fund into the future. I would expect this holding to add some stability to the Fund during market falls as it has a focus on capital preservation.

The manager returned 4.5% in Q1 and has returned 3.5% over 1 year, it continues to deliver the yield target of 4% per annum. The 1 year return of 3.5% is below the return achieved by the same manager's Fixed Interest portfolio

which the Fund is also invested in and is covered earlier. This suggests that diversification has not added any value over this, albeit short, period. I would expect this to change going forward given the uncertain economic outlook.

The manager remains cautious in their stance given the uncertain outlook and I feel the focus on delivering the yield is a good discipline in these markets as it leads to a focus on the security of future cash generation for each investment.

Asset Class/Manager	Multi Asset Income / Schroders
Fund AuM	£116m Pooled Fund; 11.1% of the Fund
Performance target	LIBOR +5%
Adviser opinion	Too early to make any assessment
Last meeting with manager	3/5/19
Fees	0.35% of fund value

The portfolio returned 5.0% during the first quarter of 2019. The most obvious comparison for this portfolio over shorter time period is the performance of the Fidelity Multi Asset income fund which is similar in structure to this one. Schroders' portfolio has a slightly higher return target and, as such, will take slightly more investment risk to achieve this. In a quarter such as this one, where all investment risk paid off, I would expect this portfolio to slightly outperform the Fidelity one, as has been the case.

It is too early to make any assessment of the performance of this fund but it is delivering the required 4% yield and following a number of meetings with the manager I believe it to be soundly constructed to enable it to continue to do so.

Currently this portfolio is invested in a dollar fund with the currency risk then hedged back to Sterling the Fund as a UK based client. The manager has offered to create a Sterling based version of this fund which will reduce the amount of currency hedging and should be marginally positive for performance going forward, especially as US interest rates rise and hedging the currency becomes more expensive. This is a sensible suggestion and it is pleasing to see the manager offer to do this at their own cost. There would, therefore, be no transaction costs incurred by the Fund in moving to this new vehicle. The Fund would initially be the only investor in the new vehicle which could hamper disinvestment somewhat if that became an issue. Longer term the manager is making this offer because they value you as a client and want to deliver the best returns possible, but also because they hope the new vehicle will be attractive to other UK based investors which could ease any future divestment by Bromley.

Following our discussions the manager has had approval internally to set up a UK domiciled fund and has contacted the FCA who will need to approve the new structure. The manager is currently working through how the assets will be transitioned across to the new Fund and how to set this up at no cost to Bromley. I would expect a further update from them before the meeting on the 15/5/19 and will provide a verbal update then.

Asset Class/Manager	UK Property/ Fidelity
Fund AuM	£49m Pooled Fund; 4.7% of the Fund
Performance target	IPD UK All Balanced Property Index
Adviser opinion	Too early to make any assessment
Last meeting with manager	
Fees	0.75% of fund value

The portfolio returned 0.2% in the first quarter, in line with its benchmark, but is below the benchmark return over a one year period. Given the portfolio has been in its investment phase over the last year, I regard this performance as acceptable because UK commercial property is expensive to trade and as such their will have been noticeable costs incurred during this phase. This portfolio is now fully funded.

The portfolio 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 longer term despite the potential for near term weakness with scope for short term volatility through the Brexit process.

Global Economy

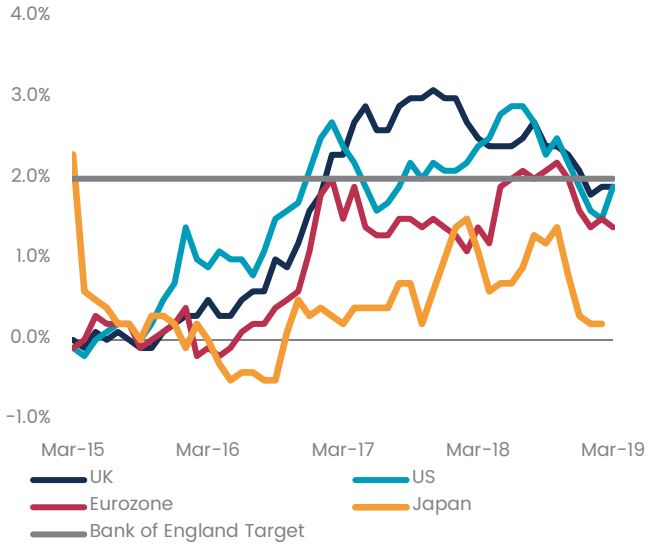
The global expansion continues at a reduced pace with many major economies heading towards the latter stages of the business cycle. The Fed's change in monetary policy stance, as it slashed it's forecasted interest rate hikes and the optimism of resolving the US-China trade tensions helped riskier assets outperform this quarter. However, the concerns over the slowdown of the global economy persist.

