Appendix 5

MJ HUDSON Allenbridge

London Borough of Bromley

Quarterly Report

Q4 2019

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Performance Summary

It was only 12 months ago that we ended 2018 with a very poor investment market. All risk assets fell in Q4 2018 with global equities down 13.5% and the only positive contribution coming from Government Bonds and Gold. At the end of 2018 central banks, led by the US Federal Reserve (US Fed), responded to the poor market conditions and weakening economic data by softening their rhetoric and reverting to a more accommodative monetary policy. The US Fed eventually cut rates three times in 2019 starting in Q3. The result has been a much more benign 2019 than was forecast at the start of that year with all risk assets producing strongly positive returns. Global equity markets rose 28% in local currency led by the US market, with returns only slightly less in sterling terms due to a partial recovery in the UK currency as some daylight was shed on the BREXIT process by the general election. Government Bonds returned high single digit figures as loose monetary conditions pushed bond yields down and all forms of credit also produced strongly positive returns. It has been a year when it was difficult to lose money!

With inflation continuing to surprise on the downside, what we have learnt from the past year is that whilst central banks would like to be able to raise interest rates into a recovering economy, they will revert to a more accommodative stance at the first signs of market nervousness. This means that, with inflation remaining subdued, central banks are increasingly taking their lead from markets.

With central banks, led by the US Fed, underpinning markets, we expect 2020 to provide a lower return than 2019 but again be a benign investment market with much noise, particularly political, and some volatility but outright recessions and market collapses do not seem to be on the cards at present.

Nonetheless, we must be towards the end of a prolonged economic cycle globally, political rhetoric and disharmony are at levels not seen since the 1960's, liquidity in investment markets has deteriorated and climate change and environmental issues look set to affect all aspects of life going forward. They say 'bull' markets climb a wall of worry and this one certainly fits that description.

In the last investment report, I questioned whether the economic slowdown being experienced at that time was a) a mid-cycle adjustment; b) a longer-term stagnation or c) the onset of a recession? During the fourth quarter we saw the effect of the three US rate cuts and other central banks' easing policies begin to take effect and the economic data stabilised and showed some minor signs of improvement. This was helped by the initial stages of a resolution to the US- China trade disputes and the UK Election result lifting some of the uncertainty over BREXIT (temporarily).

This minor economic improvement resulted in a sell-off in Government bonds in Q4 across the developed world as investors took on more investment risk given the more stable economic outlook, but the sell-off was minor and higher yielding bonds still produced positive returns for the period.

The Fund finished the quarter with a valuation of £1.141bn a rise of 2.3% over the quarter. This was above the rise in the total Fund benchmark which returned 0.8% over the quarter. The outperformance was driven by Baillie Gifford in their global equity portfolio where they added 1.5% at the total Fund level through their strong performance relative to the index. The rise at the total Fund level may appear muted given the strong investment returns at the asset class level in local currencies was much of this performance was offset by a strong Sterling, driven by some momentary clarity over the Brexit process. Over the last year the Fund has returned an exceptional 20.2%, 4.7% above the index. This has been driven by three factors

- The strong performance of the underlying asset managers in Bonds and Equities
- The strong performance of asset markets in general which allows the Multi Asset Income funds to deliver a strong return against their cash plus benchmarks
- The tactical decision to be overweight Equities against the Strategic Asset Allocation

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 with the Fund's one-year return at 20.2%% and five year return 11.6% per annum. The Fund continues to show a strong relative outperformance of its benchmark over all longer time periods.

ASSET ALLOCATION

With the strong performance by the Baillie Gifford global equity portfolio over the quarter, the exposure to equities has risen further

Asset Class	Fund weight (30/6/19)	Strategic B/M weight	Difference
Equities	64.6%	60%	+4.6%
Fixed Interest	12.7%	15%	-2.3%
Property	4.2%	5%	-0.8%
Multi Asset Income	18.5%	20%	-1.5%

Percentage figures may not add up due to rounding.

My recommendation is to rebalance back to the Strategic Asset Allocation as part of the Strategic Asset Allocation Review currently being undertaken by MJ Hudson.

Executive Summary

- Overall, 2019 was a much stronger performance year for most asset classes than 2018, as the significant volatility that weighed heavily on returns in Q4 2018 dissipated early in the year and markets subsequently remained buoyant.
- Whilst the US Fed cut rates for the third time in the year by 25bps in October, none of the other major central banks followed suit, nor did the US Fed have much appetite for further cuts in 2019 or 2020 with an expressed unwillingness to cut rates further given the current economic outlook. Central bank policies may diverge during the next year, as loose monetary policy remains key for the European Central Bank (ECB) and the Bank of Japan (BoJ) whilst the data in the US remains more balanced.
- During the quarter, US stock market performance was buoyed by better than expected economic data and strengthening indications that an initial trade deal with China would be secured soon. Towards the end of the quarter, this culminated with official confirmation from both countries that a deal would be signed in mid-January albeit this was more about avoiding further escalation than a real rolling back of current tariffs. The S&P 500 ended the quarter up 9.1%, bringing year to date returns to an impressive 31.5%.
- UK stock market performance was modestly positive in Q4 with the FTSE All-Share gaining 4.2%. This subdued performance (in comparison to other equities indices) came as no-deal Brexit uncertainty fluctuated upon Boris Johnson's attempt at a new withdrawal deal and his decisive election win in mid-December. Even though UK indices rose mildly over the quarter, the returns for the whole of 2019 were still solid at 19.1% for the FTSE All-Share.

