Conventional

Managed Portfolio Service - Portfolio 3

Quarterly Update - Q1 2019

In brief

- Risk assets performed strongly over the quarter, with equities advancing after weakness at the year end.
- Alternative investments, global listed infrastructure and global real estate investment trusts posted solid returns.
- Fixed income funds provided an additional source of returns, as interest-rate risk subsided.
- The Conventional MPS portfolios performed strongly over the quarter, delivering returns in excess of their composite benchmarks.

Global overview

The current global economic growth environment remains subdued. Since our last outlook, our short-term activity indicators have deteriorated while global business sentiment indicators have yet to bottom.

In response to this, we are seeing policy stabilisers kick in. Central banks in developed markets have put tightening on hold while in China, policymakers are adding to stimulus. Finally, some of the political risks that plagued markets in 2018 have become less acute in the short term.

Central bankers have found it easier to justify their policy on account of still subdued inflation. Lower global energy prices in 2018 have depressed headline price growth, but underlying measures of inflation have also been soft. Indeed, even the US economy, which has enjoyed an unusual late-cycle fiscal stimulus, is still delivering muted inflation. This makes it easier for central bankers to delay tightening in a more uncertain economic environment.

The speed and extent of the shift in the Federal Reserve's (Fed) interest rate stance has been most remarkable. From signalling multiple further hikes, the Fed is now guiding that the next move is as likely to be up as down. In the Eurozone, the European Central Bank has pushed back its guidance on rate increases until at least 2020. The Bank of Canada has also become more 'dovish' while the Bank of England is on hold amid Brexit uncertainty. Elsewhere, the Bank of Japan's yield curve control framework is on lockdown and, in many developed markets, policy tightening is on ice.

Signs also point towards Chinese policymakers taking further steps to loosen domestic policy. They have already cut reserve requirement ratios and these will likely be lowered further. Other credit easing measures have been implemented too, although there is still a desire to constrain shadow-banking growth. Personal and corporate tax have also been cut again, adding to last year's fiscal easing.

Before November's G-20 meeting, we feared that the US would impose a 25% tariff on all imports from China by the end of Q1 2019. At the same time, intransigence in both Rome and Brussels over Italy's 2019 budget left open the potential for a more serious debt crisis. However, in both instances, brinkmanship has softened, as leaders faced the economic, political and financial consequences of their aggressive stances.

Because the underlying drivers remain in place, these political risks have most definitely not gone away. But if the current uneasy truces hold, the drag from uncertainty on growth and returns should moderate as the year progresses. This is also true of Brexit. Although we cannot rule out a catastrophic 'no-deal' scenario, our assessment is that a softer outcome remains more likely.

The combination of easing short-term political risk and the more accommodative policy stance is loosening financial conditions. Government bond yields have fallen sharply, the trade-weighted dollar has depreciated and capital flows to emerging markets have picked up. In addition, corporate credit spreads have narrowed and equity prices have rallied. It is our judgement that this loosening will have some efficacy. Indeed, in aggregate we expect global GDP growth to slow from 3.6% for 2018, to 3.2% in 2019. Thereafter, we anticipate it picking up to 3.5% in 2020. We believe that the maximum change in growth will be felt in the second half of 2019 and the first half of 2020, before moderating again.

This impulse should be most powerful in emerging market (EM) economies. Last year, they were caught in the crosshairs of US and Chinese policy tightening, slowing global trade growth, and building risks around protectionism. Relief on all these fronts, alongside other cyclical effects, will help those EM economies hit hardest in 2018. Therefore, while aggregate EM growth is expected to drop to 4.2% in 2019, (from 4.6% in 2018), we now expect it to jump back to 4.7% in 2020.

Contrary to EM economies, the developed markets' story is a little more nuanced. The open Eurozone economy will benefit most from the acceleration in global production and trade cycles that we expect. Japan will similarly enjoy a better global growth backdrop, albeit with the domestic headwind from a consumption tax hike in the autumn. Meanwhile, we expect the US to continue to slow, with the fading 2018 fiscal stimulus still dominating its growth profile.

We should emphasise that the pick-up in growth we expect over coming months is unlikely to be as powerful as 2016/17. This is because policy stimulus will be more muted and there is less spare capacity to be absorbed. Moreover, the risks to this turnaround in growth are tilted to the downside. That is, excessive borrowing in key countries and sectors could potentially constrain the growth impulse from easier financial conditions. Overarching all this remains a rather murky political environment. The starting gun has been fired on the US presidential race next year. The UK, meanwhile,

remains in political paralysis over Brexit, while Europe struggles to bring together various strands of electoral discontent. As such, it is plausible that more aggressive easing from major central banks will be necessary before growth bottoms out.

