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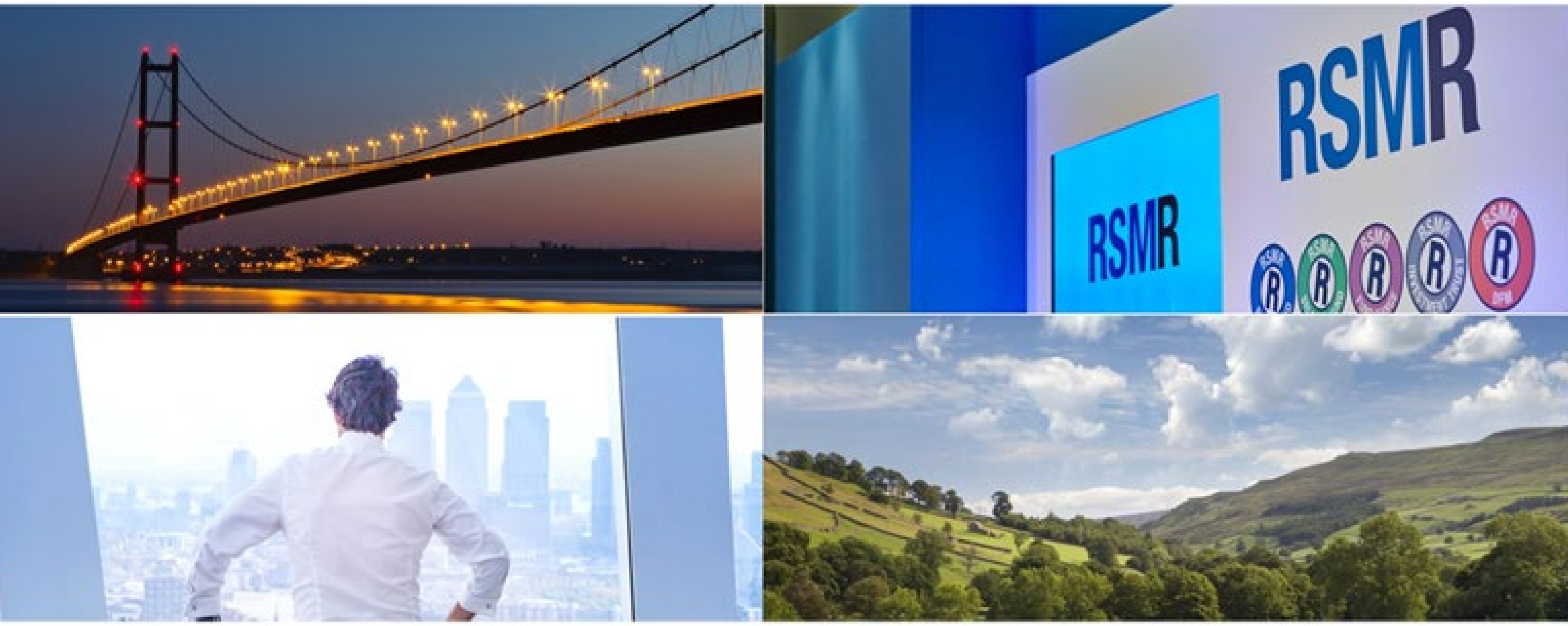

PRIVATE & CONFIDENTIAL

Grayside
Quarterly Portfolio Review
October 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

The third quarter saw a continuation of the strong global equity market returns seen in Q2, following a difficult start of the year. This was despite a number of economic and political concerns, including the potential escalation of trade wars between the US and China, a possible peak in global economic growth, further US interest rate increases and an interest rate increase by the Bank of England, the gradual reduction in global monetary policy stimulus, political uncertainty in Italy, Brazil and Mexico and economic concerns in Turkey and Argentina and possible contagion effects.

From a sterling investor's perspective, returns from individual global equity markets were mixed with very strong returns from the US, good returns from Japan and Europe and flat/slightly negative returns from Asia and emerging markets. The worst performing major developed market was the UK. Value had a better quarter relative to growth in a number of markets, although growth continued to outperform in the US and the UK.

