Appendix 5

MJ HUDSON Allenbridge

London Borough of Bromley

Quarterly Report

Q3 2019

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Performance Summary

The third quarter of 2019 was characterised by the continued strong performance of Government bonds including UK Gilts. Over the quarter the UK All-Gilts index returned 6.5% and is up 11.8% over the last year. This pales beside the return from UK Index-Linked Gilts where the index returned 8.7% in the quarter and is up 17.9% over the year, matching the return from the MSCI Global Equity index although the latter has benefited from the weakness of Sterling against the US dollar. This strong performance in global Government bond markets is driven by renewed monetary loosening; the cutting of interest rates and the return of quantitative easing; all pushing more money into the system and forcing investors to chase yield. There is a dichotomy here however, Whilst Government bond yields are falling across the globe and stock markets are rising, the cost of credit has not declined in the same way. Investment Grade and High Yield bonds have seen prices rise (yields have fallen) but by no more that the fall in the risk-free rate as measured by the equivalent Government bond. Credit spreads have been stable to widening slightly.

What we have is Government bond investors pushing prices up (yields down) driven by monetary policy and the fear of a global recession, Equity investors pushing prices up despite the fear of a recession and no earnings growth and corporate bond investors responding to the fall in Government bond yields but widening credit spreads saying that they feel corporates are in no better position to repay their debts now than before despite the lower interest rate. This is, of course, an oversimplification, but it does highlight the pressure on markets at present.

As you will see from the Global Outlook section later in this report, whilst we are worried about how markets are behaving, we do not expect this to lead to a major market fall at the present stage, mainly because global economic growth looks subdued but stable for a while yet. The adage is that bull markets climb a wall of worry, that is certainly the case this time!

The Fund finished the quarter with a valuation of £1.118bn a rise of 2.4% over the quarter. This was slightly behind the rise in the benchmark which returned 3.0% over the quarter. The underperformance was driven by Baillie Gifford in their global equity portfolio whose underperformance against their benchmark hit the Total Fund performance by about 1% partly offset by the outperformance of the other global equity manager MFS whose outperformance added about 0.5% at the Total Fund level. Elsewhere the performance of the Schroders Multi-Asset income portfolio lagged that of the equivalent Fidelity portfolio and is now 4.5% behind the Fidelity portfolio over the last year. I will discuss this further with the manager before the next meeting.

The Fund has still returned a very impressive 9% per annum over the last 32 years and as yet this shows no sign of slowing as the Fund one year return at 8% and three year return 8.1% per annum. The Fund continues to show a strong relative outperformance of its benchmark over all longer time periods.

ASSET ALLOCATION

With bonds providing a marginally better performance than equities over the quarter the Fund's tactical asset allocation will have created a small drag on performance but this has been of a lesser degree than that of the individual managers for this period. With income from both the Multi-Asset portfolios and UK Property portfolio being paid out each quarter, their weighting will fall as a percentage of the Total Fund over time.

Asset Class	Fund weight (30/6/19)	Strategic B/M weight	Difference
Equities	63.8%	60%	+3.8%
Fixed Interest	13.2%	15%	-1.8%
Property	4.3%	5%	-0.7%
Multi Asset Income	18.8%	20%	-1.2%

Percentage figures may not add up due to rounding.

MULTI ASSET CREDIT

As an update, given the strong performance of Government bonds and global equities over the last 9 months, the committee has lost no value in delaying a move into Multi Asset Credit so far. A review of this asset class will be included as part of the Strategic Asset Allocation Review that MJHudson Allenbridge are currently conducting for your Fund.

Executive Summary

- Central banks globally shifted to a more dovish stance. Both the US Federal Reserve (Fed) and the European Central Bank (ECB) cut rates in Q3, with the former cutting rates twice. Bond yields suggest that further cuts are expected in the near future. The ECB resumed quantitative easing along with a rate cut and reiterated that it will do whatever it takes to keep the European economy growing.
- Continuing trade tensions and the emergence of some mixed economic data dampened equity performance and these issues look set to continue; however, these were balanced by the Fed rate cuts. The S&P 500 ended the quarter up 1.7%, bringing year to date returns to a very healthy 20.6% in Sterling terms.
- UK stock market delivered more muted returns with the FTSE All-Share gaining 1.2%. This mixed but subdued performance came as Boris Johnson replaced Theresa May as Prime Minister and took a harder line towards negotiations with the EU, and Brexit uncertainty continued even as the UK approached the third withdrawal deadline with a General Election now scheduled for 12th December. Even though the FTSE 100 only rose slightly over the quarter, the year to date returns were still positive at 14.2%.
- European stocks provided the strongest regional equity returns over the quarter, spurred on by looser ECB monetary policy but ultimately held down by geopolitical concerns: the US-China trade tensions, Brexit, and unstable governments in Italy and Spain. The Euro STOXX 50 index gained 3.1% over Q3.
- Whilst developed market equities mostly posted minor positive gains, emerging markets fared worse. Returns [illegible] npact of the US-China trade war and continuing US dollar strength. The MSCI Emerging Markets index was down -4.2% for Q3.