- European stocks also produced modest gains over the quarter, held down by geopolitical concerns, including the US-China trade tensions, Brexit and unstable governments in Italy and Spain. The Euro STOXX 50 index gained 5.2% over Q4.
- Emerging markets fared well compared to other markets in Q4, although performance was slightly more muted on a year-to-date basis, as US-China trade tensions and civil unrest dragged down returns. These were counter-balanced by a generally improving outlook, the announcement of an initial trade deal to be signed by the US and China and a weakening dollar. The MSCI Emerging Markets Index was up 11.7% for Q4.
- Volatility dropped over the course of Q4, due to a more benign market environment, with the VIX index, which is a measure of stock market volatility, declining to 13.8 from 16.2 in Q3. This is at the low end of longer-term data.
- With the US Fed cutting rates and all developed world central banks in dovish mood, the scope for a gentle economic reacceleration increased leading government bond yields to rebound, as investors increased their risk appetite. US Treasuries held their value best of all government bonds, with a loss of -0.8% cumulative total return over Q4. UK Gilts were the worst performing developed world government bonds and returned -4.2% with UK index linked bonds falling by -9.4% over the period. These falls underline how sensitive all government bond yields are to any sign of improvement in economic fundamentals.
- The higher yield available further down the credit curve enabled High Yield Credit to withstand the pull back with US Corporate High Yield bonds returning 2.6% over the quarter.
- Sterling experienced a strong final quarter, as investor fears of a no-deal Brexit and a Corbyn government faded with the results of the general election, although Brexit remains the core influence on Sterling. Sterling rose in value against the Euro by 4.9% in Q4 and against the dollar by 7.9%. This will have negated much of the return from international equities for an unhedged portfolio.
- The Dollar weakened in Q4, with the Dollar Spot Index falling by -3.0%. This was due to a combination of US Central Bank policy, the unfolding of the trade war and muted domestic economic data. Of the major free-floating currencies, only the Japanese Yen was down against the Dollar in Q4, as investors with an increased risk appetite left the safe-haven currency in favour of other currencies.
- For the first time in the past 12 months, the UK property market saw a rise in house prices of over 1%. The average house price rose to £215,282, representing an increase from last quarter of 1.4% on a seasonally adjusted basis. Meanwhile, commercial property prices only increased by 1.0% over the last quarter, with office values remaining flat.
- Commodity markets generally fared well in Q4, with some notable exceptions. Soft commodities performed well all around and metals (gold, copper, silver and palladium) all performed strongly. Energy saw mixed performance, with Brent prices up 8.6%, contrasting with a fall in the price of natural gas of -6.1%.

Global Outlook

As we consider markets for 2020, we recall how the past year has been a record year for risk assets, and, in particular, the US equity market which stood out by reaching all-time highs and delivered returns which will be hard to match in the coming year.

However, we remain constructive on markets for the current year as we expect modest economic growth and do not currently anticipate a US recession, a global recession or a major macro-economic shock, although, by its nature, the latter tends to arrive with little warning. Political uncertainty will continue, with the backdrop of the upcoming 2020 US election, so we expect volatility to be more elevated in the coming year. Investor positioning continues to be driven by a desire to mitigate risk yet achieve high returns resulting in a somewhat bar-bell approach to investing with record inflows in passive investments but also into more complex alternatives and illiquid private markets. We expect continued growth in alternative investments going forward.

We are constructive on equities. Whilst US valuations are high, we expect Equities to outperform Bonds as moderate economic growth continues. Exposure to defensive stocks, in particular, will be beneficial in the late-cycle environment. Emerging markets equities should continue to benefit from easy monetary policy, especially as the US Dollar is less likely to strengthen as interest rate differentials have been reduced by the recent US rate cuts.

We expect monetary policy to continue to be accommodative, although the scale of central bank interventions may be reduced. The US Fed is unlikely to cut rates further unless economic data deteriorates sharply but will stay 'lower for longer', as other central banks (ECB and BoJ) should continue in their current easing mode. We would hope to see central banks, particularly in Europe where they have more limited monetary firepower, adopt greater fiscal stimulus to accompany the monetary stimulus. The theme of monetary and fiscal combination is likely to become more prominent over the coming year. This may help support markets and delay a recession. In particular, Mme Lagarde has started her presidency of the ECB by pressing governments to loosen fiscal policy. This may take some time to feed through. In the eurozone, ECB actions are likely to benefit peripheral European countries. In terms of impact on currencies, FX volatility is expected to be lower within Europe due to the reduced policy and economic divergence across the region.

The trade war between US and China will continue to effect macro-economic growth. We expect the rhetoric to continue on both sides, with the eventual trade deal being negotiated in phases. Despite the delays the long-term prospects for a successful US-China deal have improved. A second trade thread is likely to be around the taxation of internet and technology companies, the majority of whom are US domiciled. The requirement is for a global agreement on how to tax these entities but with most global institutions under threat and this US administration adopting a self-centred approach in many policy areas, such agreement appears unlikely and the use of trade tariffs to coerce 'opponents' remains a possible outcome.