The Bank of England raised interest rates in August, as inflation has started to surprise on the upside despite modest currency weakness, and wage growth has shown further signs of increasing. The Bank cited a disorderly Brexit as a threat to UK growth and Brexit remains a constant topic of debate, with markets fluctuating on any positive or negative news of an exit deal with Europe. European political risk reared its head again with the new Italian government announcing a higher than expected fiscal budget, which is a concern given the already high levels of government debt to GDP. European economic data has begun to weaken but remains positive, unemployment continues to fall across the region, inflation remains well contained but the ECB has stated it will end its QE on buying programme at the end of 2018, but does not expect to raise interest rates until the second half of 2019.

For sterling investors, the US was again the best performing market this quarter, having continued to be driven by 'growth' sectors, particularly technology, with the recent tax cuts having a positive effect on corporate earnings. The latest figures showed strong growth, with inflation gradually increasing but still relatively contained. The Fed continued with their interest rate increases, and they expect to increase rates once more in 2018 and four times in 2019. The main concern relates to the impact on business, inflation, growth etc. of the trade/tariff 'wars' between the US and a number of other countries, particularly China, which escalated this quarter.

Asian and emerging market equities were relatively flat this quarter, not helped by the continued strength of the US dollar (many companies have US dollar denominated debt) and the ongoing trade/tariff 'wars' between the US and various other countries, but particularly China due to the level of exports. Japanese equities again performed well, as economic growth improved, inflation is increasing, wage growth has been improving and the currency has remained relatively weak, the latter due to the government's ongoing QE programme that is unlikely to end any time soon.

The strength of the US dollar versus sterling meant that returns from many global fixed income indices were higher in sterling terms and that sterling hedged investments underperformed. Globally, credit (investment grade and high yield) outperformed government bonds and long-dated bonds underperformed in the UK. Inflation-linked bonds underperformed conventional bonds globally but outperformed in the UK. Local currency emerging market debt was marginally negative following a very difficult previous quarter.

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. The industrials sector continues to lead the way and there are increasing concerns about the UK high street with more retail firms struggling financially.

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 last made some changes to the high level asset allocations in the January 2018 quarterly review and 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%

NB: The property funds currently in the portfolio are now in the new IA Direct Property sector following the IA's decision to split the old IA Property sector into 2 new sectors. As a result, this sector is now contained within the composite benchmarks, where relevant, on a current and historic basis.

Growth Portfolios

The absolute performance of the Growth portfolios was positive across the board and the portfolios performed close to their respective comparative composite benchmarks. The higher risk portfolios struggled versus their most comparative IA sector averages.

The tables below show the model asset allocations of the Growth model portfolios, as at the end of September 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%	18.50%	29.50%	34.00%	34.00%
International Equities	7.50%	25.50%	36.50%	47.00%	64.00%
Property	10.00%	10.00%	10.00%	10.00%	0.00%
Fixed Interest	53.00%	34.00%	22.00%	7.00%	0.00%
Absolute Return	20.00%	10.00%	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%	-4.50%	-2.00%	-2.00%	-4.00%
International Equities	-2.50%	2.50%	5.00%	5.00%	4.00%
Property	0.00%	0.00%	0.00%	0.00%	0.00%
Fixed Interest	-15.00%	-8.00%	-3.00%	-3.00%	0.00%
Absolute Return	20.00%	10.00%	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 small positive return but marginally underperformed its composite benchmark this quarter and marginally 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 negative overall due to the good performance of international equities and the overall performance of the absolute return fund selections.

The Church House fund produced a small positive return but the Invesco and Jupiter funds both produced a negative return with a larger negative return from the latter. The Jupiter fund's positioning has been against the general direction of and trends in the market, being slightly short beta, slightly short duration, slightly short credit and slightly long volatility. The fund has also been tilted towards (long) UK domestic stocks and short US growth stocks.

Fixed Income

From an absolute return perspective, sterling-based fixed income investments generally produced flat/marginally positive or negative returns whereas funds with overseas currency exposure produced positive returns, partly due to US dollar strength. This meant that having mainly sterling-based and sterling-hedged fixed income funds in the portfolio was more negative for absolute performance.