Despite all this, equity markets have enjoyed a V-shaped recovery from the savage sell-off late last year. Indeed, equities enjoyed the best start to a year in almost 30 years. This appears to be a rerun of the 'bad news is good news' mentality of investors, whereby their focus turns to central bank policy response. That is, that interest rate rises will be postponed, monetary policy will be relaxed and there may be another round of quantitative easing. But, after more than a decade of central banks riding to the rescue, we believe investors have become overly relaxed. They may be in for a rude awakening when the medicine is withheld.

Fund manager views on how the global economy will develop over the coming year are near their gloomiest since 2008. As a result, many have trimmed their exposure to US stocks to the lowest point in nine months. Over a third of managers believe the S&P 500 Index has already passed its peak. Yet, some large investment houses argue that the US expansion may well continue for another two decades. They contend that persistent low inflation and low interest rates will continue to support the secular bull run. And why not? US employment is so high that people are coming back into the workforce. Furthermore, there is no evidence that bull markets die of old age – Australia recently enjoyed 27 years of continued expansion.

Much has been written on how the US market continues to look expensive compared with its global peers. However, we should take account that the US is home to the vast majority of high-growth tech stocks. The UK and Europe, on the other hand, are more slanted towards financials and industrials. We should also note that the US banking sector has endured most of its pain and restructuring. The same cannot be said for Europe. Meanwhile, US growth this year remains healthy but modest. Compare this with Europe, where a sickly, stagnant and potentially deflationary outlook seems more probable.

Performance

Equity markets enjoyed a strong rally in Q1 2019, bouncing back from a difficult Q4 2018. Having shed 11.6% in Q4, the S&P 500 Index rose 11.1% in Q1. In the UK, the FTSE All Share Index followed a Q4 loss of 10.2% with a gain of 9.4%. The portfolio performed well in this environment, delivering returns in excess of its composite benchmark. Our tactical overweight positions in equities, particularly US equities, benefited performance. Fund selection was strong within global REITs (real estate investment trusts) and absolute return investments. We hold a blend of absolute return funds within the portfolio. Namely, the Invesco Global Targeted Return Fund, Standard Life Investments Global Absolute Return Strategies and the Fulcrum Diversified Core Absolute Return Fund. These funds helped to cushion the portfolio when markets were falling during the volatility of Q4 2018. They have also enabled us to participate in the markets' recovery this quarter.

Activity

Following a strong rebound at the end of 2018, we reduced our overweight position in emerging markets local currency. At the same time, we increased our emerging market hard currency debt exposure. We did this in order to reflect equal weightings across the Neuberger Berman Emerging Market Debt Local Currency and Standard Life Investments Emerging Market Debt funds. These are our preferred areas for yield.

With the retirement of Dean Newman, manager of the Invesco Global Emerging Markets Fund, we switched into the Artemis Global Emerging Markets Fund. The Artemis Fund has a solid three-year track record and a distinct investment process, making it an attractive core holding. We also introduced the Fidelity Asia Fund to complement our holding in the Schroder Asian Income Fund.

Outlook

It was a strong quarter across asset classes. We continue to tilt our portfolios in favour of equities. This reflects our House View that the global backdrop will remain supportive of risk assets. We are, however, mindful that a mid-cycle economic slowdown is possible in the US. Therefore, we maintain broad exposure across multiple fixed income markets, absolute return funds and alternative investments.

Performance

Portfolio performance is based on Aberdeen Standard Capital MPS hosted on the Standard Life WRAP platform.

Please note: portfolio constituents and performance may vary on other platforms.

The portfolio has not been available on all platforms since inception.

Performance figures are net of the Aberdeen Standard Capital Discretionary Management Charge. However they do not include the deduction of product and adviser specific charges. The effect of these charges would be to reduce the performance levels shown. In addition, MPS portfolios are subject to fund level annual management charges, which vary over time in line with the composition of the portfolio. Please refer to the relevant Managed Portfolio Service Annual Charges Summary for more information on charges.