Table 1: Quarterly GDP Growth Rate

	US GDP	UK GDP	Eurozone GDP	Japan GDP
Q1 2019*	1.60%	0.30%	0.20%	0.10%
Q4 2018	2.20%	0.20%	0.20%	1.90%
Q3 2018	3.40%	0.70%	0.10%	-2.40%
Q2 2018	4.20%	0.40%	0.40%	1.90%

Source: Bloomberg. *Forecasts based on leading indicators.
Notes: UK Real GDP (Ticker: UKGRABIQ Index), US Real GDP (Ticker: EHGDUS Index),

Chart 1: 5-year CPI to March 2019



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 (Ticker: ECCPEST Index); Japan: Japan CPI Nationwide YOY (Ticker: JNCPIYOY Index).

GDP: US GDP growth is predicted to fall to 1.6% in Q1, last quarter's GDP was revised down to 2.2% down from the predicted 2.6%, but first quarter GDP estimates seem to be the most prone to errors. US corporate earnings were flat and consumer spending fell during the quarter. The US-China trade tensions cooled with the trade truce which was set to end on the 1st March 2019 but delayed indefinitely to allow for further trade talks.

UK GDP figures for Q1 are forecasted to increase to 0.3%, even though business activity continues to decline. The growth is expected to be driven by manufacturing companies who are stockpiling goods ahead of Brexit. Eurozone GDP is predicted to remain flat in Q1, as Germany cut their GDP forecast citing falling manufacturing demand, whilst Italy's economic prospects remain dire – as they were plunged into a recession last quarter. Japan's GDP is expected to fall in Q1, due to the country's weak exports with the global economy slowing down.

CPI: US inflation continued to fall as the annual CPI dipped to 1.9% for Q1. US unemployment fell by 0.1% to reach 3.8% in March. Meanwhile wage growth remained at 3.2% - the same as Q4.

In the UK, the consumer price index fell in Q1 to 1.9% below the Bank of England target of 2.0%. The falling inflation compared to Q4 was due to lower food costs, which helped boost living standards. UK wage growth rose the fastest since summer 2016 and unemployment levels remain low.

Central Banks: Central banks took steps to move towards an accommodative monetary policy amid concerns over the global economy slowing down. The Federal Reserve has deferred all of its planned interest rates hikes in 2019 and will end its balance sheet reduction programme later this year. The European Central Bank stated that it would keep rates constant at least until the end of the year as it again downgraded its growth forecasts. The Bank of England left rates unchanged at 0.75% with the continued Brexit uncertainty.

Political Headlines: Political uncertainties over Brexit negotiations continued to prevail as the UK and EU agreed an extension. Additionally, President Trump ended the longest US government shutdown in history when he finally agreed a new federal budget, which did not include funding for his wall. Later on in February, Trump went on to declare a national emergency to gain funding to build a wall along the US-Mexico border.

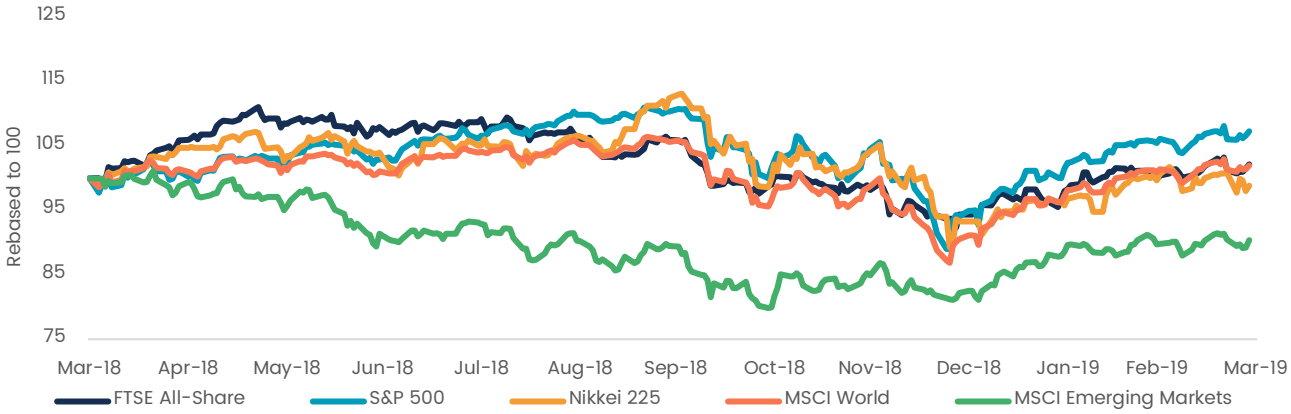
Equities

In Q1, global equities bounced back from one of the worst quarters seen in many years as the MSCI World Equity Index increased by 12.7%[3]. The easing of US-China trade tensions and political uncertainties helped alleviate the fears that upset the market in Q4; however, concerns over the resilience of the global economy continue to persist.