The main positive was the strategic bond fund performance, as they both outperformed their sector average in the composite benchmark with the Schroder Strategic Credit fund benefiting from its natural low duration positioning.

The Schroder Absolute Return Bond fund has been selected for its defensive qualities and its relative performance was mixed this quarter, as it outperformed the average investment grade bond fund but underperformed the average global bond and strategic bond fund.

The main negative was the performance of the global bond fund holdings, as they all produced a negative return, albeit relatively small, and underperformed their sector average. The Standard Life fund has been selected to provide the portfolio with some defence against any rise in global inflation but fund performance was more negative than conventional global bonds, although the fund performed more or less in line with its own benchmark index.

UK Equities

The portfolio underweight was positive given the negative return from the main UK equity market and the underperformance of UK equities on a global basis.

The average IA UK All Companies fund underperformed the main UK equity index this quarter, as larger companies outperformed mid-cap companies. Fund selection was positive, as the Investec fund outperformed the IA sector average, although it did produce a small negative absolute return.

International Equities

The portfolio underweight to international equities was negative given the good, positive return from the main global equity market.

The average IA Global fund underperformed the main global equity index by a reasonable margin this quarter. Fund selection, however, was positive, as the Artemis fund outperformed the IA sector average by a reasonable margin.

Property

Both property funds continued to produce solid, positive returns with the Janus Henderson fund marginally outperforming the IA sector average and the F&C fund very marginally underperforming.

Changes

We are not recommending any portfolio changes this quarter.

Balanced Growth Portfolio

The Balanced Growth Portfolio produced a positive return and marginally outperformed its composite benchmark and also 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, which was added in the previous quarterly review, in place of fixed income and UK equities was mixed due to the underperformance of UK equities but the overall negative performance of the absolute return fund selections. The Church House fund produced a small positive return but the Invesco fund produced a small negative return.

Fixed Income

From an absolute return perspective, sterling-based fixed income investments generally produced flat/marginally positive or negative returns whereas funds with overseas currency exposure produced positive returns, partly due to US dollar strength. This meant that having mainly sterling-based and sterling-hedged fixed income funds in the portfolio was more negative for absolute performance.

The Schroder Absolute Return Bond fund has been selected for its defensive qualities and its relative performance was mixed this quarter, as it outperformed the average investment grade bond fund but underperformed the average global bond and strategic bond fund.

The main negative was the performance of the global bond fund holdings, as they all produced a negative return, albeit relatively small, and underperformed their sector average. The Standard Life fund has been selected to provide the portfolio with some defence against any rise in global inflation but fund performance was more negative than conventional global bonds, although the fund performed more or less in line with its own benchmark index.

UK Equities

The portfolio's small underweight to UK equities was positive, as they underperformed on a global basis whilst the main UK equity market produced a negative return.

The average IA UK All Companies fund underperformed the main UK equity index this quarter, as larger companies outperformed mid-cap companies. Fund selection was positive, as the Investec, Merian (previously Old Mutual) and Schroder funds outperformed the IA sector average, the latter producing a small positive return, whilst the Franklin fund underperformed.

International Equities

The overweight to international equities, both in absolute terms and versus UK equities, was positive given the performance of the main global equity market.

The average IA Global fund underperformed the main global equity index by a reasonable margin this quarter. Fund selection, however, was positive, as the Artemis, Troy and Merian (ex-Old Mutual) funds outperformed the IA sector average, the first two by reasonable margins, whilst the Baillie Gifford fund only marginally underperformed.

Property

Both property funds continued to produce solid, positive returns with the Janus Henderson fund marginally outperforming the IA sector average and the F&C fund very marginally underperforming.

Changes

We are not recommending any portfolio changes this quarter.

Progressive Growth Portfolio

The Progressive Growth Portfolio produced a small positive return and marginally outperformed its composite benchmark. The portfolio underperformed its most comparable IA sector average, suffering mainly from lower equity exposure. The main contributors to performance, both positive and negative, are highlighted within the sections below.

Fixed Income

From an absolute return perspective, sterling-based fixed income investments generally produced flat/marginally positive or negative returns whereas funds with overseas currency exposure produced positive returns, partly due to US dollar strength. This meant that having mainly sterling-based and sterling-hedged fixed income funds in the portfolio was more negative for absolute performance.