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

- Volatility continued to rise steadily in equity markets: the VIX index increased from 15.1 to 16.2.
- Government bond prices continued to rise (yields fall) for the first two months of the quarter due to concerns over the US-China trade tensions. This trend partially reversed towards the end of the quarter as central banks loosening their monetary policies.
- Whilst both investment grade and high yield corporate bond spreads were broadly unchanged during Q3, spreads remain below historic averages. The Fed rate cuts increased investor confidence in the its commitment to economic growth, partially counteracting less than stellar economic news. The Bloomberg Barclays US Corporate Investment Grade TR Index Unhedged returned 3.1%, bringing the year to date figure up to an astounding 13.2%.

- Sterling experienced higher than usual volatility levels during Q3 and hit a 34-year intraday low against the dollar in early September of 1.196. The euro also lost value against the dollar as the ECB restarted its bond buying programme despite the US Fed cut interest rates.
- The Chinese renminbi reached new lows against the dollar, breaching the 7RMB:1USD mark in what is thought to have been a Chinese government-backed devaluation in response to the continuing trade tensions between the US and China. However, given US Presidential elections next year we do expect some more positive news in this area as it will suit both sides to secure an agreement at the current time.
- Similar to the previous quarter, the UK commercial property returns were also low and only increased 0.5% over the third quarter.
- Commodity markets faced mixed returns during Q3. Energy and soft commodities performed very poorly while the precious metals sector saw decent gains. Brent Crude was down -8.7%, while the central banks cutting interest rates led to the gold price increasing by 3.7%.

Global Outlook

The third quarter of the year was another good quarter for both developed market equities and bond indices, although emerging market equities suffered. Clearly a key theme of the quarter is the dovish stance of the US and European central banks, with the ECB restarting monetary stimulus measures. Indeed, the programmes put in place contrast with the rhetoric at the beginning of the year and Central banks have been described as essentially 'capitulating' and reversing course from their previous signals of tightening policy over the last couple years, with the move to expand the Fed balance sheet once again. This is helping to support risk assets, with the S&P 500 near record highs for the year but also pushing bond yields down (prices up) giving positive returns for both asset classes.

At the same time, the IMF considers that the world economy is in a 'precarious' situation and reduced its growth forecast to the lowest level since 2008, on factors including the US-China trade war and the ongoing Brexit uncertainty. Furthermore, many investors consider that we are near the end of the economic and hence market cycle.

The rhetoric directed at Chairman Powell from the White House may have contributed to the pressure on the Fed to cut interest rates. However, rising concern about the potential future effectiveness of Central bank policy easing, led to a correction in US momentum stocks. Conversely, Value stocks had better performance in a notable reversal of previous months. This can sometimes be indicative of a change in market behaviour but it is uncertain as yet.

On September 12, ECB cut rates, and announced strong stimulus measures including a new form of its asset purchasing programme, printing EUR 20 bn a month to buy more bonds. The ECB's deposit rate is now at a record low of minus 0.5 per cent. Most European equity markets initially reacted well, especially the Eurostoxx. But the announcement was accompanied by an explicit call for more fiscal stimulus. There has already been some dissension within the ECB on the effectiveness of further monetary stimulus, and Christine Lagarde, the incoming ECB president, has pledged to review the ECB's policies on negative rates and bond-buying. Christine Lagarde is due to replace Mario Draghi on November 1, and this change of ECB president could yet lead to more changes. Overall, we expect more fiscal stimulus alongside monetary stimulus, which would be supportive in the short term, but could raise investor concerns about future inflation. This chimes with moves in the US and UK where political parties across the spectrum are ditching austerity in favour of increasing government spending. It would seem increasingly likely that and further economic slowdown will be met with more fiscal spending which again should be inflationary.

The ongoing US-China geopolitical trade war continued over the quarter. After the Shanghai trade talks in July, President Trump announced new tariffs of 10% on more than $300bn of goods from China. As Chinese policymakers let their currency weaken in response and the Yuan (vs USD) cross the 7 level for the first time since the global financial crisis, leading the US to formally label China a currency manipulator. The trade wars are being closely watched by markets with the increase in trade tensions triggering a risk off move. Given US Presidential elections next year and President Trumps desire to get re-elected, we would expect a more emollient stance going forward as it will suit both sides to talk up an agreement at the current time.

Germany issued 30y bonds at negative yields for the first time. UK 30 y bonds fell to all-time lows. In the US, the yield curve inverted at the 2y and 10y points (notably, for the first time since 2006). When the US and China announced the intention to resume trade talks in early September, the US 10y Treasury was up 11 bp, the biggest one day rise in nearly two years. Given the political power struggle which underlies the trade tensions, these are likely to be a persistent feature of the investment landscape going forward. This is not just about trade but global hedgemony!

In September, there were significant disruptions in money markets. Rates in the overnight repo market rose as high as 10% on September 17. In this context the Fed promised to lend at least $75bn a day until Oct 10. Liquidity crunches in money markets are reminiscent of the global financial crisis, as is the Fed intervention in repo markets to provide emergency liquidity is a potential source of concern. These liquidity pressures are likely to contribute to continued monetary stimulus from the Fed but highlight stresses within markets at the current time.