It is therefore likely that geopolitical risks will remain high and, by focusing on trade, do have the ability to directly influence the outlook for the global economy and hence be disruptive for markets. This may be the 'new normal'. The tensions between the US and Iran may add volatility to markets, particularly oil markets and, unfortunately, an escalation here may suit Trump's re-election hopes in the short term. However, as some commentators have noted, as much as the potential for escalation, there is perhaps a greater chance for peace going forward.

The substantial liquidity injections into money markets (repo markets) conducted by the US Fed through the latter half of 2019 are likely to continue to provide some shorter-term support to markets; however, the need for intervention is also indicative of deeper liquidity issues. We expect more consequences of these liquidity problems going forward and this remains an area of concern.

In terms of political outlook, in the near-term, the ongoing impeachment process of the US President could add uncertainty to markets, as the many twists and turns during the House investigation process, could find an echo in the trial in the Senate. The timelines for the trial are more likely to be more extended given the rhetoric on both sides. It is less the impeachment process which will impact markets but the President's response and his desire to be re-elected for a second term which will be more influential in market sentiment.

Following the clear mandate in the UK election the risks on the path to Brexit have reduced from the turmoil of the previous year. We expect continued uncertainty on the prospects for trade deals, however, with limited clear sight of the future trading relationship with the EU at the current time, although the path to a deal with the US may become easier. Providing talks with the EU remain constructive we would expect that Sterling will rally further over the course of the year but longer-term prospects are as unclear as the country's future trading relationships at present.

Performance report

Asset Class/ Manager	**Global Equities/ Baillie Gifford**
Fund AuM	£475m Segregated Fund; 41.6% 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	No meeting this quarter
Fees	0.65% on first £30m; 0.5% on next £30m; 0.35% thereafter

The portfolio finished off the year with a flourish returning 5.2% over the fourth quarter against 1.5% for the index. This took the one-year return to an exceptional 28.6% which is an equally exceptional 6.2% ahead of the index return. The portfolio has outperformed its benchmark by 3.3% over 5 years which is ahead of its performance target and by 1.1% since inception in December 1999. Importantly, the portfolio continues to have a high Active Share which means it deviates significantly from the benchmark index. It also shows low turnover, with an average holding period of 7 years or more for each investment.

It is this long-term focus and belief in building a relationship with the companies they invest in through the thorough analysis of each business that is a core part of their investment process. Because they know each company well and are highly likely to be invested over the long-term they are in a position to aid corporate management to make long term decisions and invest in the future of the business rather than just achieving the next quarterly earnings report. This long-term commitment also means they are in a position to have meaningful conversations with management about the way they invest and their impact on the environment, society and the wider group of stake-holders in the business. It is obviously in the Fund's interests for its asset managers to act in this way.

The performance of this portfolio since the Global Financial Crisis in 2008/9 has been quite remarkable. However, whilst I have a very high regard for the manager and the investment philosophy and process behind this portfolio, I would note that, with interest rates falling over this period and the world moving to a slower pace of economic growth, investors have increasingly put a premium on stocks which can continue to deliver growth in this environment which has played to Baillie Gifford's strengths. I continue to back this manager to deliver strong returns into the future but do see this recent strong performance as exceptional.

Asset Class/ Manager	**Global Equities/MFS**
Fund AuM	£262m Segregated Fund; 23.0% of the Fund
Benchmark/ Target	MSCI World Index
Adviser opinion	
Last meeting with manager	23/1/20 Daniel Blass; David Holding/ John Arthur
Fees	0.6% on first £25m; 0.45% on next £25m; 0.4% thereafter

MFS returned 0.4% in the third quarter, 1.0% behind their benchmark. Their one-year performance is strong with a return of 24.9% against 21.7% for the index. Over the long-term the portfolio has performed well, outperforming its benchmark by 1.7% since inception in December 2013. Over the quarter much of the negative performance impact came from the technology sector and Apple in articular where the portfolio is under-weight in an area of the market which performed well over the period.

Similar to the Baillie Gifford portfolio discussed above, MFS invest over the long term and the portfolio has a high Active Share which means it deviates significantly from the index in its holdings. Rather than focusing on growth as Baillie Gifford do, MFS look for high quality, sustainable companies with a defendable business franchise. Because the outlook for this type of stock is more stable, they carry less investment risk than the Bailie Gifford portfolio and so the MFS portfolio will struggle to keep up with a rapidly rising market in the short term. (Remember that despite the return for the benchmark over this quarter being only 1.4%, this was in Sterling terms. In local currency, global markets were up 7% plus.) Much of the outperformance achieved over the last year was during the summer months when the overall performance of the market was muted but it is notable that this year the market was not led by just a small group of high tech stocks but by a rerating of a range of high quality, dependable companies which suited MFS's investment philosophy and process better.

The two global equity portfolios continue to balance each other well in terms of investment risk whilst still both adding to the long-term performence of the Fund.