There were no significant outperforming or underperforming funds this quarter.

UK Equities

The portfolio's small underweight to UK equities was positive, as they underperformed on a global basis whilst the main UK equity market produced a negative return.

The average IA UK All Companies fund underperformed the main UK equity index this quarter, as larger companies outperformed mid-cap companies. Fund selection was positive, as the Investec, Merian (ex-Old Mutual) UK Alpha and Schroder funds outperformed the IA sector average, the latter producing a small positive return, whilst the Franklin fund underperformed.

Specific mid-cap exposure would have been more negative on a relative basis but the Merian (ex-Old Mutual) UK Mid-Cap fund outperformed the main mid-cap index.

International Equities

The overweight to international equities was positive given the performance of the main global equity market. The lack of any specific US equity exposure was the main negative, as the market continued to perform strongly, as was specific exposure to Asia and Emerging Markets.

The average IA Global fund underperformed the main global equity index by a reasonable margin this quarter. Fund selection, however, was positive, as the Merian and Troy funds outperformed the IA sector average by reasonable margins whilst the Baillie Gifford fund only marginally underperformed.

Fund selection within Asian equities was negative, as the BlackRock fund underperformed its sector average by a reasonable margin and underperformed its own benchmark index by a larger margin. Sector allocation was positive but stock selection within sectors, particularly Financials, Materials, and Industrials, was very negative. Both country allocation and stock selection within countries were also negative.

Fund selection was positive in Europe and Emerging Markets but marginally negative in Japan.

Property

Both property funds continued to produce solid, positive returns, although both funds very marginally underperformed their IA sector average.

Changes

We are recommending a couple of portfolio changes this quarter.

We have tempered our outlook for both Asian and European equities, although we still remain marginally positive overall. It is decided to reduce their weighting by 1.5% each and add this to our currently favoured region, Japan.
Given the higher weighting to Japan, it is decided to split the allocation between two funds with very different investment styles that are already contained in higher risk portfolios, **JPM Japan** and **Man GLG Japan Core Alpha**. This means the Schroder Tokyo fund will be removed from the portfolio.

Adventurous Growth

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

Fixed Income

From an absolute return perspective, sterling-based fixed income investments generally produced flat/marginally positive or negative returns whereas funds with overseas currency exposure produced positive returns, partly due to US dollar strength. This meant that having two sterling-based fixed income funds in the portfolio was more negative for absolute performance.

Fund selection was positive, as both funds outperformed their IA sector average.

UK Equities

The portfolio's small underweight to UK equities was positive, as they underperformed on a global basis whilst the main UK equity market produced a negative return.

The average IA UK All Companies fund underperformed the main UK equity index this quarter, as larger companies outperformed mid-cap companies. Fund selection was positive, as the AXA, Merian (ex-Old Mutual) UK Alpha and Schroder funds outperformed the IA sector average, the latter producing a small positive return, whilst the Franklin fund underperformed.

Specific mid-cap exposure would have been more negative on a relative basis but the Merian (ex-Old Mutual) UK Mid-Cap fund outperformed the main mid-cap index.

International Equities

The overweight to international equities was positive given the performance of the main global equity market. The lower weighting to US equities was a negative, as the market continued to perform strongly, as was specific exposure to Asia (highest regional weighting) and Emerging Markets.

Relative to the IA sector average, fund selection within Asian equities was marginally positive, as the BlackRock fund underperformed its sector average by a reasonable margin and underperformed its own benchmark index by a larger margin but the First State fund produced a positive return and outperformed by a larger margin. For the BlackRock fund sector allocation was positive but stock selection within sectors, particularly Financials, Materials, and Industrials, was very negative. Both country allocation and stock selection within countries were also negative.

Fund selection in Europe was negative overall due to the level of underperformance from the Schroder European Alpha Plus fund. Stock selection within sectors and countries was the main driver of underperformance, particularly in the Healthcare and Financials sectors and in Germany.

Fund selection was positive in the US but negative in Emerging Markets due to the level of underperformance from the JPM fund, which more than offset marginal outperformance from the

Lazard fund. Selection was positive in Japan due to the good outperformance from the Man GLG fund, as large cap value stocks had a strong relative quarter.