UK: In addition to the above, Prime Minister Theresa May's withdrawal agreement failed to pass for the third time, as Parliament expressed its will against her deal as well as a no-deal Brexit. To avoid crashing out of the EU without a deal, Theresa May agreed an extension potentially until the 31st October. The FTSE 100 rose, in line with global equities, by 9.5% and the FTSE All-Share by 9.4% over the quarter.

US: The S&P500 rallied by 13.6%, as the longest US government shutdown in history was resolved for the time being, following President Trump backing down from requesting funds for building his wall along the US-Mexico border. Although in February, Trump declared a national emergency to gain access to funds to build his wall. US-China trade tensions calmed over the quarter as expectations grew towards a resolution on the matter.

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 and the Nikkei Index were up by 9.4% and 9.3% over the quarter, in line with global market sentiment but Japanese equities continue to lag behind other developed markets. In February, many major non-financial firms downgraded their corporate earnings citing the slowdown in global economic growth and the uncertainty surrounding the US-China trade disputes as the main factors.

Emerging Markets: The MSCI EM Index rallied by 9.9% with the stable US Dollar, perceived progress in US-China trade talks and the recovery in oil prices helping to boost returns. Uncertainty still persists in many regions with Brazilian equities falling as President Bolsonaro tries to reform the country's pension system.

EU: The MSCI EMU Index rose by 12.0% over the quarter. Growth worries continue to plague EU as Italy slipped into a recession and Germany continues to show signs of weakness as growth stalled. While in France, the Yellow Vest Movement protests continue, what started as a rebellion against fuel tax has now progressed into a movement for economic and social justice.

China: The MSCI China Index increased by 18.0% over the quarter with the cooling of trade tensions mentioned above. At the National People's Congress in March, the Chinese Government announced greater investment into infrastructure and a stimulus package, which gave tax cuts to businesses and consumers to help ease the pressure off the economy. This helped raise China's GDP to 6.4% in Q1 and seems to have averted a more major economic

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

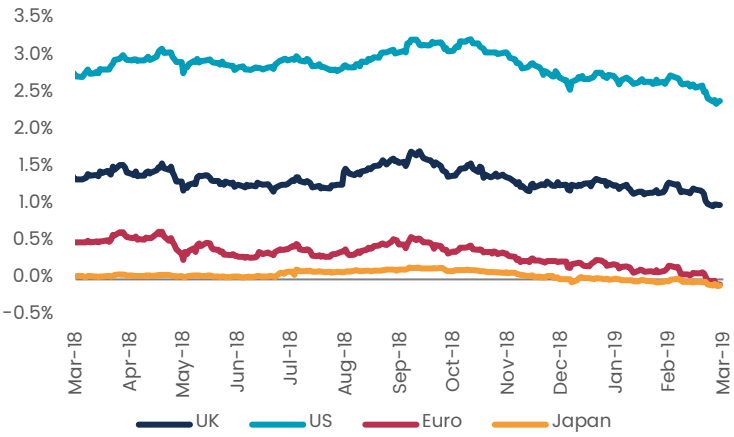
slowdown although high debt levels in the economy persist.

Fixed Income

Global bond markets performed well over the quarter with the Fed changing to a dovish stance and the ECB indicating that interest rates would not rise in 2019 as the global economy shows signs of slowing down.

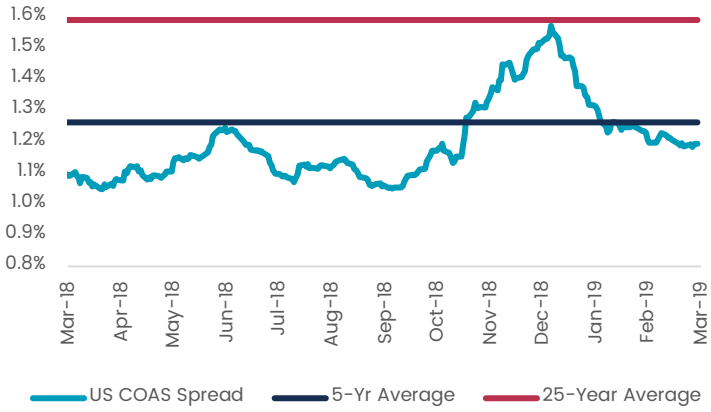
Government Bonds: Government bond yields continued to fall (prices increase) over the quarter given the above as lower growth expectations took hold. US 10-year bond yields fell over the quarter from 2.68% to 2.41%, as the 3-month and 10-year treasury yield curve inverted – a widely used indicator used to predict a recession. 10-year Bund yields fell from 0.24% to -0.1%, the first time yields have dropped to negative territory since October 2016, as the German economy continues to soften on the back of a weak export outlook. 10-year Italian bond yields fell from 2.7% to 2.5%. UK 10-year Gilts yields also fell from 1.28% to 1.00%, as Brexit uncertainty continued to linger on.

