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Grayside
Quarterly Portfolio Review
October 2017

Background

The asset allocations and fund selections are reviewed formally on a quarterly basis. This Quarterly Review documents the review that has taken place and any changes resulting from it.

As Nucleus is the main platform used, all funds selected will be checked for availability on this platform.

To put this review in context, it should be read in conjunction with our investment bulletin issued earlier in the month.

Quarterly Market Commentary

The third quarter passed relatively incident free, which led to the continuation of very low volatility levels at equity market level, despite the verbal confrontation between the United States and North Korea. Don't be fooled by headline volatility levels though, as individual stocks saw both large gains and large falls. The greatest volatility has been seen within fixed and currency markets with the strength of the euro and the weakness of the US dollar the most noticeable, which in turn affected the direction of global fixed income markets.

There are always exceptions but the majority of the main global equity markets produced good, positive returns this quarter for sterling-based investors, particularly Asia, emerging markets and Europe, although returns were stronger in local currency terms due to the relative currency movements. Growth stocks continued to outperform in the US, Asia and emerging markets whilst there was outperformance from value in the UK and Europe.

Q3 UK economic growth was disappointing, as consumer spending remained weak with rising inflation eating into disposable income, and was among the weakest within the major global economies. European economic data continues to improve with PMI data still in expansion territory, unemployment falling and inflation remaining stable, albeit lower than the European Central Bank would like. This should be positive for European equities.

The Federal Reserve announced their intention to start their balance sheet reduction programme in October, which will begin through not re-investing a certain proportion of the proceeds of maturing bonds that they currently hold. What effect this will have on markets when it begins is difficult to say. There continues to be a lack of policy direction from Washington with tax reform expected to be the next significant item on the President's agenda.

The weakening US dollar in the quarter, coupled with President Trump's inability to deliver policy objectives, continued to benefit Asia and emerging markets, and returns were very positive. There was a large rise in the price of oil, which was particularly beneficial to market returns from oil exporting countries such as Russia, Brazil and the rest of Latin America, despite the ongoing political turmoil.

Fixed income markets were generally negative in the quarter as the threat of higher inflation, increasing interest rates and reduction in monetary policy support weighed on the asset class. Currency hedged indices and sterling-denominated assets generally outperformed given the movement of sterling relative to the US dollar in particular. Global government bond and credit markets were negative with the main positive being emerging market debt. Further price weakness could be seen in government bonds over the next 12 months, as traditionally ten-year government bond yields should be around nominal GDP levels.

UK commercial property continues to produce relatively consistent monthly returns with income being the main driver, as opposed to capital appreciation, and rental growth being more sector and regional specific. Sterling weakness has encouraged overseas investors to invest mainly in London properties, which has, to some extent, countered the possibility of the region suffering declines from Brexit uncertainty. The industrials sector continues to perform strongly, helped by the logistics required to satisfy demand from online purchasing.

Comparative Performance - Benchmarks

Each of the portfolios has a composite benchmark for performance comparison purposes whose underlying constituents represent the sector averages for each fund selected within the portfolio (e.g. UK Gilt for Allianz UK Gilt, UK All Companies for JOHCM UK Opportunities etc.)

Strategic Asset Allocations

We made some changes to the high level asset allocations in the October 2016 quarterly review and we are not proposing any further changes at this time.

Below are the strategic asset allocations that became effective from 1st November 2016:

Risk Level	Cautious	Balanced	Progressive	Adventurous	Specialist
Asset Allocation	**%**	**%**	**%**	**%**	**%**
UK Equities	15.00%	30.00%	33.00%	36.00%	38.00%
International Equities	5.00%	16.00%	26.00%	34.00%	44.00%
Specialist Equities	0.00%	0.00%	4.00%	8.00%	16.00%
Property	10.00%	10.00%	10.00%	10.00%	0.00%
Fixed Interest	68.00%	42.00%	25.00%	10.00%	0.00%
Cash	2.00%	2.00%	2.00%	2.00%	2.00%
	100.00%	100.00%	100.00%	100.00%	100.00%
Specialist Equities = Emerging Markets & Specialist					

Growth Portfolios

Performance of the Growth portfolios during the quarter was good with only the Cautious portfolio underperforming its composite benchmark, although the levels of outperformance from the others were not significant. The highest risk portfolio produced the highest absolute return.