Property

Both property funds continued to produce solid, positive returns, although both funds very marginally underperformed their IA sector average.

Changes

We are recommending a couple of portfolio changes this quarter.

We have tempered our outlook for both Asian and European equities, although we still remain marginally positive overall. It is decided to reduce the Asian weighting by 4% and the Europe weighting by 2%, so both are now 10%. 2% will be added to US equities to reduce the underweight relative to other markets and 4% will be added to our currently favoured region, Japan.

Specialist Growth Portfolio

The Specialist Growth Portfolio produced a small positive return and performed in line with its composite benchmark but underperformed its most comparable IA sector average. The main contributors to performance, both positive and negative, are highlighted within the sections below.

UK Equities

The portfolio's underweight to UK equities was positive, as they underperformed on a global basis whilst the main UK equity market produced a negative return.

The average IA UK All Companies fund underperformed the main UK equity index this quarter, as larger companies outperformed mid-cap companies. Fund selection was mixed, as the AXA, Investec and Schroder funds outperformed the IA sector average, the latter producing a small positive return, whilst the JOHCM and Man GLG funds underperformed.

Specific mid-cap exposure would have been more negative on a relative basis but the Merian (ex-Old Mutual) UK Mid-Cap fund outperformed the main mid-cap index.

Smaller companies outperformed large and mid-cap companies this quarter, so specific exposure would have been more positive but for reasonable underperformance from the Franklin fund.

International Equities

The overweight to international equities was positive given the performance of the main global equity market. The lower weighting to US equities was a negative, as the market continued to perform strongly, as was specific exposure to Asia (equal highest regional weighting) and Emerging Markets.

Relative to the IA sector average, fund selection within Asian equities was negative overall, as the BlackRock fund underperformed its sector average by a reasonable margin and underperformed its own benchmark index by a larger margin, as did the Baillie Gifford fund, but the First State fund produced a positive return and outperformed by a larger margin. For the BlackRock fund sector allocation was positive but stock selection within sectors, particularly Financials, Materials, and Industrials, was very negative. Both country allocation and stock selection within countries were also negative.

Fund selection in Europe was negative overall due to the level of underperformance from the Schroder European Alpha Plus fund. Stock selection within sectors and countries was the main driver of underperformance, particularly in the Healthcare and Financials sectors and in Germany.

Fund selection was positive in the US but negative in Emerging Markets due to the level of underperformance from the JPM fund, which more than offset marginal outperformance from the Lazard fund. Selection was positive in Japan due to the good outperformance from the Man GLG fund, as large cap value stocks had a strong relative quarter.

Changes

We are recommending a couple of portfolio changes this quarter.

We have tempered our outlook for both Asian and European equities, although we still remain marginally positive overall. It is decided to reduce the Asian and European weightings by 3% each, so both are now 14%. 2% will be added to US equities to reduce the underweight relative to other markets and 4% will be added to our currently favoured region, Japan.

Income Portfolios

Performance of the Income portfolios was positive across the board but they all outperformed their respective comparative composite benchmarks.

The tables below show the current asset allocations of the Income model portfolios, as at the end of September 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 positive return, marginally underperforming its composite benchmark but marginally outperforming its most comparable IA sector average. The current historic yield is 3.4%. The main positive and negative contributors are highlighted within the sections below.

Fixed Income

From an absolute return perspective, sterling-based fixed income investments generally produced flat/marginally positive or negative returns whereas funds with overseas currency exposure produced positive returns, partly due to US dollar strength. This meant that having mainly sterling-based and sterling-hedged fixed income funds in the portfolio was more negative for absolute performance.

Relative fund performance within the corporate bond, high yield and strategic bond sectors was mixed with no fund notably outperforming or underperforming.

The main positive was the performance of the Templeton Global Bond fund, which comfortably outperformed the IA global bond sector average. This was mainly due to currency positioning with underweight positions to the Japanese yen and the euro being particularly strong contributors.

The Standard Life fund has been selected to provide the portfolio with some defence against any rise in global inflation but fund performance was more negative than conventional global bonds, although the fund performed more or less in line with its own benchmark index.

