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Grayside
Quarterly Portfolio Review
April 2018

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.

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

Quarterly Market Commentary

In complete contrast to the whole of 2017, the first quarter of 2018 saw the return of volatility and very negative returns from equities which seemed to catch many investors by surprise, despite the ongoing global synchronised economic growth environment and the supportive monetary policy backdrop. The first concern was the improving US wage growth data, which investors interpreted as meaning the Federal Reserve may need to raise interest rates faster than expected. The second concern, later in the quarter, was the verbal escalation in trade wars (tariffs) between the US and China, although nothing has actually been implemented at the time of writing.

From a sterling investor's perspective, returns from the majority of global equity markets were negative with the UK being the worst performer amongst the major regions and Japan and emerging markets outperforming. Returns from overseas markets were much better in local currency terms with the exception of Japan due to relative currency movements. Growth stocks outperformed value in most regions, most notably the US and Japan, with the main exceptions of emerging markets and, to a much smaller degree, Europe.

The UK was the worst performing major region. Consumer spending and retail sales remain weak, inflation is still above target and above current wage inflation, and debt levels have increased to support spending habits and/or service old debts. Brexit is an ever-present concern with the market fluctuating on positive and negative news regarding negotiations with the EU. European economic data continues to be very positive with strong PMI figures, unemployment falling further and inflation stabilising below target with euro strength and politics (Italy, formation of a German government, anti-EU rhetoric from Hungary / Poland / Turkey) being the main concerns.

The Federal Reserve began their balance sheet reduction programme in October, so we are still in the relatively early days, and any significant impact may not be known for some time. Monetary policy is certainly becoming less accommodative. President Trump has finally pushed through his corporate tax reforms, which should be positive for corporate earnings, particularly mid-cap and smaller companies, and with mid-term elections due in November we may see more proposed reforms over the coming months.

Fixed income markets performed much better than equity markets but were very mixed in terms of which produced a positive absolute return. The conventional and index-linked UK government bond markets outperformed and produced small positive returns with longer-dated assets producing the best returns. Corporate bond markets, investment grade and high yield, both in the UK and globally, underperformed their government bond counterparts and produced negative returns. Emerging market debt was the best performer, producing a reasonable positive return. Relative currency movements meant that sterling-hedged assets comfortably outperformed their unhedged equivalents.

UK commercial property continued 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.

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 any UK gilt holdings and UK All Companies for any UK equity growth)

Strategic Asset Allocations

We made some changes to the high level asset allocations in the last quarterly review, so we are not proposing any changes this quarter

Below are the current strategic asset allocation that became effective in February 2018:

Risk Level	Cautious	Balanced	Progressive	Adventurous	Specialist
Asset Allocation	**%**	**%**	**%**	**%**	**%**
Cash	2.00%	2.00%	2.00%	2.00%	2.00%
UK Equities	10.00%	23.00%	31.50%	36.00%	38.00%
International Equities	10.00%	23.00%	31.50%	42.00%	60.00%
Property	10.00%	10.00%	10.00%	10.00%	0.00%
Fixed Interest	68.00%	42.00%	25.00%	10.00%	0.00%
Absolute Return	0.00%	0.00%	0.00%	0.00%	0.00%
Others	0.00%	0.00%	0.00%	0.00%	0.00%
	100.00%	100.00%	100.00%	100.00%	100.00%

Growth Portfolios

Performance of the Growth portfolios was negative across the board with the lower risk portfolios producing the better returns but they all outperformed their respective comparative composite benchmarks and most outperformed their comparative IA sector averages.