The table below shows the asset allocations of the Growth model portfolios, as at the end of September 2017:

Risk Level	Cautious	Balanced	Progressive	Adventurous	Specialist
Asset Allocation	**%**	**%**	**%**	**%**	**%**
UK Equities	10.00%	30.00%	33.00%	36.00%	38.00%
International Equities	5.00%	16.00%	26.00%	34.00%	48.00%
Specialist Equities	0.00%	0.00%	4.00%	8.00%	12.00%
Property	10.00%	10.00%	10.00%	10.00%	0.00%
Fixed Interest	58.00%	42.00%	25.00%	10.00%	0.00%
Others	15.00%	0.00%	0.00%	0.00%	0.00%
Cash	2.00%	2.00%	2.00%	2.00%	2.00%

Cautious Growth Portfolio

The Cautious Growth Portfolio underperformed its composite benchmark this quarter but not significantly and produced a small positive return. It performed in line with its most comparable IA sector average. The main contributors to performance, both positive and negative, are highlighted within the sections below.

Multi-Asset, Absolute Return

An allocation to absolute return was negative this quarter, given the negative return from both our fund selections.

The Jupiter fund only produced a small negative return but the Invesco Perpetual fund produced a slightly larger loss.

Fixed Income

Government bond markets – UK, global and index-linked – underperformed credit markets this quarter. Having little direct exposure to conventional UK gilts and no direct exposure to UK index-linked gilts were both positive, as was having some exposure to a sterling hedged fund (Vanguard) within global bonds. High yield was the best performer, so having no conventional exposure was a negative.

Sterling assets outperformed this quarter, which was both a positive and a negative for the portfolio. The in-built hedging in the Standard Life fund helped it to produce a small positive return in a generally tough market for index/inflation-linked assets. It also helped the M&G Global Floating Rate High Yield fund to produce a positive return, although it underperformed its sector average due to outperformance from more conventional high yield.

The M&G Global Macro Bond fund produced a negative return this quarter and underperformed its sector average by a reasonable margin. Being one of the larger portfolio holdings this was a more notable detractor.

The selection of the Schroder fund in place of conventional fixed income exposure was a positive from an absolute perspective, but the fund underperformed within the absolute return sector it sits within.

UK Equities

Fund selection was negative, as both funds underperformed the sector average and the main UK equity index with the Jupiter fund producing a small negative return and underperforming by reasonable margins. Sector allocation was the main negative, mainly due to the lack of exposure to the strongly performing Oil & Gas sector but also the very large overweight to Consumer Services, and stock selection was also negative.

International Equities

Given the outperformance of UK equities this quarter from a sterling investor's perspective, global equity exposure could have been more negative in absolute terms. The average IA global equity fund underperformed relative to the main global equity index but the Artemis fund performed well and outperformed its sector average by a decent margin.

Property

Both the Henderson and Aberdeen property funds outperformed the IA sector average in the composite benchmark, as this was a poor quarter for global property securities. The relative performance of UK commercial property and global/UK/European property securities and REITs funds will always be a factor in these funds' and the portfolio's relative performance.

Changes

We are not recommending any changes to the portfolio this quarter.

Balanced Growth Portfolio

The Balanced Growth Portfolio outperformed its composite benchmark this quarter and produced a reasonable, positive return, and outperformed its most comparable IA sector average. The main contributors to performance, both positive and negative, are highlighted within the sections below.

Fixed Income

Government bond markets – UK, global and index-linked – underperformed credit markets this quarter. Having little direct exposure to conventional UK gilts and no direct exposure to UK index-linked gilts were both positive, as was having some exposure to a sterling hedged fund (Vanguard) within global bonds. High yield was the best performer, so having no specific exposure was a negative. Sterling assets outperformed this quarter and the in-built hedging in the Standard Life fund helped it to produce a small positive return in a generally tough market for index/inflation-linked assets.