UK Equities

The small portfolio underweight was positive given the negative return from the main UK equity market and the underperformance of UK equities on a global basis.

The average IA UK Equity Income fund underperformed the main UK equity index this quarter, as larger companies outperformed mid-cap companies. Fund selection was negative overall, as the Premier fund underperformed the IA sector average by a reasonably large margin whilst the Threadneedle fund outperformed by a much smaller margin. Stock selection was the main driver of underperformance for the Premier fund, particularly in the Consumer Services and Financials sectors, as sector allocation was a neutral factor.

International Equities

The average IA Global Equity Income fund underperformed the main global equity index by a reasonable margin this quarter. Fund selection was negative, as the Artemis fund marginally underperformed the sector average but the Schroder fund underperformed by a reasonably large margin. Regional positioning was a key negative due to the large overweight position to UK equities and a large underweight position to US equities. Sector allocation was also negative, as was stock selection within sectors, particularly the Consumer Discretionary and Financials sectors.

Property

Both property funds continued to produce solid, positive returns with the Janus Henderson fund marginally outperforming the IA sector average and the F&C fund very marginally underperforming.

Others

An allocation to the VT Gravis fund was very positive on a relative basis, as the fund comfortably outperformed the main fixed income markets and UK commercial property funds.

Changes

We are recommending some portfolio changes this quarter.

We would like to reduce our fixed income exposure, particularly the strategic bond exposure, in favour of a more diversified source of income. We recommend adding the **Investec Diversified Income** fund, an income-focused, multi-asset fund that has multiple sources of income within its portfolio, and reducing each of our strategic bond fund holdings.

In addition, there has been announced changes to the management team of the Fidelity Strategic Bond fund with Ian Spreadbury stepping down at the end of 2018. Less experienced fund managers will be taking over and, although Fidelity has a strong fixed income team, we are recommending an alternative option with the **TwentyFour Dynamic Bond** fund.

Finally, the level of UK equity exposure in the **Schroder Global Equity Income** fund is much higher than we would like in this part of the portfolio, particularly as our current view on UK equities is relatively negative. We recommend replacing the Schroder fund with the **Fidelity Global Enhanced Income** fund, which is already contained in the other income portfolios.

Balanced Income Portfolio

The Balanced Income Portfolio produced a small positive return but marginally underperformed its composite benchmark and its most comparable IA sector average. The current historic yield is just over 3.6%. The main positive and negative contributors are highlighted within the sections below.

Fixed Income

From an absolute return perspective, sterling-based fixed income investments generally produced flat/marginally positive or negative returns whereas funds with overseas currency exposure produced positive returns, partly due to US dollar strength. This meant that having mainly sterling-based and sterling-hedged fixed income funds in the portfolio was more negative for absolute performance.

Relative fund performance within the corporate bond, high yield and strategic bond sectors was mixed with no fund notably outperforming or underperforming.

The Standard Life fund has been selected to provide the portfolio with some defence against any rise in global inflation but fund performance was more negative than conventional global bonds, although the fund performed more or less in line with its own benchmark index.

UK Equities

The small portfolio underweight was positive given the negative return from the main UK equity market and the underperformance of UK equities on a global basis.

The average IA UK Equity Income fund underperformed the main UK equity index this quarter, as larger companies outperformed mid-cap companies. Fund selection was negative overall, as the Premier fund underperformed the IA sector average by a reasonably large margin, the JOHCM fund marginally underperformed whilst the Threadneedle fund outperformed by a much smaller margin.

Stock selection was the main driver of underperformance for the Premier fund, particularly in the Consumer Services and Financials sectors, as sector allocation was a neutral factor.

International Equities

The average IA Global Equity Income fund underperformed the main global equity index by a reasonable margin this quarter. Fund selection was negative overall, as the Artemis and Threadneedle funds marginally underperformed the sector average, the Fidelity fund marginally outperformed but the Schroder fund underperformed by a reasonably large margin. Regional positioning was a key negative due to the large overweight position to UK equities and a large underweight position to US equities. Sector allocation was also negative, as was stock selection within sectors, particularly the Consumer Discretionary and Financials sectors.