The tables below show the model asset allocations of the Growth model portfolios, as at the end of March 2018, and the differences to the main strategic asset allocations:

Portfolio Allocations

Risk Level	Cautious	Balanced	Progressive	Adventurous	Specialist
Asset Allocation	**%**	**%**	**%**	**%**	**%**
Cash	2.00%	2.00%	2.00%	2.00%	2.00%
UK Equities	7.50%	21.00%	29.50%	34.00%	34.00%
International Equities	7.50%	28.00%	36.50%	47.00%	64.00%
Property	10.00%	10.00%	10.00%	10.00%	0.00%
Fixed Interest	58.00%	39.00%	22.00%	7.00%	0.00%
Absolute Return	15.00%	0.00%	0.00%	0.00%	0.00%
Others	0.00%	0.00%	0.00%	0.00%	0.00%

Differences to SAA

Risk Level	Cautious	Balanced	Progressive	Adventurous	Specialist
Asset Allocation	**%**	**%**	**%**	**%**	**%**
Cash	0.00%	0.00%	0.00%	0.00%	0.00%
UK Equities	-2.50%	-2.00%	-2.00%	-2.00%	-4.00%
International Equities	-2.50%	5.00%	5.00%	5.00%	4.00%
Property	0.00%	0.00%	0.00%	0.00%	0.00%
Fixed Interest	-10.00%	-3.00%	-3.00%	-3.00%	0.00%
Absolute Return	15.00%	0.00%	0.00%	0.00%	0.00%
Others	0.00%	0.00%	0.00%	0.00%	0.00%

Cautious Growth Portfolio

The Cautious Growth Portfolio produced a negative return but outperformed its composite benchmark this quarter and outperformed 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

The allocation to absolute return in favour of fixed income and equities was marginally positive due to the negative returns from equities this quarter. The Invesco Perpetual fund produced a very small positive return whilst the Jupiter fund produced a small negative return.

Fixed Income

The conventional and index-linked UK government bond markets were the main outperformers this quarter, so only having a small exposure to the former and having no direct exposure to the latter was negative for the portfolio. Corporate bonds and high yield underperformed government bonds both in the UK and globally, which was negative for the average strategic bond fund. Unhedged global bond funds also had a relatively difficult quarter, partly due to currency movements.

The majority of the fixed income holdings in the portfolio produced a negative return, albeit relatively small in most cases.

The Standard Life fund has been selected in place of UK index-linked exposure and this was a small negative for absolute returns but the fund did outperform its IA sector average by a decent margin.

The selection of the Schroder Absolute Return Bond fund in place of conventional fixed income exposure was positive, as the fund produced a reasonable, positive return, and the fund also comfortably outperformed within the IA absolute return sector it sits within.

The M&G Global Floating Rate High Yield fund produced a very small negative return but outperformed its more conventional high yield sector average.

The worst performer of the fixed income holdings was the M&G Global Macro Bond fund, although it underperformed its IA sector average by an acceptable margin.

UK Equities

The average IA UK All Companies fund outperformed the main UK equity index by a reasonable margin this quarter. Fund selection was very marginally positive, as the Investec fund marginally outperformed the IA sector average.

International Equities

The average IA Global fund marginally underperformed the main global equity index and fund selection was negative, as the Artemis fund underperformed the IA sector average.

Property

Both property funds continued to produce solid, positive returns and comfortably outperformed the IA sector average, 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 portfolio changes this quarter.

Balanced Growth Portfolio

The Balanced Growth Portfolio produced a negative return but outperformed its composite benchmark this quarter 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

The conventional and index-linked UK government bond markets were the main outperformers this quarter, so only having a small exposure to the former and having no direct exposure to the latter was negative for the portfolio. Corporate bonds and high yield underperformed government bonds both in the UK and globally, which was negative for the average strategic bond fund. Unhedged global bond funds also had a relatively difficult quarter, partly due to currency movements.

The majority of the fixed income holdings in the portfolio produced a negative return, albeit relatively small in most cases.

The Standard Life fund has been selected in place of UK index-linked exposure and this was a small negative for absolute returns but the fund did outperform its IA sector average by a decent margin.

The selection of the Schroder Absolute Return Bond fund in place of conventional fixed income exposure was positive, as the fund produced a reasonable, positive return, and the fund also comfortably outperformed within the IA absolute return sector it sits within.

The worst performer of the fixed income holdings was the M&G Global Macro Bond fund, although it only underperformed its IA sector average by an acceptable margin.

UK Equities

The average IA UK All Companies fund outperformed the main UK equity index by a reasonable margin this quarter. Fund selection was positive overall, as the Investec and Threadneedle funds marginally outperformed the IA sector average, the Schroder fund strongly outperformed and the Old Mutual fund marginally underperformed. The Schroder fund benefited from very positive stock selection, particularly in the Industrials and Consumer Staples sectors.