The M&G Global Macro Bond fund produced a negative return this quarter and underperformed its sector average by a reasonable margin.

The selection of the Schroder fund in place of conventional fixed income exposure was a positive from an absolute perspective, but the fund underperformed within the absolute return sector in which it sits.

UK Equities

Fund selection was mixed, as the Threadneedle and Investec funds underperformed the sector average and the main UK equity index but the Old Mutual and Schroder funds outperformed both comparators.

International Equities

Given the outperformance of UK equities this quarter from a sterling investor's perspective, global equity exposure could have been more negative in absolute terms. The average IA global equity fund underperformed relative to the main global equity index but both the Baillie Gifford and Old Mutual funds performed well and both outperformed the sector average by decent margins.

Property

Both the Henderson and Aberdeen property funds outperformed the IA sector average in the composite benchmark, as this was a poor quarter for global property securities. The relative performance of UK commercial property and global/UK/European property securities and REITs funds will always be a factor in these funds' and the portfolio's relative performance.

Changes

We are recommending a couple of related changes to the portfolio this quarter.

To emphasise our current asset allocation views we would like to incorporate an underweight position to UK equities versus the strategic asset allocation and an overweight to international equities. We would also like to introduce an underweight to fixed income, in addition to some of our more defensive fixed income holdings.

It is recommended to add 5% to international equities and to adopt 2% and 3% underweight positons to UK equities and fixed income respectively. The **Artemis Global Growth fund**, which is a pragmatic, stock picking fund, will be added to the portfolio.

Progressive Growth Portfolio

The Progressive Growth Portfolio outperformed its composite benchmark this quarter and produced a good, positive return and outperformed its most comparable IA sector average despite having a relatively low equity content versus the average. The main contributors to performance, both positive and negative, are highlighted within the sections below.

Fixed Income

Government bond markets – UK, global and index-linked – underperformed credit markets this quarter. Having no direct exposure to conventional UK gilts and UK index-linked gilts were both positive. High yield was the best performer, so having no specific exposure was a negative.

Fund selection was very positive overall, as the Templeton Global Total Return Bond fund was the only fund selection to underperform its IA sector average, although it underperformed the main global bond indices by smaller margins.

UK Equities

Fund selection was marginally positive overall, as the Franklin and Investec funds underperformed the sector average and the main UK equity index but the Old Mutual UK Alpha and Schroder funds outperformed both comparators.

Marginally the best performer was the Old Mutual UK Mid Cap fund, which benefited from the general outperformance of mid-caps but the fund also marginally outperformed its own benchmark index.

International Equities

Given the outperformance of UK equities this quarter from a sterling investor's perspective, global equity exposure could have been more negative from an absolute perspective. The average IA global equity fund underperformed relative to the main global equity index but both the Threadneedle and Old Mutual funds performed well and both outperformed the sector average by decent margins.

Asian equities outperformed on a global basis, so specific exposure was positive, and the BlackRock fund outperformed its peer group and benchmark index.

Emerging Market equities comfortably outperformed on a global basis. Specific exposure would have been more positive but the Lazard fund underperformed its sector and benchmark index, as its 'value' investment style significantly underperformed 'growth' again this quarter.

European equities also outperformed and fund selection was very positive, as the BlackRock European Dynamic fund significantly outperformed its peer group and comfortably outperformed the main European equity index. Stock selection was the main performance driver, particularly in the Consumer Services, Industrials and Technology sectors.

Japan equities underperformed this quarter. Specific exposure would have been more negative but the Schroder fund outperformed the index and marginally outperformed its sector average.

Property

Both the Threadneedle and Aberdeen property funds outperformed the IA sector average in the composite benchmark, as this was a poor quarter for global property securities. The relative performance of UK commercial property and global/UK/European property securities and REITs funds will always be a factor in these funds' and the portfolio's relative performance.