Property

Both property funds continued to produce solid, positive returns with the Janus Henderson fund marginally outperforming the IA sector average and the F&C fund very marginally underperforming.

Others

An allocation to the VT Gravis fund was very positive on a relative basis, as the fund comfortably outperformed the main fixed income markets and UK commercial property funds.

Changes

We are recommending some portfolio changes this quarter.

We would like to reduce our fixed income exposure, particularly the corporate bond, strategic bond and high yield exposure, in favour of a more diversified source of income. We recommend adding the **Investec Diversified Income** fund, an income-focused, multi-asset fund that has multiple sources of income within its portfolio, and reducing each of our corporate bond, strategic bond and high yield fund holdings.

Finally, the level of UK equity exposure in the **Schroder Global Equity Income** fund is much higher than we would like in this part of the portfolio, particularly as our current view on UK equities is relatively negative. We recommend replacing the Schroder fund with the **TB Saracen Global Income & Growth** fund, which has a similar value-orientated investment style.

Progressive Income Portfolio

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

Fixed Income

From an absolute return perspective, sterling-based fixed income investments generally produced flat/marginally positive or negative returns whereas funds with overseas currency exposure produced positive returns, partly due to US dollar strength. This meant that having a majority of sterling-based and sterling-hedged fixed income funds in the portfolio was more negative for absolute performance. Relative fund performance within the part of the portfolio was mixed with no fund notably outperforming or underperforming their respective sector averages.

UK Equities

The small portfolio underweight was positive given the negative return from the main UK equity market and the underperformance of UK equities on a global basis.

The average IA UK Equity Income fund underperformed the main UK equity index this quarter, as larger companies outperformed mid-cap companies. Fund selection was negative overall, as the Premier fund underperformed the IA sector average by a reasonably large margin, the JOHCM and Marlborough funds marginally underperformed, the Threadneedle fund outperformed by a much smaller margin whilst the Schroder fund produced a small positive return and comfortably outperformed. Stock selection was the main driver of underperformance for the Premier fund, particularly in the Consumer Services and Financials sectors, as sector allocation was a neutral factor.

International Equities

The average IA Global Equity Income fund underperformed the main global equity index by a reasonable margin this quarter. Fund selection was negative overall, as the Artemis and Threadneedle funds marginally underperformed the sector average, the Fidelity fund marginally outperformed but the Schroder fund underperformed by a reasonably large margin. Regional positioning was a key negative due to the large overweight position to UK equities and a large underweight position to US equities. Sector allocation was also negative, as was stock selection within sectors, particularly the Consumer Discretionary and Financials sectors.

Property

Both property funds continued to produce solid, positive returns, although they very marginally underperformed the IA sector average.

Others

An allocation to the VT Gravis fund was very positive on a relative basis, as the fund comfortably outperformed the main fixed income markets and UK commercial property funds.

Changes

We are recommending one portfolio change this quarter.

The level of UK equity exposure in the **Schroder Global Equity Income** fund is much higher than we would like in this part of the portfolio, particularly as our current view on UK equities is relatively negative. We recommend replacing the Schroder fund with the **TB Saracen Global Income & Growth** fund, which has a similar value-orientated investment style.

SRI Portfolios

Strategic Asset Allocations

We made some changes to the high level asset allocations in the first quarter of 2018 and 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 September 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 positive returns but underperformed their respective composite benchmarks, albeit not significantly. Below are comments relating to positive and negative fund contributors.

Fixed Income

From an absolute return perspective, sterling-based fixed income investments generally produced flat/marginally positive or negative returns whereas funds with overseas currency exposure produced positive returns, partly due to US dollar strength. This meant that having sterling-based fixed income funds in the portfolio was more negative for absolute performance.

All the funds selected through the three portfolios outperformed the fixed income index in the composite benchmark, as sterling corporate bonds outperformed UK government bonds over the period. Within their IA sectors fund performance was mixed with two of the four corporate bond funds outperforming whilst the two funds in the sterling corporate bond sector underperformed, although not significantly, due to their greater focus on investment grade bonds versus high yield.

UK Equities

The underweight to UK equities across the portfolios was positive, as they underperformed on a global basis whilst the main UK equity market produced a negative return.