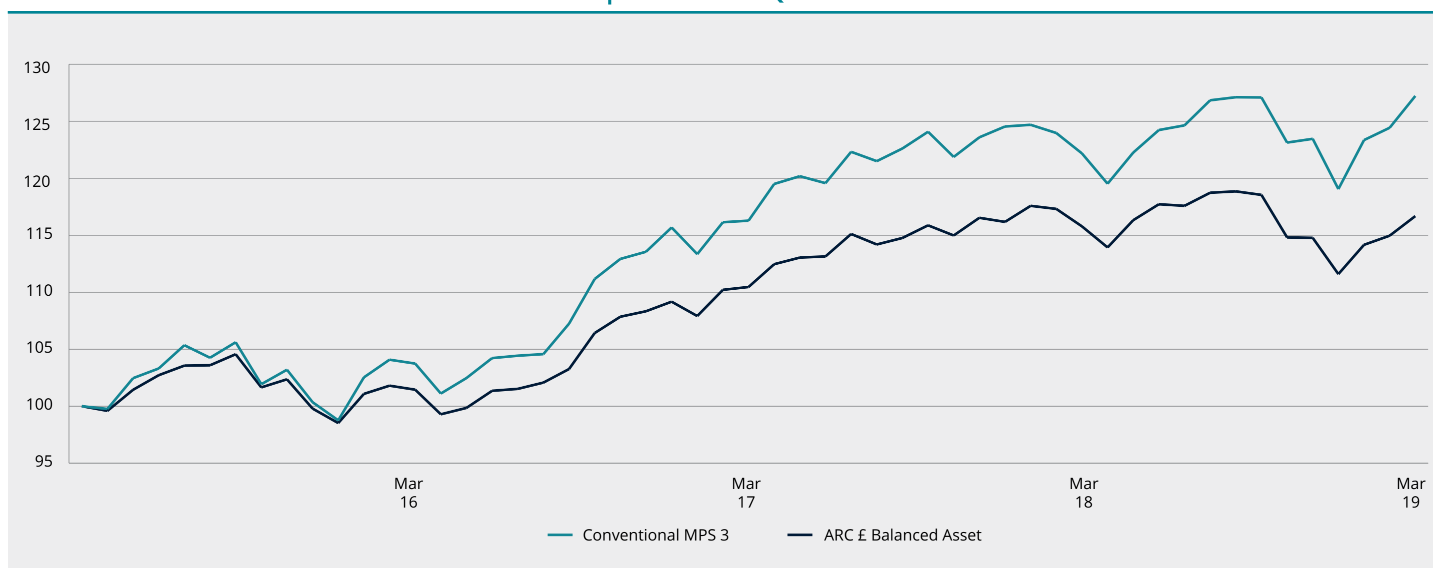
ARC Private client indices ARC private client indices are based on actual client portfolio returns provided by various investment management companies. These portfolio returns are allocated to one of four categories based on the volatility of their returns relative to world equities, and an average return is calculated for each category. Grouping portfolios by their volatility differs from the traditional approach, which compares portfolios which have similar asset allocations. Instead, investment managers may use whatever asset allocation they consider appropriate to achieve the desired levels of return and volatility.

Performance: Conventional MPS Portfolio 3

	Performance (%) 1st Quarter 2019	Performance (%) 3 years	Performance (%) Since Inception[1]	Volatility Since Inception (%)
Conventional MPS Portfolio 3	6.86	22.06	27.22	6.61
ARC £ Balanced Asset	4.56	15.13	16.68	4.84

The performance figures may vary due to product specific charges and should be viewed on an indicative basis.
[1]30/11/2014 - 31/03/2019
Volatility calculated using monthly returns. Any holdings referred to relate to the Aberdeen Standard Capital MPS hosted on the Standard Life WRAP platform. Differences in holdings may occur on other platforms due to fund and shareclass availability.

Performance: Conventional MPS Portfolio 3 Inception to end Q1 2019



Asset allocation: Conventional MPS Portfolio 3

Asset allocation	MPS Model Strategy 3 as at end December 2018* (%)	MPS Model Strategy 3 as at end March 2019* (%)	Change +/-
UK Corporate Bonds	10.5%	10.5%	0.0%
Global Index-Linked Government Bonds	5.6%	5.6%	0.0%
Global High-Yield Bonds	7.5%	7.5%	0.0%
EM Debt Hard Currency	5.7%	5.7%	0.0%
EM Debt Hard Currency	5.7%	5.7%	0.0%
UK Equities	11.4%	13.4%	+2.0%
North American Equities	21.7%	21.7%	0.0%
European Equities	6.0%	5.2%	-0.8%
Developed Asian Equities	2.6%	2.6%	0.0%
Japanese Equities	4.3%	3.4%	-0.9%
Emerging Market Equities	2.0%	1.2%	-0.8%
Global REITs	5.0%	5.0%	0.0%
Global Infrastructure	2.0%	2.0%	0.0%
Absolute Return Funds	10.0%	10.0%	0.0%
Cash	0.5%	0.5%	0.0%
Total	**100.0%**	**100.0%**	

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* The data is rounded to 1dp and small variances to totals may occur.
This data is based on Aberdeen Standard Capital MPS hosted on the andard Life WRAP platform.

The figures shown here refer to the past. Past performance is not a reliable guide to future performance. As with any investment, the value of your fund can go down as well as up and may be worth less than you invested.

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