Changes

We are recommending a couple of related changes to the portfolio this quarter.

To emphasise our current asset allocation views we would like to incorporate an underweight position to UK equities versus the strategic asset allocation and an overweight to international equities. We would also like to introduce an underweight to fixed income, in addition to some of our more defensive fixed income holdings.

It is recommended to add 5% to international equities and to adopt 2% and 3% underweight positons to UK equities and fixed income respectively. Increases will be made to our global equity holdings and to our preferred Asian and European equity regions.

Adventurous Growth

The Adventurous Growth Portfolio outperformed its composite benchmark this quarter and produced a good, positive return. It also comfortably outperformed its most comparable IA sector average. The main contributors to performance, both positive and negative, are highlighted within the sections below.

Fixed Income

Government bond markets – UK, global and index-linked – underperformed credit markets this quarter. Having no specific exposure to conventional UK gilts, UK index-linked gilts and global government bonds were all positive. High yield was the best performer, so having no specific exposure was a negative.

Fund selection was positive overall, as both strategic bond funds outperformed their sector average with the TwentyFour fund producing the strongest return.

UK Equities

Fund selection was positive overall, as only the Franklin fund underperformed the sector average and the main UK equity index, with AXA Framlington, Old Mutual UK Alpha and Schroder funds outperforming both comparators.

Marginally the best performer was the Old Mutual UK Mid Cap fund, which benefited from the general outperformance of mid-caps but the fund also marginally outperformed its own benchmark index.

International Equities

Given the outperformance of UK equities this quarter from a sterling investor's perspective, global equity exposure could have been more negative from an absolute perspective.

Asian equities outperformed on a global basis, so specific exposure was positive but fund selection was a slight detractor despite the BlackRock fund outperforming its peer group and benchmark index. The reason was the negative return and reasonably significant underperformance from the Stewart Investors Asia Pacific Leaders fund. Sector allocation was negative mainly due to the large overweight positions in Healthcare and Consumer Staples, regional exposure was negative almost exclusively due only having a very small weighting to China and stock selection was negative, inclusive of some off-benchmark positions.

Emerging Market equities comfortably outperformed on a global basis. Specific exposure was more positive due to outperformance from the JPM fund.

European equities also outperformed and fund selection was marginally positive, as the Schroder European Alpha Plus fund significantly outperformed its peer group and outperformed the main European equity index by a greater margin than the Jupiter fund underperformed by. The fund's style allocation, particularly being underweight growth defensives, was a positive but the main positive was stock selection within their growth defensives and industrial cyclicals categories.

Japan equities underperformed this quarter. Specific exposure was slightly more negative due to underperformance from the Man GLG fund, which suffered from the underperformance of large cap value stocks and sectors within Japan. The Schroder Tokyo fund outperformed the index and marginally outperformed its sector average.

US equities underperformed this quarter so only having a relatively small weighting was a positive. In addition, the Artemis fund outperformed its sector average and the main index by decent margins.

Property

Both the F&C and Threadneedle property funds outperformed the IA sector average in the composite benchmark, as this was a poor quarter for global property securities. The relative performance of UK commercial property and global/UK/European property securities and REITs funds will always be a factor in these funds' and the portfolio's relative performance.

Changes

We are recommending a number of changes to the portfolio this quarter.

To emphasise our current asset allocation views we would like to incorporate an underweight position to UK equities versus the strategic asset allocation and an overweight to international equities. We would also like to introduce an underweight to fixed income, in addition to some of our more defensive fixed income holdings.

It is recommended to add 5% to international equities and to adopt 2% and 3% underweight positons to UK equities and fixed income respectively. Increases will be made to our preferred Asian and European equity regions.

In addition, although we understand the reasons behind the underperformance, the Stewart Investors fund has been a little disappointing recently and we suggest switching to another core fund, **First State Asia Focus**, which has a slightly more pragmatic investment approach.