International Equities

The average IA Global fund marginally underperformed the main global equity index. Fund selection was mixed, as the Artemis and Troy funds underperformed the IA sector average whereas the Old Mutual and Baillie Gifford funds outperformed, the latter by a decent margin. Country and sector allocations were both positive but the main performance driver was stock selection with US exposure particularly positive and stocks in the Financials and Consumer Discretionary sectors were key contributors.

Property

Both property funds continued to produce solid, positive returns and comfortably outperformed the IA sector average, 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 one fund change to bring greater consistency of UK equity fund selection across the growth portfolios. The **Threadneedle UK fund** is currently only contained in this portfolio and we suggest switching into the **Franklin UK Managers Focus** fund, which already sits within higher risk portfolios.

Progressive Growth Portfolio

The Progressive Growth Portfolio produced a negative return but outperformed its composite benchmark this quarter 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

The conventional and index-linked UK government bond markets were the main outperformers this quarter, so having no direct exposure to both was negative for the portfolio. Corporate bonds and high yield underperformed government bonds both in the UK and globally, which was negative for the average strategic bond fund. Unhedged global bond funds also had a relatively difficult quarter, partly due to currency movements.

All of the fixed income holdings in the portfolio produced a negative return, albeit relatively small in most cases. The worst performer in absolute terms was the Templeton fund, although it only underperformed its IA sector average by a reasonably small margin.

UK Equities

The average IA UK All Companies fund outperformed the main UK equity index by a reasonable margin this quarter. Fund selection was mixed overall, as the Investec fund marginally outperformed the IA sector average, the Schroder and Franklin funds outperformed with the former performing particular well on a relative basis, and the Old Mutual UK Alpha fund marginally underperformed. The Schroder fund benefited from very positive stock selection, particularly in the Industrials and Consumer Staples sectors. The Franklin fund also benefited from positive stock selection, particularly in the Information Technology sector.

The Old Mutual UK Mid-Cap fund also underperformed despite the outperformance of mid-caps versus large caps but the fund underperformed its own benchmark index by an acceptable margin.

International Equities

Having specific exposure to Emerging Markets and Japan was very positive, as these areas outperformed on a global basis, but exposure to Europe was negative, as the region produced a larger negative return and marginally underperformed on a global basis.

The average IA Global fund marginally underperformed the main global equity index. Fund selection was mixed, as the Threadneedle fund underperformed the IA sector average whereas the Old Mutual fund outperformed.

Regional fund selection was neither particularly positive nor particularly negative, as they all performed relatively closely to their respective IA sector averages.

Property

Both property funds continued to produce solid, positive returns and comfortably outperformed the IA sector average, 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 fund changes to bring greater consistency of global equity fund selection across the growth portfolios. The **Threadneedle Global Select** is currently only contained in this portfolio and we suggest removing it and switching into/adding the **Baillie Gifford International** and **Troy Trojan Global Equity** funds, which already sit within the Balanced risk portfolio, and reducing exposure to the Old Mutual Global Equity fund.

Adventurous Growth

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

Fixed Income

The conventional and index-linked UK government bond markets were the main outperformers this quarter, so having no direct exposure to both was negative for the portfolio. Corporate bonds and high yield underperformed government bonds both in the UK and globally, which was negative for the average strategic bond fund. Unhedged global bond funds also had a relatively difficult quarter, partly due to currency movements.

Both of the strategic bond fund holdings in the portfolio produced a very small negative return but outperformed their IA sector average.

UK Equities

The average IA UK All Companies fund outperformed the main UK equity index by a reasonable margin this quarter. Fund selection was mixed overall, as the AXA Framlington fund marginally outperformed the IA sector average, the Schroder and Franklin funds outperformed with the former performing particular well on a relative basis, and the Old Mutual UK Alpha fund marginally underperformed. The Schroder fund benefited from very positive stock selection, particularly in the Industrials and Consumer Staples sectors. The Franklin fund also benefited from positive stock selection, particularly in the Information Technology sector.