Asset Class/Manager	Fixed Interest/ Fidelity
Fund AuM	£83m Unit Trust; 7.3% 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

In the first three quarters of 2019 both equity prices and bond prices rose. Bond prices because central banks across the globe were cutting interest rates into what appeared to be an economic slowdown; equity prices because this central bank activity was pumping more liquidity into markets, much of which found its way into financial assets. The fourth quarter was different in that small signs of a stabilisation in economic data, coupled with the actions that central banks have now taken to boost economic demand, plus progress in US-China trade talks, all gave a stronger outlook for risk assets including equities but reduced the prospect of further interest rate cuts into the future, pushing bond prices down (yields higher). In the UK the Conservative election victory temporally cleared the Brexit air and thereby also aided the markets interpretation of the domestic UK economic outlook which pushed UK Government Gilt prices down. Because this fall in bond prices was quite muted and was driven by an improving economic outlook, the cost of credit fell so that corporate bonds and higher yielding bonds were still able to produce positive returns as the higher yield outweighed the fall in the Gilt price.

The Fidelity portfolio fell -1.8% over the quarter which was better than the benchmark which fell 2.5%. Over the last year the portfolio returned 9.3%, outperforming its benchmark by 1.1%. Over all longer time periods, including since inception in May 1998, this portfolio has outperformed its benchmark and is slightly ahead of its performance target.

The yield on this portfolio is now 1.8% with a duration of just over 10 years. I believe it to be unlikely that we will see a further sustained period of strong returns for both equities and bonds going forward as any further strength in bond prices requires signs of an outright economic recession which would be negative for equities.

Asset Class/Manager	Fixed Interest/ Baillie Gifford
Fund AuM	£62m Unit Trust; 5.5% of the Fund
Performance target	44% Sterling Gilts; 44% Sterling Non-Gilts; 6% Emerging Market debt; 6% High Yield. Index +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

With UK Government Gilt and investment grade corporate bond prices falling over the quarter it was a difficult period for fixed interest assets and, similarly to above, this portfolio produced a negative return over the quarter falling by -1.2%. This was better that the benchmark return, however, as this fell 2.1%.

The performance of this portfolio has been strong over the last year and the portfolio has matched the outperformance of the Fidelity portfolio commented on above over this time period. This portfolio has also now outperformed its benchmark since inception in 2013 but is below its performance target of benchmark +0.75% per annum. Bailie Gifford have strengthened the investment team responsible for this mandate over the past few years, appointing a fixed income strategist to aid in making the broader market direction calls and it is in this area where returns appear to have improved as evidenced by the last quarter where the portfolio was adequately positioned to add value as high quality bonds fell, reversing the direction of the previous three quarters. The selection of individual bonds to hold in the portfolio continues to add value suggesting credit analysis and selection remains strong. I see this as an improvement but require this to be maintained over the long term to give full confidence in the manager's abilities.

Asset Class/Manager	Multi Asset Income / Schroders
Fund AuM	£119m 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	16/1/20 John Arthur/ Geoff Day
Fees	0.35% of fund value

With strongly rising equity markets globally, offset in the UK by a rise in the value of Sterling, accompanied by falling Government and Investment Grade Bond prices, it was a complex quarter for a Multi Asset Income manager. Schroders made a strong call early in the quarter to increase risk assets, particularly equities, at the expense of investment grade credit and this aided returns over the quarter. The portfolio returned 2.4% in the fourth quarter and has returned 10% over one year. This includes the income distributed back to the Fund. The last year has been a strong period for all asset classes and I would not expect the portfolio to deliver such high returns going forward. The manager believes the portfolio has captured 40-45% of equity market upside but has a volatility of only one third that of the equity market. This portfolio is perhaps less diversified than the equivalent Fidelity portfolio commented on below but is achieving its aims in terms of return, yield and low volatility.

Asset Class/Manager	Multi Asset Income / Fidelity
Fund AuM	£93m Pooled Fund; 8.1% 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	31/1/20 John Arthur/ Paul Harris
Fees	0.4% on first £20m; 0.3% on next £30m; 0.25% on next £100m; 0.18% thereafter

The portfolio returned 0.8% over the quarter which was below that achieved by the similar Schroders' portfolio commented on above. The manager had less exposure to equities and more exposure to investment grade bonds as well as a slightly lower exposure to Sterling based assets, each of which was detrimental to performance. Nonetheless Fidelity have returned 11% over the past year which is above the Schroders' portfolio return of 10.1% and this is a good performance as it has been achieved with a low level of volatility and significant diversification across asset classes. The yield on the portfolio matches the similar Schroders' portfolio at 4.2%.

The manager remains defensive in mindset and has built a diversified portfolio with a long-term mindset to protect the assets within the portfolio, whilst maintaining the yield. I expect the portfolio to be slightly less volatile than the similar Schroders' portfolio and it may lag that portfolio under strong market conditions but I believe it to be well constructed to fulfil the investment mandate it has been given.