The level of geopolitical uncertainty contributed to the strong move up in Gold (+3.7%). On the weekend of September 14, the attacks on the Saudi Aramco oil infrastructure facilities reduced the supply of oil, pushing prices up nearly 20%, until the facilities were repaired, and production restored. It also led to the postponing of the planned IPO for Saudi Aramco, initially expected to reach record levels. Having said this, the softening macroeconomic outlook and rising importance of US shale production, which can be ramped up quickly at prices over $60-odd, are likely to contain oil prices in the medium term.

Performance report

A disappointing quarter for the manager in Q3 with the portfolio underperforming the index by 2.7%, returning 0.7% against 3.4% for the MSCI All Countries Global index. The Baillie Gifford portfolio has holdings in Prudential and AIA, both insurance stocks focusing on the rapidly growing life assurance markets in Asia. This companies operate across Asia and this includes exposure to Hong Kong where recent pro-democracy disturbances have destabilised both the local economy and equity markets. Whilst this issue does not undermine the long-term growth opportunities these companies are exposed to and Baillie Gifford have not altered their position, I do have some concerned because I do not see an ending to this which is acceptable to both sides, the pro-democracy demonstrators and the Chinese government.

Asset Class/ Manager	**Global Equities/ Baillie Gifford**
Fund AuM	£451m 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 meet their performance target
Last meeting with manager	30/6/19 John Arthur/John Carnegie; Paul Roberts
Fees	0.65% on first £30m; 0.5% on next £30m; 0.35% thereafter

In addition to this the portfolio was affected by a small number of stock specific issues among a couple of the smaller holdings and a higher exposure to Emerging Market equities than the index.

None of this should detract from the very strong long-term returns produced by this manager since inception in in December 1999, approaching 20 years. The performance since the Global Financial crisis in 2008 has been exceptionally strong. This has occurred during a period of falling interest rates when growth stocks have a tendency to out-perform. We have been in a period when growth is a scarce resource and hence rated at an increasing premium. I continue to have a very high regard for the global equity team Baillie Gifford but would expect the outperformance to become more muted going forward.

Asset Class/ Manager	Global Equities/MFS
Fund AuM	£261m Segregated Fund; 23.4% of the Fund
Benchmark/ Target	MSCI World Index
Adviser opinion	
Last meeting with manager	No meeting this quarter
Fees	0.6% on first £25m; 0.45% on next £25m; 0.4% thereafter

MFS returned 5.6% in the third quarter, surpassing their index return by 2.3%. Their one-year performance is exceptionally strong with a return of 13.3% against 7.3% for the index. This compares with a return of 7.0%, slightly below their benchmark, for the Baillie Gifford global equity portfolio commented on above over the same period, although Baillie Gifford's longer-term performance remains superior.

Recent analysis by MJHudson confirms my expectation that these two managers produce relative performance figures which are negatively correlated at -0.2%. This suggests that if one manager should outperform their benchmark by 10% the other should underperform by 2% over the same one-month period. This negative correlation dampens down the overall volatility of the Fund's equity performance against the benchmark and in doing so allows the Fund to employ individual managers who run high conviction, concentrated portfolios with strong investment philosophies.

It is quite difficult to pin point what has led to the pick-up in performance over the last year, the previous 12-month period was actually quite difficult for the manager and had bought the longer term performance down to benchmark levels. The portfolio has not changed substantially. It seems more driven by the market having more of an eye on valuation levels rather than chasing pure growth which makes sense for the late stages of an economic cycle.

Asset Class/Manager	Fixed Interest/ Fidelity
Fund AuM	£84m 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	8/7/19 John Arthur/Paul Harris/Suzy Fredjohn
Fees	0.35% on first £10m; 0.3% on next £10m; 0.21% on next £30m; 0.18% thereafter

The Fidelity bond portfolio returned 4.8% over the third quarter, slightly below its benchmark return of 5.1%. Over the last year this portfolio has returned 12.4% against a benchmark return of 12.2%. Since inception in May 1998 the portfolio has returned 6.8% per annum outperforming its benchmark by 0.8% per annum and thereby hitting its performance target.

With economic indicators slowing across the globe since mid-2018, it has been a good environment for investment grade global bonds. The interest rate cuts in Q3 from the ECB and US Fed were well signalled and have been anticipated since late 2018. Markets are still signalling further rate cuts but I feel this may be too optimistic. With many government bond markets now with negative yields including Germany, Japan and Switzerland, investors are willing to pay a premium and ultimately take a loss because they need the reliability and liquidity that government bonds offer. This does underline the cost of being 'risk free' in the current environment but if the global economy stabilises and interest rates need to rise slightly then many bond investors could be looking at a greater loss as yields rise. The majority of market forecasters are now predicting 0-1% annual return from UK 10-year Gilts over the next ten years. The problem is that they might be correct over the longer period but this does not give any insight into the path taken to get there and a global recession could push more Government bonds into negative territory before an eventual recovery sees bond yields rise.

Government bonds provided the best return over the quarter with credit spreads widening slightly due to the deteriorating global economic environment. The widening of credit spreads had a slightly detrimental effect on performance over the quarter and was the reason for the small underperformance. The manager remains cautious of taking risk at present in the UK market due to the heightened level of political and economic uncertainty.