The average IA UK All Companies fund underperformed the main UK equity index this quarter, as larger companies outperformed mid-cap companies, so this was a performance headwind. Fund performance within the funds' IA sectors was strong with only the Amity UK fund marginally underperforming. There was particularly strong relative performance from the Liontrust SF UK Growth fund, which is held across the portfolios, and the Standard Life UK Ethical funds, which is in the Balanced and Progressive portfolios, the latter benefiting from good stock selection.

International Equities

The overweight to international equities relative to UK equities was positive for the portfolios this quarter.

The average IA Global fund underperformed the main global equity index by a reasonable margin this quarter and this was a significant performance headwind. All the funds across the portfolios underperformed the global equity index but they also all underperformed their IA sector average. The largest underperformer was the Amity International fund, which continued to suffer from its large underweight to US equities and overweight to Asian equities.

Changes

We are recommending the addition of one fund to the Balanced and Progressive portfolios, which is the **Unicorn UK Ethical Income** fund. This is a multi-cap fund with a mid-cap/smaller companies bias that employs a negative ethical screen together with an ESG filtering process. Reductions will be made to existing holdings to incorporate the new fund.

Summary

Global economic growth forecasts have become more muted recently with concerns about the negative effects of geopolitics and the current trade/tariff ‘wars’, particularly between the US and China with the latter expected to see slowing growth - which will have a knock-on effect on other markets -, higher US interest rates and generally tighter monetary policy, higher global inflation, ongoing US dollar strength and contagion within emerging markets, amongst others. President Trump and the US economy are the leading players in this situation with the introduction of corporate tax cuts at a time of already strong US growth potentially prolonging the US’ economic growth cycle, conveniently around the time of the US mid-term elections. The possibility of strong economic growth, leading to higher inflation and a strong dollar, in turn leading to higher interest rates, is likely to be good for the US over the short-term and should support global growth but could lead to difficulties within Asian and emerging market countries with high levels of foreign-denominated debt and current account deficits (e.g. Turkey, Argentina, South Africa).

Our favoured asset class over the medium to longer-term remains equities, despite the shorter-term concerns, with a continued preference for non-UK equities versus UK equities. We have moved to a slightly more positive view on ‘value’ versus ‘growth’, supported by solid economic growth, rising global inflation, higher interest rates and higher bond yields plus their relative valuation levels.
Our favoured region is Japan with reasonable economic growth levels, attractive valuations both relative to their history and versus comparable markets, and ongoing monetary policy support. Our view on European equities has been tempered slightly, as economic indicators have weakened over the short-term, the ECB is exiting QE at the end of the year, which could be inflationary and see a stronger euro, and Italian politics has been making headlines again. We have also tempered our view on Asian equities due to some of the issues mentioned earlier, namely the possible negative impact of the trade/tariff wars on the region, a weakening in economic data, impact of higher US interest rates and further US dollar strength. We retain a neutral view on US equities, as valuations look more expensive on a global basis but corporate earnings are forecast to remain strong. The amount of money invested into passive strategies remains a potential issue and market returns are still being driven by a relatively narrow set of stocks and sectors.

UK growth improved in Q2 but remains relatively weak and the Brexit negotiations with the EU continue to create uncertainty, both at economic and corporate levels. Many businesses seem reluctant to commit to longer-term spending plans until the situation becomes clearer and some are making contingency plans that are affecting the value of sterling versus other global currencies, in particular the US dollar. Currency weakness is positive for a large part of the UK market due to the level of overseas revenues but should Brexit negotiations go better than expected then sterling could strengthen and domestic stocks could perform well, so a balance of exposure is appropriate.

In fixed interest we are relatively negative on investment grade credit and high yield, as spreads are relatively tight versus government bonds, making them vulnerable to any increase in the underlying government bond yields plus any further widening of credit spreads. The high yield 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 low in an environment of potentially rising bond yields and interest rates, reduced monetary policy support and reasonably good economic and corporate fundamentals.

UK government bonds are our least preferred sub-asset class – 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 by making a few big calls. Going back to basics, whilst fundamentals are reasonably good, valuation is not on the investor's side. There 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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