Asset Class/Manager	UK Commercial Property / Fidelity
Fund AuM	£48m Pooled Fund; 4.2% of the Fund
Performance target	IPD UK All Balanced Property Index
Adviser opinion	Too early to make any assessment
Last meeting with manager	No meeting this quarter
Fees	0.75% of fund value

The UK Property portfolio returned 0.5% over the quarter, in line with the benchmark. This is a further slowdown against previous quarters and brings the one-year return to 2.2%. The portfolio has lagged its benchmark since inception in March 2018 but this is to be expected given the high cost of investing into this asset class. Whilst the returns from this portfolio have been low against the returns of equities and bonds, our forecast returns looking forward are similar over the next 10 years and any clarity on the Brexit process will aid UK commercial property assets. The portfolio remains under-exposed to retail assets against its benchmark and still believes this to be an area of extended market weakness. Progress on the two major refurbishments in the portfolio are continuing as planned.

Global Economy

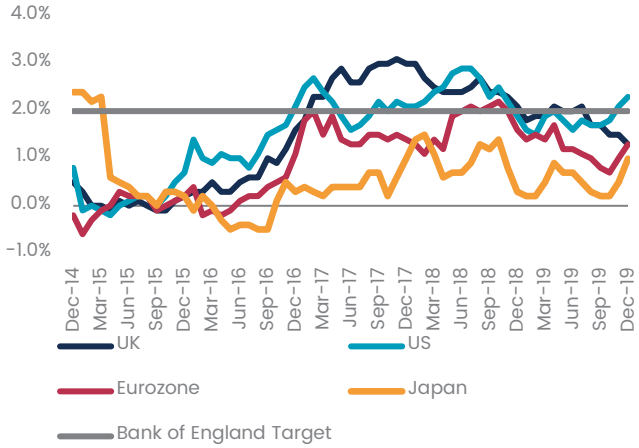
Running into Q4, expectations for Global economic data were poor. In the event the data was not as bad as expected. Aside from the US Fed, which cut interest rates for the third time in the year, the other major central banks remained committed to lose monetary policy but declined to cut rates. Meanwhile, pressure is mounting on governments to loosen fiscal policies, most notably in the Eurozone, where extended quantitative easing and the continued slowing of the economy have raised questions over what room is left for monetary policy to stimulate growth. The announcement of an initial US-China trade deal and a new majority government in the UK helped to ease global political uncertainty.

Table 1: Quarterly GDP Growth Rate

	US GDP	UK GDP	Eurozone GDP	Japan GDP
Q4 2019*	2.2%	0.1%	0.2%	0.4%
Q3 2019	2.1%	0.4%	0.2%	1.8%
Q2 2019	2.0%	-0.2%	0.2%	1.3%
Q1 2019	3.1%	0.5%	0.4%	2.2%

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 December 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).

	CPI		
	October	November	December
UK	1.50	1.50	1.30
US	1.80	2.10	2.30
Eurozone	1.70	1.00	1.30
Japan	0.20	0.50	0.99*

GDP: US GDP is expected to grow 2.2% in Q4, whilst last quarter's GDP was revised up from 1.9% to 2.1%. The US consumer confidence index grew from 125.1 in August to 126.5 in December; however this was a decrease from 126.8 in November. US-China trade tensions continued to cause concern.

In the UK, Q4 GDP growth is expected to be around 0.1%, due to continuing long-term Brexit uncertainty, the running down of supplies ordered by businesses as part of no-deal Brexit contingencies and political uncertainty leading up to the December election. The British Chamber of Commerce Quarterly Economic survey pointed to a worsening service sector; continuing negative indicators for manufacturing and export orders; and the lowest manufacturing investment for eight years. In the Eurozone, GDP growth is predicted to be 0.2% for Q4, as growth in the region continued to remain weak, especially in Germany.

CPI: In Q4, inflation levels in the US rose from 1.7% at the end of the previous quarter, to 2.3%. The majority of price rises were due to housing, medical care and gasoline, whilst used cars and trucks, household furnishings and operations and airline fares declined in price.

In the UK, the consumer price index fell from 1.7% at the end of Q3 to 1.3%; this is below the 2.0% target set by the Bank of England (BoE). The decline was driven primarily by accommodation services and clothing, while the greatest increases in prices came from water, electricity, gas and other fuels.

Central Banks: In Q4, central banks continued with dovish policies, but the pace of interest rate cuts slowed. Whilst the US Fed cut rates once more, the BoE, ECB and BoJ all held rates steady. The US Fed stated that it does not plan to reduce rates further in the near future unless the outlook changes materially. This was shown with its involvement in the Repo market at the end of Q4, with the aim of stopping a repeat of September's Repo interest rate spikes. In her first months as ECB president, Mme Lagarde reiterated Draghi's loose stance on monetary policy and continued to press for governments to loosen fiscal policy. It was also announced that Andrew Bailey, head of the FCA, will take over from Mark Carney as Governor of the Bank of England on 16th March 2020.