Asset Class/Manager	**Fixed Interest/ Baillie Gifford**
Fund AuM	£63m Pooled Fund; 5.6% of the Fund
Benchmark/ Target	Tailored benchmark
Adviser opinion	Performance matching benchmark
Last meeting with manager	2/5/19 John Carnegie; Paul Roberts/John Arthur
Fees	0.3% of fund value

The portfolio continues to produce a mixed performance relative to its benchmark returning 3.9% in the third quarter against a 4.6% return for its benchmark. Over 1 and 3 years the portfolio has approximately match the benchmark return and has equalled the benchmark return of 6.2% per annum since inception in December 2013.

This portfolio has a slightly broader mandate than the Fidelity mandate commented on above. This allows the manager to invest a small proportion of the fund in higher yielding bonds including emerging market ones and to take some currency positions. Over this quarter a position in Norwegian Krone caused the underperformance against the benchmark as oil prices weakened. The portfolio now yields 2.4% to redemption but returns over the next few years will be driven mainly by the performance of the global economy with further upside in bond prices requiring a global recession.

Asset Class/Manager	Multi Asset Income / Schroders
Fund AuM	£116m Pooled Fund; 10.4% of the Fund
Performance target	LIBOR +5% including a yield of 4% per annum
Adviser opinion	Too early to make any assessment
Last meeting with manager	7/10/19 John Arthur/ Geoff Day/ Councillors Onslow and Allot
Fees	0.35% of fund value

The portfolio returned 0.5% over the third quarter and has now returned 2.25% over one year. This is acceptable but slightly disappointing given higher returns in equities and bonds over the period. The portfolio continues to distribute the required yield at 4.4% per annum. Over the period, London Borough of Bromley Pension Fund's portfolio was transitioned from the Schroder ISF Global Multi-Asset Income to Schroder Global Diversified Income. The performance reported on here represents that achieved by Bromley's assets managed by Schorders over the period. The change means the portfolio is now Sterling focused rather than being hedge back from a US Dollar focused fund, this should result is some small performance benefit over the longer term as the cost of currency hedging is reduced.

The manager remains defensive in mindset but given the strong performance of Government bonds and credit in general over the quarter has reduced bond holdings in favour of some defensive yet higher yielding equity positions. Equity exposure has risen from 26% of the portfolio at the start of the quarter to 47% at the end of Q3. Although some hedges remain in place. In essence the market environment has been more positive than Schroders expectations over the last 12 months and as such they have not captured as much of the upside as they could have particularly within their equity holdings.

Asset Class/Manager	Multi Asset Income / Fidelity
Fund AuM	£93m Pooled Fund; 8.4% of the Fund
Performance target	LIBOR +4% including a yield of 4% per annum
Adviser opinion	Too early to make any assessment
Last meeting with manager	7/10/19 John Arthur/ Paul Harris/ Councillors Onslow and Allot
Fees	0.4% on first £20m; 0.3% on next £30m; 0.25% on next £100m; 0.18% thereafter

The portfolio returned 2.1% in the third quarter and has now returned 6.6% over a one-year period. This compares well with the 2.25% annual return delivered by Schroders in the portfolio commented on above. The portfolio has a current yield of 4.6%

Similar to Schroders, the manager is taking a defensive stance in the portfolio at present, the difference between the performance of the two portfolio is mainly within the returns achieved in the equity portion. Fidelity have managed their equity exposure more effectively and held any hedges at less cost, allowing the portfolio to benefit more from the appreciation of equity markets over the last twelve months. In addition, the funds holds a slightly longer bond duration than the Schroders portfolio which again has aided performance.

Asset Class/Manager	UK Commercial Property / Fidelity
Fund AuM	£48m Pooled Fund; 4.3% of the Fund
Performance target	IPD UK All Balanced Property Index
Adviser opinion	Too early to make any assessment
Last meeting with manager	23/5/19 Conference
Fees	0.75% of fund value

The UK Property portfolio returned 1.2% against the benchmark return of 1.1% over the quarter, this brings the one year return to 4.1% against the index return of 4.9%. The portfolio yields 4.6% at present.

The fund remains underweight retail and shopping centres and overweight industrial and South East offices. Vacancy rates have risen in the quarter as two major properties undergo major refurbishment, an office building in Cardiff being redeveloped as private residential and the refurbishment of a logistics unit in Wigan. The manager did forewarn of the expected increase in vacancy rate and is confident that the redevelopments will add value over 2020. The manager is also carrying a cash balance of 6.8% of NAV at present but this is unlikely to be a major drag on performance give the subdued investment returns expected in the short term.

I note that the manager has a slightly higher performance calculation for their fund over the last year showing it has outperformed the benchmark over that period. This differs from the performance calculation made by the custodian. I will always take the latter's figure as correct but if this situation continues, I will look to discuss the issue with the two parties with a view to reconciling the figures.