Specialist Growth Portfolio

The Specialist Growth Portfolio outperformed its composite benchmark this quarter and produced a good, positive return. It also comfortably outperformed its most comparable IA sector average. The main contributors to performance, both positive and negative, are highlighted within the sections below.

UK Equities

Fund selection was positive overall, as only the Investec fund underperformed the sector average and the main UK equity index of the 'mainstream' funds with the Legal & General UK Alpha fund performing particularly well with stock selection a significant positive, mainly in the Industrials and Healthcare sectors, as sector allocation was marginally negative.

Marginally the best performer was the Old Mutual UK Mid Cap fund, which benefited from the general outperformance of mid-caps but the fund also marginally outperformed its own benchmark index.

Specific smaller companies exposure would have been much more positive but for reasonable underperformance of its sector average from the Franklin fund. Despite this, the fund only underperformed its own benchmark index by a relatively small margin.

International Equities

Given the outperformance of UK equities this quarter from a sterling investor's perspective, global equity exposure could have been more negative from an absolute perspective.

Asian equities outperformed on a global basis, so specific exposure was positive and fund selection was a further positive as both funds outperformed the peer group and benchmark index by decent margins.

Emerging Market equities comfortably outperformed on a global basis and there was outperformance from the JPM fund. Smaller companies underperformed within the region, which did not help the Franklin Templeton fund, but it also underperformed its own benchmark index by a reasonable margin. The smaller portfolio weighting reduced the impact.

European equities also outperformed and fund selection was marginally positive, as the Schroder European Alpha Plus fund significantly outperformed its peer group and outperformed the main European equity index by a greater margin than the Jupiter fund underperformed by. The fund's style allocation, particularly being underweight growth defensives, was a positive but the main positive was stock selection within their growth defensives and industrial cyclicals categories.

Japan equities underperformed this quarter. Specific exposure was slightly more negative due to underperformance from the Man GLG fund, which suffered from the underperformance of large cap value stocks and sectors within Japan. The Schroder Tokyo fund outperformed the index and marginally outperformed its sector average.

US equities underperformed this quarter so only having a relatively small weighting was a positive. In addition, the Artemis fund outperformed its sector average and the main index by decent margins.

Changes

We are recommending a number of changes to the portfolio this quarter.

To emphasise our current asset allocation views we would like to incorporate an underweight position to UK equities versus the strategic asset allocation and an overweight to international equities.

It is recommended to add 4% to international equities and to decrease UK equities by the same amount. Increases will be made to our preferred Asian and European equity regions.

Income Portfolios

Performance of the Income portfolios during the quarter was good, as they outperformed or performed very close to their composite benchmarks, although the levels of outperformance were relatively small. The highest risk portfolio produced the highest absolute return.

The table below shows the current asset allocations of the Income model portfolios, as at the end of September 2017:

Risk Level	Cautious Income	Balanced Income	Progressive Income
Asset Allocation			
UK Equities	13.00%	26.00%	30.00%
International Equities	7.00%	18.00%	29.00%
Specialist Equities	0.00%	0.00%	0.00%
Property	10.00%	10.00%	10.00%
Fixed Interest	68.00%	44.00%	29.00%
Others	0.00%	0.00%	0.00%
Cash	2.00%	2.00%	2.00%

Cautious Income Portfolio

The Cautious Income Portfolio outperformed its composite benchmark this quarter and produced a small positive return. It also outperformed its most comparable IA sector average. The main positive and negative contributors are highlighted within the sections below.

Fixed Income

Government bond markets – UK, global and index-linked – underperformed credit markets this quarter. Having no direct exposure to conventional UK gilts and UK index-linked gilts were both positive. High yield was the best performer, so having no conventional exposure was a negative.

Sterling assets outperformed this quarter, which was both a positive and a negative for the portfolio. The in-built hedging in the Standard Life fund helped it to produce a small positive return in a generally tough market for index/inflation-linked assets. It also helped the M&G Global Floating Rate High Yield fund to produce a positive return, although it underperformed its sector average due to outperformance from more conventional high yield.

The Templeton Global Bond fund was the most notable underperformer this quarter.