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

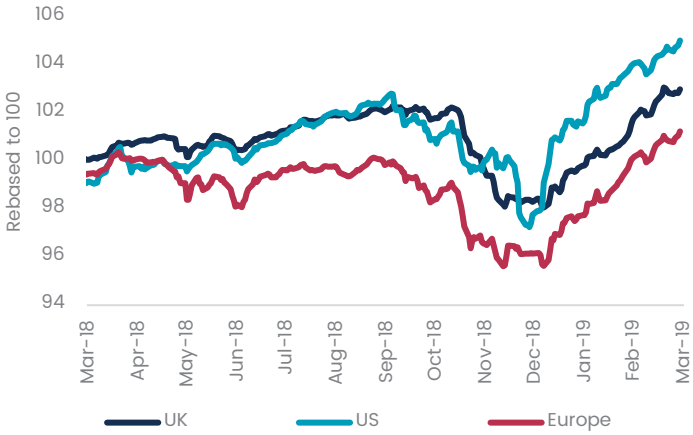


Source: Bloomberg. Notes: Bloomberg Barclays US Corporate Total Return Value Unhedged USD (Ticker: LUACTRUU INDEX)
Option-Adjusted Spreads (OAS) represent the difference between the index yield and the yield of a comparable maturity treasury.

Investment Grade Corporate Bonds: Corporate bonds had a good start to the year thanks to the Fed, as the Bloomberg Barclays US Corporate TR Index returned 5.1% over the quarter with spreads narrowing to levels last seen in Q3 of 2018. Corporate debt levels as a share of GDP continue to grow and remain higher than pre 2008 crisis levels. Leverage is increasing and credit quality in bonds declining, this needs to be watched. In February, the OECD warned companies would need to repay or refinance $4 trillion within the next three years, which is approximately the same as the balance sheet of the Fed.

High Yield Credit: High Yield (HY) credit posted significant gains in Q1, as it overturned a gloomy end to the year to outperform government and corporate bonds, as inflows soared with investors pouring capital into riskier assets. The Bloomberg Barclays US High Yield Bond Index returned 7.26% over the quarter, as investors were buoyed by the Fed's more dovish stance.

Chart 5: High Yield Corporate Bonds



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Currencies

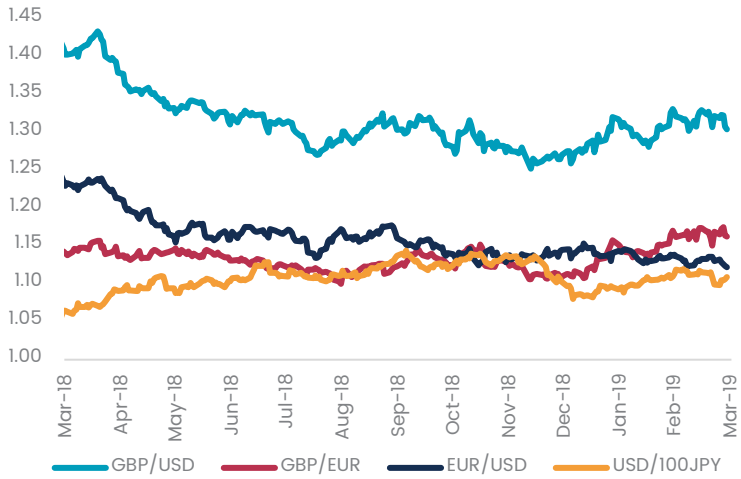
The US Dollar Index fell over the quarter (signaling Dollar weakness) as the Fed scrapped plans to raise interest rates citing a possible economic slowdown. Sterling remained volatile but rose against other major currencies over the quarter, as the government secured an extension to negotiations on leaving the European Union and Parliament expressed its will against a no-deal Brexit. The Japanese Yen fell over the quarter as investors reacted to the Fed's dovish stance and sought higher yielding currencies. The Euro fell following concerns over Italy's economy affecting markets as the country entered into an economic recession.