Global Economy

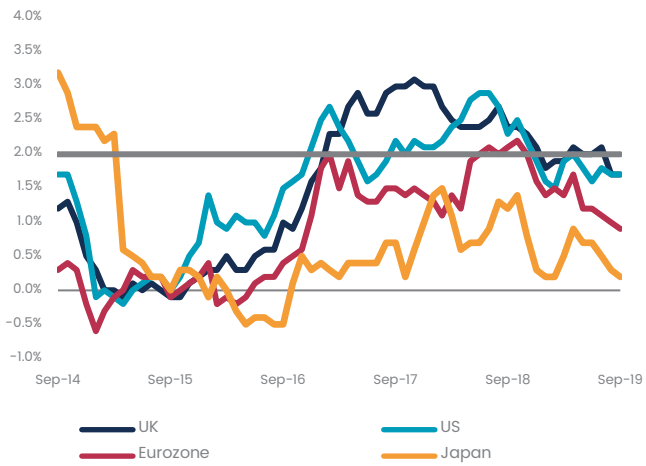
The Federal Reserve set the tone for the global economy over Q3 in its much-anticipated move of lowering rates. The Fed cut rates in July and September, lowering the target range to 1.75% - 2%. In Europe, the ECB also took measures to stimulate the economy by also cutting rates and re-starting its programme of quantitative easing. Meanwhile, global markets made slight gains, whereas emerging markets fared poorly as many were hit by the knock-on effects of the Fed's rate cut and continued US-China trade tensions. In the UK, Boris Johnson became Prime Minister and Brexit uncertainty continued.

Table 1: Quarterly GDP Growth Rate

	US GDP	UK GDP	Eurozone GDP	Japan GDP
Q3 2019*	1.9%	0.3%	0.2%	0.6%
Q2 2019	2.0%	-0.2%	0.2%	1.3%
Q1 2019	3.1%	0.5%	0.4%	2.2%
Q4 2018	2.2%	0.2%	0.2%	1.8%

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 is expected to grow 1.9% in Q3, as last quarter's GDP was revised up from 1.8% to 2.0%. This came as the consumer confidence index fell in August from 134.2 to 125.1, and as US-China trade tensions continued to cause concern.

In the UK, Q3 GDP growth is expected to be at 0.3%, despite the continued political uncertainty in the country. The slight reversal to positive this quarter was largely due to the services sector (which makes up approximately 80% of the UK economy), in particular film and television production. In the Eurozone, GDP growth is predicted to be 0.2% for Q3, as the ECB restarted quantitative easing in September amidst weakening growth in the region.

CPI: In Q3, inflation levels in the US stayed consistent with the end of the previous quarter, rising from 1.6% to 1.7%. The indices for housing, and food costs increased but were counterbalanced by falls in energy, used cars and trucks.

In the UK, the consumer price index fell from 2.0% at the end of Q2 to 1.7%; this is below the 2.0% target set by the Bank of England. This decline was driven by motor fuels, electricity, gas and other fuels, and second-hand cars. These moves were partly offset by increases in the costs of furniture, household appliances, hotel stays, recreation, and cultural items.

Central Banks: In Q3, central banks turned towards more dovish policies, with the Federal Reserve cutting rates twice, totalling a 50bp cut, for the first time after a decade. At the same time, the ECB cut rates, for the first time since 2016, by 10 bps, further into negative territory to a record low of -0.5%, as well as restarted its quantitative easing programme. This will make it harder for the incoming ECB president Lagarde to continue further loose monetary policies. Across the world, 43 central banks have cut interest rates a total of 67 times in Q3, compared to 26 cuts in Q2, and 19 in Q1. The Bank of England has held firm on interest rates as Brexit uncertainty continued to prevail.

Political Headlines: In the UK, Boris Johnson started his new role as Prime Minister, amidst claims that he would avoid at all costs requesting an extension to Brexit from the European Union. In the US, the main headline was the Federal Reserve cutting interest rates first in July then again in September. In Japan, Abe was re-elected as Prime Minister, while in Italy there was a split in the governing coalition between the Five Star and the Democratic Party.