UK Equities

The small underweight to UK equities versus the strategic asset allocation was a marginal negative given their small outperformance globally this quarter.

Fund selection was marginally positive overall, as the Premier fund outperformed the IA sector average and the main UK equity index by a larger margin than the Threadneedle underperformed by.

International Equities

Given the small outperformance of UK equities this quarter, global equity exposure was marginally negative from an absolute perspective.

This was offset to a small degree by outperformance from the Artemis fund versus its sector average, although it marginally underperformed the main global equity index.

Property

Both the Henderson and Aberdeen property funds outperformed the IA sector average in the composite benchmark, as this was a poor quarter for global property securities. The relative performance of UK commercial property and global/UK/European property securities and REITs funds will always be a factor in these funds' and the portfolio's relative performance.

Changes

We are recommending a couple of linked changes to the portfolio this quarter.

The medium to longer-term outlook for fixed income returns remains relatively unattractive, particularly from more conventional assets, and we would like to diversify away from fixed income, taking an underweight position versus the strategic asset allocation and introducing an alternative income fund.

The **VT (Gravis) UK Infrastructure Income** fund is managed by an infrastructure specialist, Gravis Capital Partners, and invests predominantly in infrastructure-related investment trusts but can also invest in equities and fixed income. It targets a 5% income yield and provides something different to the portfolio. Reductions will be made to our investment grade corporate bond holdings to accommodate this.

Balanced Income Portfolio

The Balanced Income Portfolio outperformed its composite benchmark this quarter and produced a reasonable, positive return. It also outperformed its most comparable IA sector average. The main positive and negative contributors are highlighted within the sections below.

Fixed Income

The small overweight to fixed income versus the strategic asset allocation was a negative this quarter.

Government bond markets – UK, global and index-linked – underperformed credit markets this quarter. Having no direct exposure to conventional UK gilts and UK index-linked gilts were both positive. High yield was the best performer, so having no conventional exposure was a negative.

Sterling assets outperformed this quarter, which was both a positive and a negative for the portfolio. The in-built hedging in the Standard Life fund helped it to produce a small positive return in a generally tough market for index/inflation-linked assets. It also helped the M&G Global Floating Rate High Yield fund to produce a positive return, although it underperformed its sector average due to outperformance from more conventional high yield.

The Templeton Global Total Return Bond fund was the most notable underperformer this quarter.

UK Equities

The underweight to UK equities versus the strategic asset allocation was a marginal negative given their small outperformance globally this quarter.

Fund selection was very mixed, as the Premier and JOHCM funds comfortably outperformed the IA sector average and the main UK equity index but the Threadneedle and Invesco Perpetual funds both underperformed, the latter by a large margin.

International Equities

Given the small outperformance of UK equities this quarter, global equity exposure was marginally negative from an absolute perspective.

This was offset to a small degree by positive fund selection overall with outperformance from the Artemis and Schroder funds versus the sector average, with the latter performing particularly strongly, but reasonably large underperformance from the Fidelity fund.

Property

Both the Henderson and Aberdeen property funds outperformed the IA sector average in the composite benchmark, as this was a poor quarter for global property securities. The relative performance of UK commercial property and global/UK/European property securities and REITs funds will always be a factor in these funds' and the portfolio's relative performance.

Changes

We are recommending a couple of linked changes to the portfolio this quarter.

The medium to longer-term outlook for fixed income returns remains relatively unattractive, particularly from more conventional assets, and we would like to diversify away from fixed income, taking an underweight position versus the strategic asset allocation and introducing an alternative income fund.

The **VT (Gravis) UK Infrastructure Income** fund is managed by an infrastructure specialist, Gravis Capital Partners, and invests predominantly in infrastructure-related investment trusts but can also invest in equities and fixed income. It targets a 5% income yield and provides something different to the portfolio. Reductions will be made to our investment grade corporate bond and strategic bond holdings to accommodate this.