Table 2: Currency Rates as At March 2019

	Quarter-end Value	% Quarter Change
GBP/EUR	1.16	4.4%
GBP/USD	1.30	2.3%
EUR/USD	1.12	-2.0%
USD/100JPY	1.10	1.1%

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

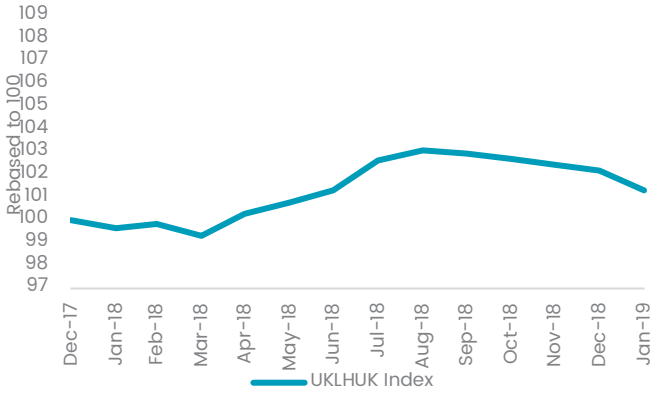


UK Property

The UK property market slowed down in Q1, given the uncertain economic outlook which weighed on buyer sentiment, although some sub-sectors like the industrial and office sector performed well.

Commercial Property: CBRE reported that UK commercial property returned 0.7% in Q1 2019, whilst rental values remained flat and capital values fell by 0.6%. The retail sector remained under pressure as shopping centres continued to underperform. In Q1, the retail sector returned -1.3% driven by the fall in capital value and rental value. The industrial sector saw total returns of 1.9% over the quarter, and the office sector posted total returns of 1.8%.

Residential Property: Annual house price growth dropped from 2.1% in March 2018 to 0.7% in March 2019, according to data from Nationwide, as consumer confidence weakened and the number of properties coming onto the market declined. Regional house prices were varied with prices in London and southern regions falling. These regions are now showing an annual change in house prices of -3.8% and -1.1% respectively. The contraction was due to several years of outperformance leading to house prices becoming less affordable. Northern Ireland saw the strongest annual growth of 3.3% and 4%, while Scotland saw increases.



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

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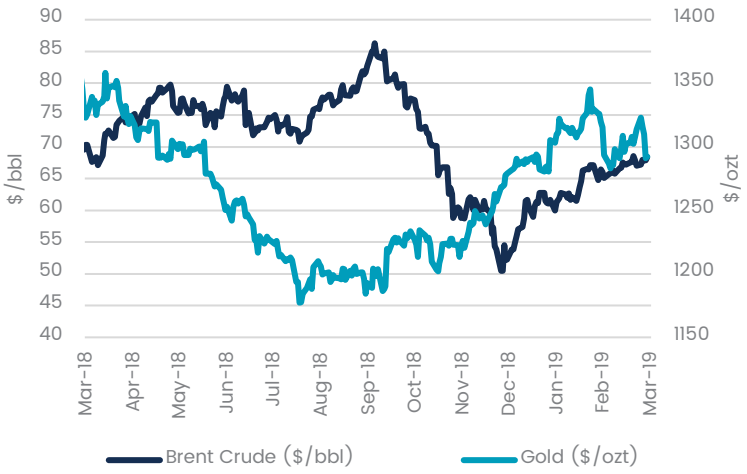
Commodities

Commodities were generally positive over the quarter as Brent Crude and copper prices increased. Gold was flat over the quarter following the gains it made towards the end of last year, as the Fed's dovish stance drove investors towards riskier asset.

Oil: In Q1, crude oil prices rose from $54 to $69 per barrel – an increase of 27% - as lower supply drove prices up. OPEC with support from Russia continued to cut its production by 1.2 million barrels a day to avoid oversupply in the market. The US began sanctioning Venezuelan oil to further put pressure on the Maduro regime with President Trump recognising Juan Guaidó as the acting President of Venezuela. The US continued sanctioning Iran while allowing oil waivers to eight nations with President Trump mulling over whether to extend these agreements in May.

Gold: Prices were volatile over the quarter as prices increased by a mere 0.91%. With trade tensions seeming to make progress and the Fed not planning to raise interest rates.

Chart 8: Gold and Brent Crude Oil Prices



Source: Bloomberg.
Notes:
Gold United States Dollar Spot (Ticker: XAU Currency)
Generic 1st Brent Crude Oil (Ticker: CO1 Commodity)

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