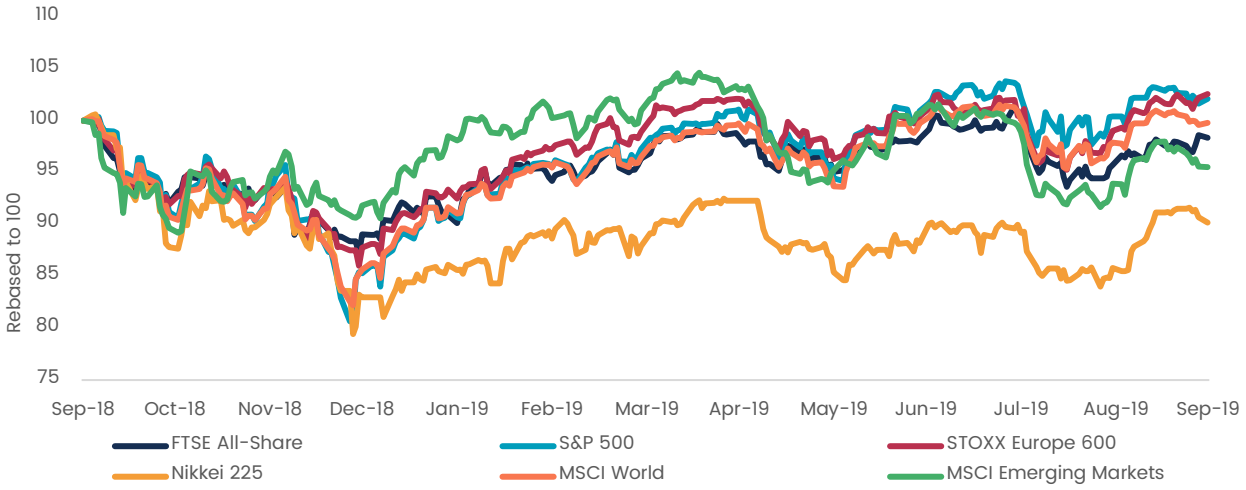
Equities

Over the course of Q3 2019, equity markets were a mixed picture: developed equity markets experienced broadly modest growth, helped by central bank action, while emerging market economies fared less well delivering a mix of low or negative returns. Moves by the Federal Reserve and the ECB helped to sustain UK and US equities. US company earnings are estimated to be overall in decline based on reports in earnings season.

UK: UK markets were slightly up in Q3 with the FTSE 100 up by 0.9% while the FTSE All-Share rose 1.2%, bringing its year to date returns to 14.3%. Defensive sectors performed well while more economically sensitive sectors such as financials underperformed. Some investors took advantage of sterling weakness and relative value opportunities in UK equities.

US: The US stock market made small gains over the quarter. The S&P 500 index ended Q3 up just 1.7%. Sectors including real estate, utilities and consumer staples performed relatively well while energy, materials and healthcare, the latter given the political sensitivities, performed poorly. Value stocks performed well, while Momentum stocks performed poorly,

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) STOXX Europe 600 (Ticker: SXXP Index)

Nikkei 225 Index (Ticker: NKY Index) MSCI World Index (Ticker: MXWO Index) MSCI Emerging Markets (Ticker: MXEF Index)

Japan: While the Japanese equities market had a difficult start to the quarter, it picked up significantly in September. The Nikkei 225 was up 3.0% over Q3; this added to the positive year to date gains of 10.8%. As Abe was re-elected as Prime Minister, this sent a positive message reassuring markets of the continuation of Abe's policies.

Emerging Markets: The MSCI Emerging Markets index was down -4.2% for Q3. Markets in Argentina fared particularly poorly after surprise primary election results worried investors about the future of their current pro-business government. The effect of the US-China trade war took its toll on emerging economies as well as global growth concerns. Although MSCI Emerging Markets index returns were poor during Q3, the year to date returns are still positive at 6.1% to the end of September.

EU: The Euro STOXX 50 increased by 3.1% in Q3. Like other developed markets, the EU region made modest but positive gains over the quarter, boosted by the ECB's move to re-start quantitative easing. However, the knock-on effects of the US-China trade tensions, coupled with political uncertainty in the UK, Italy and Spain meant that equity markets' growth was not pronounced.

China: The MSCI China Index fell by -4.4%. This came as the Chinese government attempted to counter the negative effects of the US-China trade tensions by boosting its economy with tax cuts, interest rate cuts and increases in government spending.

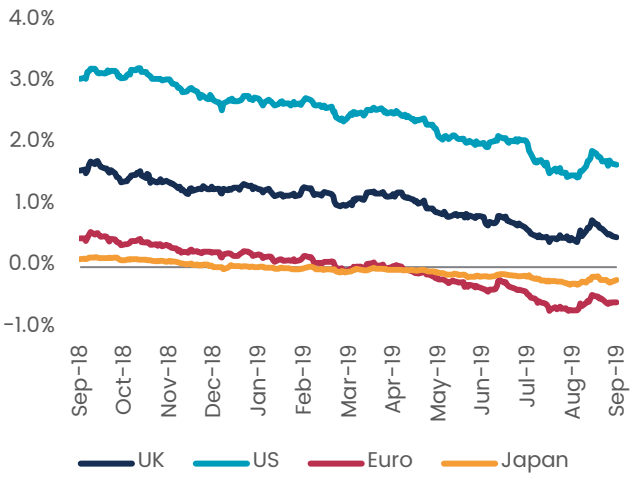
Fixed Income

In Q3, bond yields continued to stay at historically low levels, though there was a mid-September recovery in response to central bank easing and concerns around global growth. Declining yields led to positive results across most fixed income sectors.

Government Bonds: In Q3, bond yields fell markedly due to global economic, low inflation and trade war concerns. A recovery followed in mid-September as the US and China indicated optimism with the planned resumption of talks in October. The 10-year US Treasury yield fell by 32 bps; the US yield curve temporarily inverted, for the first time since 2007, an indication of a possible slowdown approaching.