Progressive Income Portfolio

The Progressive Income Portfolio performed virtually in line with its composite benchmark this quarter and produced a positive return. It also marginally underperformed its most comparable IA sector average. The main positive and negative contributors are highlighted within the sections below.

Fixed Income

The overweight to fixed income versus the strategic asset allocation was a negative this quarter.

Government bond markets – UK, global and index-linked – underperformed credit markets this quarter. Having no direct exposure to conventional UK gilts and UK index-linked gilts were both positive. High yield was the best performer, so having no conventional exposure was a negative.

Sterling assets outperformed this quarter, which helped the M&G Global Floating Rate High Yield fund to produce a positive return, although it underperformed its sector average due to outperformance from more conventional high yield.

The Templeton Global Total Return Bond fund was the most notable underperformer this quarter.

UK Equities

The underweight to UK equities versus the strategic asset allocation was a marginal negative given their small outperformance globally this quarter.

Fund selection was very mixed, as the Marlborough, JOHCM and Schroder funds all comfortably outperformed the IA sector average and the main UK equity index but the Threadneedle and Invesco Perpetual funds both underperformed, the latter by a large margin.

International Equities

Given the small outperformance of UK equities this quarter, global equity exposure was marginally negative from an absolute perspective.

Fund selection was very mixed, as the Artemis and Schroder funds outperformed the sector average, with the latter performing particularly strongly. There was reasonably large underperformance from both the Threadneedle and Fidelity funds. The former suffered from negative stock selection over the period, particularly in July and August and in the Consumer, Financials and Information Technology sectors. September was a much stronger month with positive stock selection across a number of different sectors.

Property

Both the Threadneedle and Aberdeen property funds outperformed the IA sector average in the composite benchmark, as this was a poor quarter for global property securities. The relative performance of UK commercial property and global/UK/European property securities and REITs funds will always be a factor in these funds' and the portfolio's relative performance.

Changes

We are recommending a couple of linked changes to the portfolio this quarter.

The medium to longer-term outlook for fixed income returns remains relatively unattractive, particularly from more conventional assets, and we would like to diversify away from fixed income, taking an underweight position versus the strategic asset allocation and introducing an alternative income fund.

The **VT (Gravis) UK Infrastructure Income** fund is managed by an infrastructure specialist, Gravis Capital Partners, and invests predominantly in infrastructure-related investment trusts but can also invest in equities and fixed income. It targets a 5% income yield and provides something different to the portfolio. Reductions will be made to a combination of our investment grade corporate bond, strategic bond and global bond holdings to accommodate this.

SRI Portfolios

Below are comments relating to fund performance this quarter where all three SRI portfolios outperformed their respective composite benchmarks.

The table below shows the current asset allocations of the SRI model portfolios, as at the end of September 2017:

Risk Level	SRI Cautious	SRI Balanced	SRI Progressive
Asset Allocation	**%**	**%**	**%**
UK Equities	14.50%	27.00%	28.00%
International Equities	9.00%	22.00%	38.00%
Specialist Equities	0.00%	0.00%	0.00%
Fixed Interest	74.50%	49.00%	32.00%
Cash	2.00%	2.00%	2.00%

Fixed Income

Government bond markets – UK, global and index-linked – underperformed credit markets this quarter. Having no direct exposure to conventional UK gilts and UK index-linked gilts were both positive. High yield was the best performer, which helped the average strategic bond fund to outperform the average investment grade bond fund, albeit not significantly.

All our fixed income funds outperformed the relevant index within the composite benchmarks, very comfortably in the case of the Rathbone fund, with the focus on credit over government bonds being very beneficial. The Royal London fund underperformed its IA sector average but was the only fund to do so.

UK Equities

The underweight to UK equities versus the strategic asset allocation was a marginal negative given their small outperformance globally this quarter.

The average UK All Companies fund performed in line with the UK equity index within the composite benchmark, so fund selection was the main driver of relative performance. The typical bias towards medium-sized and smaller companies of SRI/ethical funds was a positive this quarter due to their outperformance versus larger companies.