The Old Mutual UK Mid-Cap fund also underperformed despite the outperformance of mid-caps versus large caps but the fund underperformed its own benchmark index by an acceptable margin.

International Equities

The main positives, on a relative basis, were the exposures to Emerging Markets and Japan equities, as these areas outperformed on a global basis. Exposure to Europe (equal largest regional weighting) was negative, as the region produced a larger negative return and marginally underperformed on a global basis.

Some of the positive fund selections included the Artemis US Select fund, which outperformed its IA sector average by a reasonably large margin, and the First State Asia Focus fund.

The main negative contributors included the Man GLG Japan Core Alpha fund, which continued to suffer from the general underperformance of the large cap value investment style, and the JPM Emerging Markets fund.

Property

Both property funds continued to produce solid, positive returns and comfortably outperformed the IA sector average, 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 one change to the portfolio this quarter.

We would like to diversify the Emerging Markets exposure and recommend adding the **Lazard Emerging Markets** fund, which already sits within the Progressive portfolio and provides specific exposure to the value investment style in EM.

Specialist Growth Portfolio

The Specialist Growth Portfolio produced a negative return but outperformed its composite benchmark, although it marginally underperformed its most comparable IA sector average, mainly due to its full equity weighting (excluding the residual cash holding). The main contributors to performance, both positive and negative, are highlighted within the sections below.

UK Equities

The average IA UK All Companies fund outperformed the main UK equity index by a reasonable margin this quarter. Fund selection was mixed overall, as the AXA Framlington, Investec and JOHCM funds marginally outperformed the IA sector average and the Schroder and Man GLG funds outperformed with the former performing particular well on a relative basis. The Schroder fund benefited from very positive stock selection, particularly in the Industrials and Consumer Staples sectors. The Man GLG fund also benefited from positive stock selection, particularly in the Information Technology and Energy sectors.

Specific exposure to smaller companies was positive on a relative basis due to their outperformance versus larger companies. In addition, the Franklin fund performed strongly versus the main small cap indices, as did the average IA UK Smaller Companies fund, and outperformed the sector average.

International Equities

The main positives, on a relative basis, were the exposures to Emerging Markets and Japan equities, as these areas outperformed on a global basis. Exposure to Europe (equal largest regional weighting) was negative, as the region produced a larger negative return and marginally underperformed on a global basis.

Some of the positive fund selections included the Artemis US Select and Baillie Gifford Pacific funds, both of which outperformed their respective IA sector averages by reasonably large margins. The inclusion of a smaller companies fund within Emerging Markets was also a noticeable positive.

The main negative contributors included the Man GLG Japan Core Alpha fund, which continued to suffer from the general underperformance of the large cap value investment style, and the JPM Emerging Markets fund.

Changes

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

We would like to diversify the Emerging Markets exposure and recommend adding the **Lazard Emerging Markets** fund, which already sits within the Progressive portfolio and provides specific exposure to the value investment style in EM.

We would also like to diversify the fund holdings in Asia and recommend adding the **First State Asia Focus** fund, which already sits within the Adventurous portfolio, and reducing the Baillie Gifford Pacific and BlackRock Asia fund weightings.

Income Portfolios

Performance of the Income portfolios was negative across the board with the lower risk portfolios producing the better returns but they all outperformed their respective comparative composite benchmarks and two of the three portfolios outperformed their comparative IA sector averages.

The tables below show the current asset allocations of the Income model portfolios, as at the end of March 2018, and the differences to the strategic asset allocations:

Portfolio Allocations

Risk Level	Cautious	Balanced	Progressive
Asset Allocation	**%**	**%**	**%**
Cash	2.00%	2.00%	2.00%
UK Equities	8.00%	19.00%	28.50%
International Equities	12.00%	25.00%	33.50%
Property	10.00%	10.00%	10.00%
Fixed Interest	63.00%	39.00%	21.00%
Absolute Return	0.00%	0.00%	0.00%
Others	5.00%	5.00%	5.00%