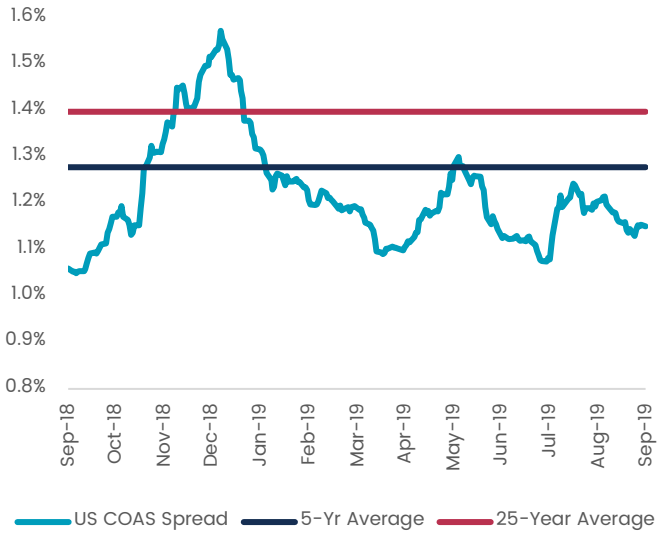
ECB policy pushed bond yields down throughout the Eurozone with Greek three-month bonds offering negative yields. 10-year German and Japanese government bond yields both fell further into negative territory. In Britain, the UK 10-year yield fell by 34 bps. This was due, once again, to Brexit uncertainty.

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

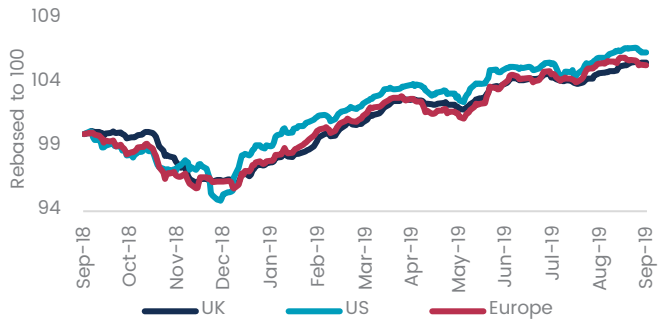


Source: Bloomberg. Notes: Bloomberg Barclays US Corporate Total Return Value Unhedged USD (Ticker: LUACTRUU INDEX)
Option-Adjusted Spreads (OAS) represent the difference between the index yield and the yield of a comparable maturity treasury.

High Yield Credit: Whilst geopolitical uncertainty continues across the globe, high yield credit generally performed well during the third quarter. The Bloomberg Barclays US Corporate High Yield TR Index Unhedged returned 1.3% over Q3. US high yield spreads to continue to be tighter than the historical average, tightening 5bp over Treasuries. Concerns over the possibility of defaults increasing due to the stage of the credit cycle remained, although corporate earnings seem to be resilient overall and the HY default rate remained low by historical standards.

Investment Grade Corporate Bonds: In Q3, IG corporate bonds outperformed government and high yield bonds: US investment grade bonds outperformed both US government and US high yield bonds; UK government, investment grade, and high yield bonds outperformed all of these.

The Bloomberg Barclays US Corporate Investment Grade TR Index Unhedged returned 3.1%, bringing the year to date return up to 13.2%. The telecoms and utility sectors had strong performance. Whilst US corporate bond option-adjusted spreads were broadly unchanged, looser monetary policy from the Federal Reserve and the ECB have supported investor confidence in the commitment of central banks to the economy.



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

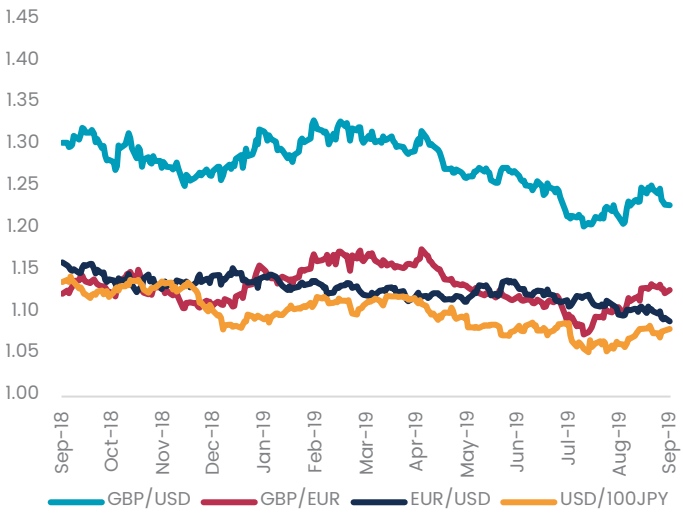
Over the course of Q3, sterling saw high levels of volatility due to Brexit uncertainty, hitting a 34-year intraday low against the dollar of 1.196 in early September and ended the quarter down -3.2%. For the world's most traded currency pair, the Euro lost -4.8% against the dollar, with both central banks implementing rate cuts and the ECB restarting its bond buying program. In addition to this, the renminbi fell to new lows against the dollar, passing the 7RMB:1USD point, a move widely thought to have been caused by a Chinese government-backed devaluation in response to the ongoing US-China trade tensions.