As a result, the Amity UK fund was the only one in this part of the portfolio to underperform its IA sector average, although this was not by a significant margin. There was particularly strong performance from the Standard Life UK Ethical fund, which is in the Balanced and Progressive portfolios. At sector level, performance was driven by the natural lack of exposure to the Tobacco and Pharmaceuticals sectors and an overweight to General Retailers with the lack of exposure to Oil

& Gas and Mining the main negatives. Stock selection was very positive with contributions across a number of different sectors.

International Equities

Given the small outperformance of UK equities this quarter, the overweight to global equities was marginally negative from an absolute perspective.

The average IA Global fund underperformed the global equity index within the composite benchmark, so this was a marginal headwind for performance. Fund selection was negative overall, as only the Jupiter Ecology fund outperformed the sector and benchmark index.

The Stewart Investors Worldwide Sustainability fund produced a small negative return over the quarter. Sector allocation was a key negative mainly due to the significant overweight position in the Consumer Staples sector, regional exposure was marginally positive but stock selection within countries was negative, particularly in the US, Japan and Germany.

Changes

We are recommending one change to all the portfolios this quarter.

In order to further diversify our fixed income holdings, where some of the weightings are larger than we would ideally like to due to the lack of quality choice, we recommend adding the **Amity Sterling Bond** fund to all the portfolios, which has recently become an RSMR SRI-rated fund. Each of the existing fixed income fund holdings will be reduced to accommodate this.

Summary

Markets continue to benefit from a synchronised global recovery at a time when monetary policy remains accommodative overall despite talks of withdrawal/tapering/reduction. This ‘goldilocks scenario’ of growth neither too hot nor too cold has provided investors with what can be described as the ‘Best of Both.’ This current sweet spot for equity markets may persist for a while yet, although the market’s reaction to ongoing central bank talk of tighter monetary conditions will be interesting, with the possibility of increased volatility after a period of unusual calm in markets. Tighter monetary policy may lead to some level of multiple contraction, resulting in markets lagging earnings growth. It is also possible that the Trump administration will enact something in the way of tax reform in the coming months thereby extending the US economic cycle, benefiting US corporates and prolonging the global economic recovery but, as ever, the devil will be in the detail.

Although below trend, global growth is still on a positive trajectory, so our favoured asset class remains equities, with more of a preference for non-UK equities versus UK equities. Within equity markets both Europe and Asia have scope to continue to play catch-up and are at last seeing earnings upgrades. Japan is still a preferred region with economic growth stronger than expected and attractive valuations (relative to their history) on both a Price-to-Book basis and versus comparable markets. We remain relatively negative on UK equities in general, as UK inflation has been rising, consumer spending has been weakening, Brexit negotiations have shown no signs of any breakthroughs and equities could be affected by rising bond yields. Small caps are our least favoured area of the UK due to the lower liquidity and their more domestic focus. We have maintained our balanced view regarding investment styles, as we are not totally convinced that value will outperform growth. Should there be more signs of improving economic growth, more consistent inflation increases, higher interest rates and higher bond yields, then there may be periods when value strongly outperforms.

Credit continues to offer the best risk/return in fixed interest. Well-managed strategic bond funds where managers have proven macro skills are a worthy part of an investor's portfolio. UK government bonds (gilts) remain our least preferred underlying sub-asset class, although we are negative on global sovereign debt as a whole. Absolute return, whilst having a place in portfolios, is dependent on manager skill so easy gains are not possible. At this stage of the cycle an appreciation of risk and strong manager selection is important.

In markets where there is little margin of safety due to full valuations, risk is something investors also need to consider, as when an economic downturn does occur high levels of leverage are likely to impact negatively, and operational gearing for some companies will have risen. This suggests investors should hold diversified portfolios rather than trying to win big by making a few big calls. Going back to basics, whilst fundamentals are improving, valuation is not on the investors' side and investor sentiment is mixed. There also remains the possibility of policy mistakes by central banks and whilst it is accepted that the sensitivity of the global economy to a rise in interest rates has increased, it is impossible to measure the extent of this.

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