Differences to SAA

Risk Level	Cautious	Balanced	Progressive
Asset Allocation	**%**	**%**	**%**
Cash	0.00%	0.00%	0.00%
UK Equities	-2.00%	-4.00%	-3.00%
International Equities	2.00%	2.00%	2.00%
Property	0.00%	0.00%	0.00%
Fixed Interest	-5.00%	-3.00%	-4.00%
Absolute Return	0.00%	0.00%	0.00%
Others	5.00%	5.00%	5.00%

Cautious Income Portfolio

The Cautious Income Portfolio produced a negative return but outperformed its composite benchmark this quarter and also outperformed its most comparable IA sector average. The current historic yield is just below 3½%. The main positive and negative contributors are highlighted within the sections below.

Fixed Income

The conventional and index-linked UK government bond markets were the main outperformers this quarter, so having no direct exposure to both was negative for the portfolio. Corporate bonds and high yield underperformed government bonds both in the UK and globally, which was negative for the average strategic bond fund. Unhedged global bond funds also had a relatively difficult quarter, partly due to currency movements.

All the fixed income holdings in the portfolio produced a negative return, albeit relatively small in most cases.
The Standard Life fund has been selected in place of UK index-linked exposure and this was a small negative for absolute returns but the fund did outperform its IA sector average by a decent margin.

The M&G Global Floating Rate High Yield fund produced a very small negative return but outperformed its more conventional high yield sector average.

The worst performer of the fixed income holdings was the Templeton fund, although it only underperformed its IA sector average by an acceptable margin.

UK Equities

The average IA UK Equity Income fund outperformed the main UK equity index this quarter.

Fund selection was marginally negative overall, as the Threadneedle fund outperformed the sector average by a decent margin but the Premier fund underperformed by a larger margin. It suffered mainly due its holding in Conviviality within the Consumer Staples sector, which fell significantly during the quarter.

International Equities

The average IA Global Equity Income fund underperformed the main global equity index by quite a reasonable margin. Fund selection provided a positive for the portfolio, as both funds outperformed the sector average with the Schroder fund outperforming by a reasonably large margin.

Property

Both property funds continued to produce solid, positive returns and comfortably outperformed the IA sector average, 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

Others

An allocation to the VT Gravis fund was negative on a relative basis, as the fund significantly underperformed the main fixed income markets. UK infrastructure came under pressure from the perceived contagion associated with Carillion and concerns about the effect on the sector of a Labour government.

Changes

We are not recommending any portfolio changes this quarter.

Balanced Income Portfolio

The Balanced Income Portfolio produced a negative return but outperformed its composite benchmark this quarter, although it marginally underperformed its most comparable IA sector average. The current historic yield is just below 3.7%. The main positive and negative contributors are highlighted within the sections below.
Fixed Income

The conventional and index-linked UK government bond markets were the main outperformers this quarter, so having no direct exposure to both was negative for the portfolio. Corporate bonds and high yield underperformed government bonds both in the UK and globally, which was negative for the average strategic bond fund. Unhedged global bond funds also had a relatively difficult quarter, partly due to currency movements.

All the fixed income holdings in the portfolio produced a negative return, albeit relatively small in most cases.

The Standard Life fund has been selected in place of UK index-linked exposure and this was a small negative for absolute returns but the fund did outperform its IA sector average by a decent margin.

The worst performer of the fixed income holdings was the Templeton fund, although it only underperformed its IA sector average by an acceptable margin.

UK Equities

The average IA UK Equity Income fund outperformed the main UK equity index this quarter.

Fund selection was marginally positive overall, as the Threadneedle fund outperformed the sector average by a decent margin and the JOHCM fund also outperformed but the Premier fund underperformed by a large margin. The latter suffered mainly due its holding in Conviviality within the Consumer Staples sector, which fell significantly during the quarter.

International Equities

The average IA Global Equity Income fund underperformed the main global equity index by quite a reasonable margin. Fund selection provided a positive for the portfolio overall, as three of the four fund selections outperformed the sector average with the Schroder fund outperforming by a reasonably large margin.

The outlier was the Threadneedle fund, which underperformed by a reasonable margin. Stock selection was negative in the Consumer Discretionary, Financials and Telecoms sectors.