Table 2: Currency Rates as at September 2019

	Quarter-end Value	% Quarter Change
GBP/EUR	1.13	0.93%
GBP/USD	1.23	-3.21%
EUR/USD	1.09	-4.17%
USD/JPY	108.08	0.21%

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: One-Year Currency Rates of Major Currency Pairs



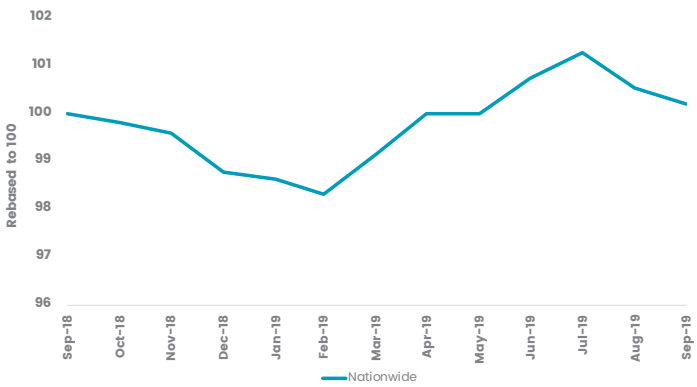
Property

In the UK, property price growth remained subdued in Q3, with the average UK house price rising by 0.2% (seasonally adjusted) to £215351.82.

Commercial Property: CBRE Research figures show that total returns for commercial property slowed to 0.5% in Q3, with property values decreasing by 0.9%. Central London office space remained tight with availability falling 3.0% to 12.7m sq ft, well below the 10-year average of 14.3m sq ft with take-up in Central increasing by 11.0% to 3.4m sq ft, bringing it above the 10-year quarterly average of 3.3m sq ft.

Residential Property: The UK residential property market remained slow, annual house price growth was at 0.2% in September, according to Nationwide. Northern Ireland remained the area in the UK with the strongest growth in Q3, despite annual price growth falling to 3.4% from 5.2% in Q2. Meanwhile in London, prices fell for the ninth consecutive quarter, -5.0% below the all-time highs recorded in Q1 2017. This is likely to be due to uncertainty in the UK and the backdrop of a slowing global economy.

Chart 7: 1-Year UK House Price Index



Source: Bloomberg. Nationwide

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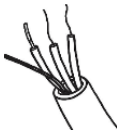
Commodities

Commodities faced a polarised third quarter with substantial losses in the energy and soft commodities sector versus a strong performance in precious metals. Brent crude led the energy sector's decline, suffering a -8.7% loss, compared to the modest 1.0% increase in natural gas prices. Gold continued to perform strongly with a 3.7% increase, while silver and palladium gained 10.0% and 7.5% respectively. Copper was down -4.7%, while nickel (used in the production of stainless steel and batteries) jumped 36% to a five-year high, due to the Indonesian government bringing forward a ban on nickel ore exports.

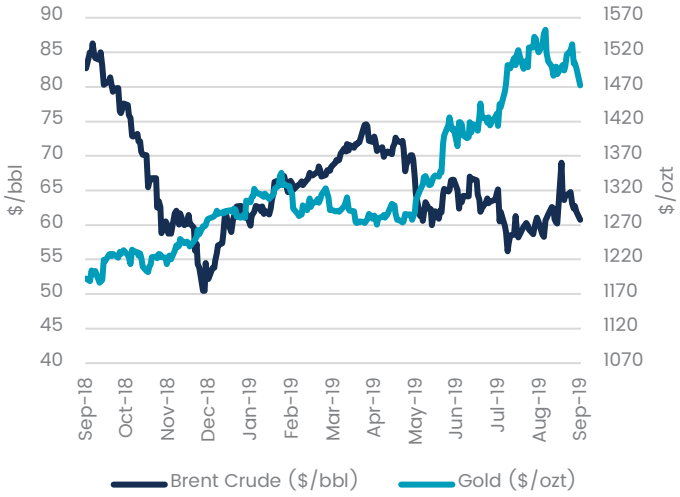
Oil: Brent prices fell -8.7% from $66.6 to $60.8 in Q3 due to continued fears about a global slowdown and geopolitical tensions. However, attacks against the Saudi Abqaiq & Khurais oil processing facilities disrupted 5.7 million barrels of oil exports, causing Brent's largest daily increase of 14.6%. This highlights the geopolitical risk in the region that accounts for 21.0% of global petroleum consumption. These gains were short-lived due to a swift response to restore capacity and the lack of military response to the attack.

Gold: Gold continued to perform well over Q3, reaching its highest price since 2013 in early September. This was in part due to the Fed's rate cuts and Trump's escalation of tariffs against China in August.



Copper: Copper prices continued to fall, declining -4.7% in Q3. This can largely be assigned to deterioration in global manufacturing and the continuation of the US-China trade tensions, with copper prices declining more than -20% since the trade-tensions began in June 2018.

Chart 8: Gold and Brent Crude Oil Prices



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

Soft Commodities: Soft commodities suffered losses across the board in Q3. Coffee and cotton were the worst performers with losses of -6.6% and -5.4% respectively, whilst sugar fell by -3.3%, orange juice by -1.2% and cocoa also fell marginally. While the sector performed poorly, with all measures posting declines by historic standards, the magnitude of the losses was comparably small. Soft commodities markets are typically volatile, and therefore subject to large price moves.

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