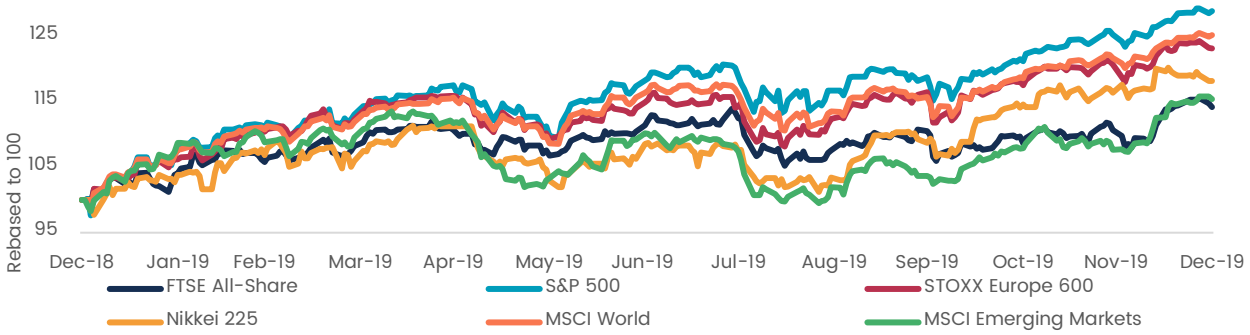
Political Headlines: In the UK, Boris Johnson was elected as Prime Minister with a significant majority. In the US, the main headline was the impeachment of President Donald Trump, with the Senate yet to vote on his removal. The new team of EU Commissioners took power on 1 December. In Germany, the new SDP leadership unexpectedly announced that they would keep their party in its coalition with Angela Merkel's CDU. Meanwhile, in France, Macron was under pressure as protests against his proposed pension reforms set him in conflict with French unions.

Equities

Over the course of Q4 2019, equity markets performed well: as political uncertainty and concerns regarding the global economy subsided so investors' risk appetite increased and, thus, so did allocations to equities. Concerns over the trade war continued to weigh on markets, with mixed messages throughout the quarter. Whilst an initial trade deal was agreed in December, alleviating some uncertainty, the trade war endures. Nonetheless, continued central bank support helped markets globally. Fears of a recession calmed, as economic data improved marginally.

According to the MSCI ACWI factor indices, Quality stocks performed strongest in absolute terms in Q4, with returns of 10.0%. Momentum stocks outperformed Value stocks. Meanwhile, Low-Volatility stocks performed the worst with a return of 7.2% which is not unusual in a rapidly rising market.

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)

UK: UK markets were slightly up in Q4 with the FTSE All-Share rising by 4.2%, bringing year to date returns to 19.1%. However, the UK was the worst performing major equity market. Domestic stocks and economically sensitive areas of the market outperformed; however, oil and gas lagged despite increasing crude oil prices. The UK small and mid-cap stocks performed well over the quarter, whilst the retail sector performed poorly.

Japan: The Japanese equity market had a very strong quarter; the Nikkei 225 was up 8.9% during Q4, pushing returns to 23.5% over the course of 2019. Japan had a good start to the quarter in October, with textiles & apparels the only sector on the Tokyo Stock Exchange to decline. 'Abenomics' restarted and the BoJ continued with loose monetary policies. However, the Japan-South Korea trade war, the typhoon and the consumption tax weighed on the economy.

China: The MSCI China Index rose by 14.0% over the quarter. The Chinese government continued to support its economy as its growth slows amid the trade war, although a Phase One deal is expected to be signed in mid-January. Despite continued instability in Hong Kong, the Hang Seng (Hong Kong's stock exchange) increased by 8.4% over the quarter.

US: The US stock market made strong gains over the quarter. The S&P 500 index reached record highs in Q4, finishing the quarter up 9.1%. Over the year, the S&P 500 rose 31.5% and was the strongest performing equity index that we track. Well-performing sectors included energy stocks, which rose as the oil price increased, whilst real estate and industrials performed below market average. S&P500 earnings in Q4 are expected to fall, on a per share basis, by -4.7%. Q3 results were a -2.2% decline on Q2.

EU: The Euro STOXX 50 increased by 5.2% in Q4. Like other developed markets, the EU region made strong positive gains over the quarter, boosted by the ECB's re-start of quantitative easing. Sectors that performed well included IT, consumer discretionary and materials.

Emerging Markets: The MSCI Emerging Markets Index was up 11.7% for Q4, bringing returns in 2019 to 18.6%, which whilst strong, is at the lower end of returns for the indices that we track. Civil unrest across some emerging markets held down equity returns, along with continued uncertainty over the US-China trade war. The increase in oil prices helped the stock market returns of some emerging markets, including Russia

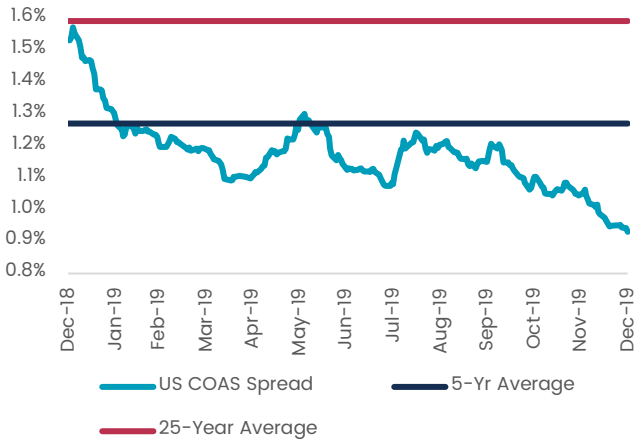
Fixed Income

In Q4, bond yields rebounded from their Q3 lows, as investor sentiment swung to be more "risk-on" in response to a decrease in global uncertainty, accommodative central bank policies and better than expected (although still weak) economic data. Overall, this has meant that government bond prices fell across the board, and corporate bond indices generally (with some exceptions) had a worse quarter than in Q3.