Property

Both property funds continued to produce solid, positive returns and comfortably outperformed the IA sector average, 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

Others

An allocation to the VT Gravis fund was negative on a relative basis, as the fund significantly underperformed the main fixed income markets. UK infrastructure came under pressure from the perceived contagion associated with Carillion and concerns about the effect on the sector of a Labour government.

Changes

We are recommending one change to the portfolio this quarter, which is a switch from the **Artemis High Income** fund into the **Artemis Strategic Bond** fund. The former has a higher correlation to equities and we have become slightly less positive on high yield as an asset class. The Strategic Bond fund provides greater flexibility.

Progressive Income Portfolio

The Progressive Income Portfolio produced a negative return but outperformed its composite benchmark and also marginally outperformed its most comparable IA sector average. The current historic yield is just over 4%. The main positive and negative contributors are highlighted within the sections below.

Fixed Income

The conventional and index-linked UK government bond markets were the main outperformers this quarter, so only having a small exposure to the former and having no direct exposure to the latter was negative for the portfolio. Corporate bonds and high yield underperformed government bonds both in the UK and globally, which was negative for the average strategic bond fund. Unhedged global bond funds also had a relatively difficult quarter, partly due to currency movements.

All the fixed income holdings in the portfolio produced a negative return, albeit relatively small in most cases.

The worst performer of the fixed income holdings was the Templeton fund, although it underperformed its IA sector average by an acceptable margin.

UK Equities

The average IA UK Equity Income fund outperformed the main UK equity index this quarter.

Fund selection was mixed overall, as the Schroder fund performed very strongly on a relative basis, the Threadneedle fund outperformed the sector average by a decent margin and the JOHCM fund also outperformed but the Marlborough fund underperformed and the Premier fund underperformed by a large margin. It suffered mainly due its holding in Conviviality within the Consumer Staples sector, which fell significantly during the quarter. The Schroder fund benefited from strong stock selection, particularly in the Consumer Staples sector but also good selections in the Financials, IT and Industrials sectors.

International Equities

The average IA Global Equity Income fund underperformed the main global equity index by quite a reasonable margin. Fund selection provided a positive for the portfolio overall, as three of the four fund selections outperformed the sector average with the Schroder fund outperforming by a reasonably large margin.

The outlier was the Threadneedle fund, which underperformed by a reasonable margin. Stock selection was negative in the Consumer Discretionary, Financials and Telecoms sectors.

Property

Both property funds continued to produce solid, positive returns and comfortably outperformed the IA sector average, 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

Others

An allocation to the VT Gravis fund was negative on a relative basis, as the fund significantly underperformed the main fixed income markets. UK infrastructure came under pressure from the perceived contagion associated with Carillion and concerns about the effect on the sector of a Labour government.

Changes

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

SRI Portfolios

Strategic Asset Allocations

We made some changes to the high level asset allocations in the last quarterly review, so we are not proposing any changes this quarter

Below are the current strategic asset allocation that became effective in February 2018:

Risk Level	SRI Cautious	SRI Balanced	SRI Progressive
Asset Allocation	**%**	**%**	**%**
UK Equities	12.00%	24.50%	33.50%
International Equities	11.50%	24.50%	29.00%
Specialist Equities	0.00%	0.00%	4.00%
Fixed Interest	74.50%	49.00%	31.50%
Cash	2.00%	2.00%	2.00%

The tables below shows the model asset allocations of the Growth model portfolios, as at the end of March 2018, and the differences to the main strategic asset allocations:

Portfolio Allocations

Risk Level	SRI Cautious	SRI Balanced	SRI Progressive
Asset Allocation	**%**	**%**	**%**
UK Equities	9.00%	19.50%	27.00%
International Equities	14.50%	29.50%	39.00%
Specialist Equities	0.00%	0.00%	0.00%
Fixed Interest	74.50%	49.00%	32.00%
Cash	2.00%	2.00%	2.00%

Differences to SAA

Risk Level	SRI Cautious	SRI Balanced	SRI Progressive
Asset Allocation	**%**	**%**	**%**
UK Equities	-3.00%	-5.00%	-6.50%
International Equities	3.00%	5.00%	10.00%
Specialist Equities	0.00%	0.00%	-4.00%
Fixed Interest	0.00%	0.00%	0.50%
Cash	0.00%	0.00%	0.00%

Performance

All three portfolios produced negative returns but outperformed their respective composite benchmarks and performed reasonably well relative to the most relevant IA sector averages. Below are comments relating to positive and negative fund contributors.