Government Bonds: In Q4, bond yields rose as the impact of accommodative central bank policies was felt and progress was made in US-China trade deal talks. The 10-year US Treasury yield rose by 25 bps and the US yield curve steepened. This was driven by optimism over a potential end to the trade war and better than expected US economic data.

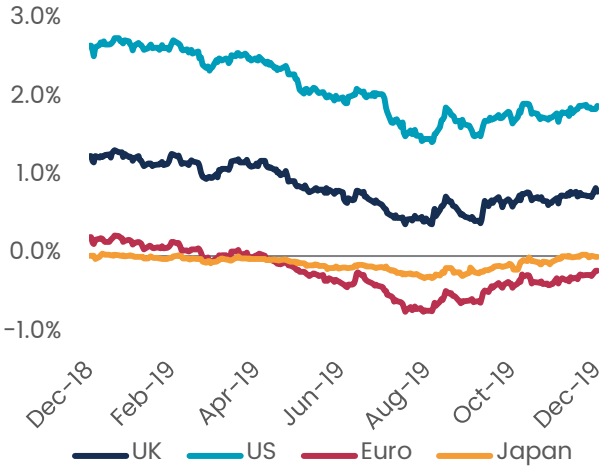
While the leadership of the ECB has changed, policy has not so far. Loose monetary policy continues, although bond yields are rising throughout the Eurozone. French government 10-year yields turned positive, whilst 10-year German bond yields rose from -0.6% to -0.2% Japanese government bond yields also rose but remained negative. In Britain, increased confidence in a Brexit deal was balanced with increased spending proposals by the new government, but overall the UK 10-year yield rose by only 33 bps.

Chart 4: US Corporate Bond Spreads



High Yield Credit: Better than expected economic data allayed fears of a recession; and reduced global tensions helped to propel US High Yield bonds to outperform developed market government bonds, as well as US IG Corporate Bonds. The Bloomberg Barclays US Corporate High Yield TR Index Unhedged returned 2.6% in Q4. US high yield spreads continue to be tighter than the historical average, tightening 27bp over Treasuries.

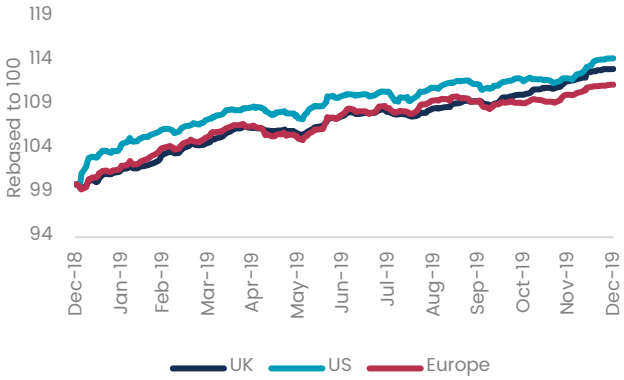
Chart 3: Government Bond Yields



Investment Grade Corporate Bonds: In Q4, IG corporate bonds outperformed government bonds but underperformed US High Yield Bonds. US Investment Grade Corporate Bonds outperformed both pan-European, and UK Corporate Investment Grade Bonds.

The Bloomberg Barclays US Corporate Investment Grade TR Index Unhedged returned 1.2%, bringing the year to date return up to 14.5%. US Corporate Bond spreads tightened due to strong foreign and domestic demand.

Chart 5: High Yield Corporate Bonds Indices



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

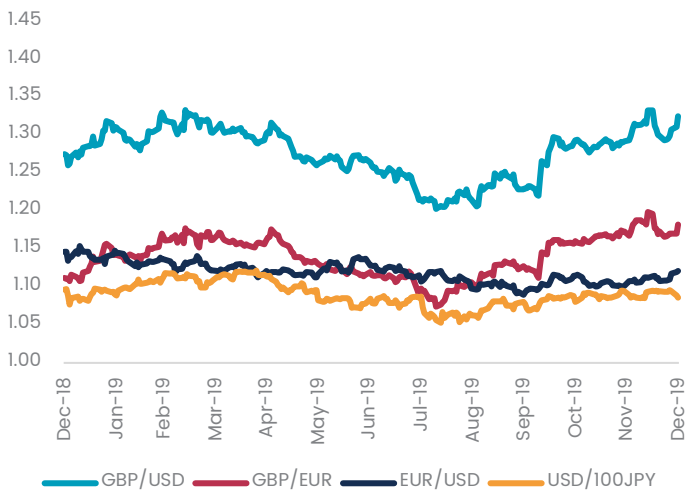
Sterling experienced a volatile quarter as investor concerns shifted from Brexit to the election and then back to Brexit to finish strongly up +7.8%. The Dollar index was down 3.0% due to dovish US central bank policy, the announcement of a potential trade deal and poor domestic economic data. In response, the Euro rose 2.9% against the Dollar. However, the Dollar rose slightly against the Japanese Yen, as investors favoured the Dollar over the Yen. Renminbi held at c.7:1USD due to continued trade war uncertainty and weakening (although still strong) Chinese economic data, balanced by Chinese Government stimulus. The Dollar was also down against the Swiss Franc by -3.2%, reflecting the more general weakness of the Dollar in Q4.