Fixed Income

The conventional and index-linked UK government bond markets were the main outperformers this quarter, so having no direct exposure to both was negative for the portfolio. Corporate bonds and high yield underperformed government bonds both in the UK and globally, which was negative for the average strategic bond fund.

All the fixed income funds within the portfolios underperformed the fixed income index within the composite benchmarks, as the index contains a healthy level of government bond exposure. All the funds underperformed their respective IA sector averages but only by relatively small margins.

UK Equities

The average IA UK All Companies fund outperformed the main UK equity index by a reasonable margin this quarter and the average IA UK Equity Income fund also outperformed the same index.

Fund selection was very positive across the portfolios, as all the funds outperformed the index in the composite benchmarks and only the Kames Ethical Equity fund underperformed its IA sector average and this was only by a relatively small margin. The strongest relative performer was the Liontrust SF UK Growth fund.

International Equities

The average IA Global fund marginally underperformed the global equity index in the composite benchmarks this quarter.

Fund selection was mainly positive with particularly good relative performance from the WHEB Sustainability fund. The fund’s investment themes were all positive on a relative basis plus there were positive company results from some of the underlying holdings. The Jupiter fund underperformed the sector by a relatively small margin but the worst performer was the Old Mutual Ethical fund, which underperformed the sector and index by reasonably large margins.

Changes

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

Summary

The 'goldilocks scenario' of growth neither too hot nor too cold and the lack of any significant inflationary pressures provided investors with what can be described as the 'Best of Both' in 2017 but the first part of 2018 has seen investors begin to question whether this environment is sustainable, particular when US interest rates are rising and the pace of global monetary policy accommodation is beginning to flatten out. We mentioned in last quarter's summary that the market's reaction to ongoing central bank talk of tighter monetary conditions would be interesting, with the possibility of increased volatility after a period of unusual calm in markets, and that is exactly what we have seen in Q1, albeit reacting to what future US interest rate policy might be (i.e. faster path of rate rises) rather than what it has actually been so far. It is possible that President Trump's corporate tax reforms may extend the US economic cycle, benefiting mainly mid-cap and smaller companies and possibly prolonging the global economic recovery. Our main concern with the US equity market remains valuation levels, although the move upwards has been driven by a select number of large index stocks and sectors, further exacerbated by the amount of money invested into passive strategies, and recent market falls has made the market more attractive on an absolute basis. The 'problem' is that valuation levels also fell in other markets, so the US still looks unattractive on a relative basis.

Global growth is still on a positive trajectory, so our favoured asset class is still 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 seeing positive earnings upgrades, although euro strength is a concern. Japan is also a preferred region with good economic growth levels and attractive valuations both relative to their history and versus comparable markets. 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.
In fixed interest we remain relatively negative on investment grade credit, as yields continue to fall and spreads versus government bonds remain tight, making them increasingly vulnerable to any increase in the underlying government bond yields plus any widening of credit spreads. We have become slightly more negative on high yield, although it is one of our more preferred fixed income markets. The asset class has a higher correlation to equities, corporate leverage levels have increased in places and higher bond yields/interest rates may affect some companies' ability to repay their debts and achieve future refinancing at acceptable rates. Credit still offers a better risk/return than government bond markets where yields are still very low in an environment of potentially rising bond yields and interest rates and good economic and corporate fundamentals. UK government bonds (gilts) are our least preferred sub-asset class, although we are negative on global sovereign debt as a whole but would prefer to take global exposure due to the greater opportunity set.

In markets where there is little margin of safety due to full valuations, risk also needs to be considered, 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 continue to 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 investor's side and investor sentiment has taken a short-term knock having been positive at the start of 2018 – much more so than at the beginning of 2017. 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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