Table 2: Currency Rates as at December 2019

	Quarter-end Value	% Quarter Change
GBP/EUR	1.18	4.65%
GBP/USD	1.33	7.78%
EUR/USD	1.12	2.87%
USD/JPY	108.61	0.49%
USD/CNY	6.96	-2.59%
USD/CHF	0.97	-3.16%

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

Chart 6: One-Year Currency Rates of Major Currency Pairs



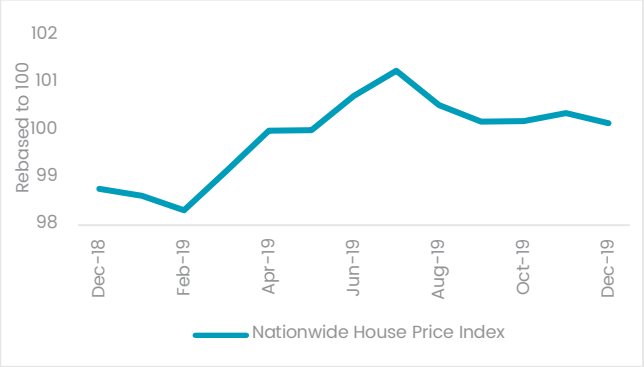
Property

In the UK, property price growth remained subdued but ahead of expectations, with the average UK house price rising by 1.4% (seasonally adjusted) to £215,282 in Q4 2019. UK property funds experienced a turbulent year, with a record £2.2 billion of outflows, the rate of which rose sharply in December, following the suspension of redemptions from M&G's Property Portfolio.

Commercial Property: Greenstreet figures show that commercial property prices rose by 1.0% in Q4 and by 3.0% in 2019. Office property values, in particular, stayed flat across the quarter, which contrasts with industrial property values, which were the best performing in Q4 and rose by 4%.

Residential Property: UK house price growth reached 1.4% in December 2019, according to Nationwide, representing the first time in the past 12 months that growth was higher than 1%. Scotland had the strongest growth in Q4, with the annual change for the quarter standing at 2.8%, up from 0.8% last quarter. Meanwhile, in London, prices fell for the tenth consecutive quarter, resulting in an annual change for the quarter of -1.8%. This is approximately 5% below the Q1 2017 all-time high and around 50% higher than London's 2007 price levels.

Chart 7: 1-Year UK House Price Index



Source: Bloomberg. Nationwide

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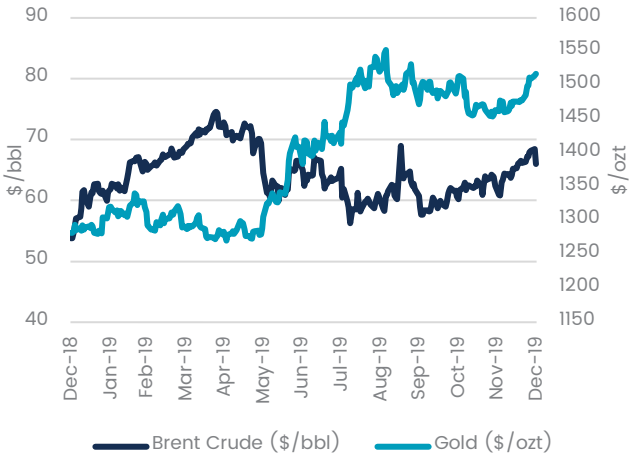
Commodities

Commodities experienced a strong fourth quarter, with gains across much of the spectrum. Soft commodities, oil and precious metals all performed well. Indeed, Brent crude led the energy sector with a rise of 8.6%. However, this contrasts with the -6.1% reduction in natural gas prices. Gold had a mixed quarter, but ultimately ended with a 3.0% increase in price, while silver and palladium gained 5.0% and 16.1% respectively. Copper was up 8.5%, while nickel (used in the production of stainless steel and batteries) reversed course compared to Q3 and declined by -19.0% due to falling demand for stainless steel, with global production mirroring this decline (down -7% YoY), except in China, where production increased by 12.6% in the first nine months of 2019.

Oil: Brent prices rose 8.6% from $60.8 to $66.0 in Q4, as fears of a recession were soothed by stronger than expected economic data and the confirmation of a US-China Phase One trade deal at the end of the quarter. The decision by OPEC+ to cut production by 500,000 bpd pushed prices almost 2% higher. Geopolitical tensions in the Middle East remain and the US-China trade war continues, with no timeline on a full trade deal.

Gold: While Gold ended the quarter up 3.0%, it entered the quarter with a sharp drop in price and stayed in the $1450-$1475/ounce region for most of Q4. It was only in late December, that a sustained rally caused gold prices to recover, with the US Fed announcement that it would not increase interest rates, as well as reduced trading volume. However, it must be highlighted that the price levels in Q3 were the highest they had been since 2013.

Chart 8: Gold and Brent Crude Oil Prices



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

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