EQInsight

Market View Q3 2017

This document presents a high level summary of our investment views. As we are making decisions about what to buy and sell in your portfolio, we want to be accountable to you by explaining what we are doing, and why.

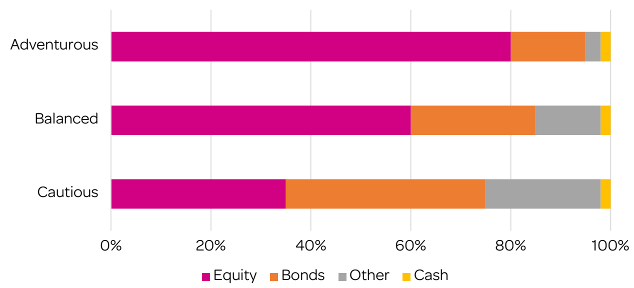
The EQ Asset Allocation Committee met on 26 July 2017. Where relevant the indicators show how our view changed since the previous meeting (April 2017). Please note: our views may change at any time.

How does this relate to my portfolio?

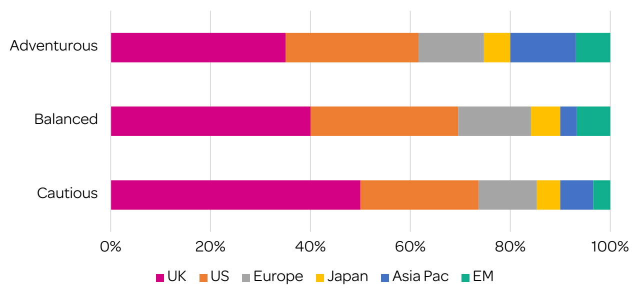
Portfolios are sometimes compared to recipes – you need the right balance of high quality ingredients to make a great meal. In the investment world there are many different types of investment or ‘asset classes’. These are our ingredients: **equities** (stocks and shares), **bonds** (debt), **property**, **commodities** (raw materials) and **alternatives** (a catch-all class for more complicated financial instruments).

Since equities are usually the largest part of any portfolio, we further distinguish between geographic regions according to the size and relevance of their markets to UK investors. This includes the **UK** itself, **North America**, **Europe**, **Japan**, **Asia Pacific** (i.e. China) and ‘**emerging markets**’ (a basket of countries that includes Brazil, Mexico, Chile, South Africa, India and others).

The overall ‘flavour’ of a portfolio is determined by its risk profile. More cautious investors will have more lower risk investments (like bonds), while more adventurous investors will have more higher risk investments (like equities). To illustrate this, here is what three typical portfolios might look like:

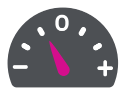


The mix of equities also changes as risk moves from low to high. Cautious portfolios will have more developed market equities, while adventurous portfolios will have slightly more developing market equities. Again, here are three examples to illustrate this:



This is important because our views (outlined over the next 3 pages) will influence your portfolio **based on its default positioning**. So for example: say our view on UK equities is negative:

Current view: Q3



Previous view: Q2
faded (if different)

Since we’re slightly concerned about the state of the UK economy, you’re likely to have fewer UK equities than usual. However, if you are an adventurous investor then you will still have more than a cautious investor, because adventurous portfolios have a larger proportion of equities overall.

Cash

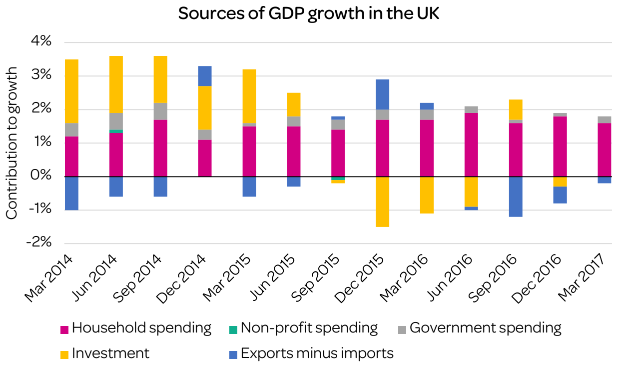
We are still holding higher levels of cash than normal.

We reduced our cash allocation slightly at the last asset allocation committee because we felt that a number of market risks had abated: Brexit now looks like a very UK-centric issue, European politics have stabilised and Donald Trump’s most disruptive behaviour has so far been confined to Twitter. We remain cautious so will spread this cash across a variety of asset classes.

UK

The UK economy slowed at the start of the year. Political instability has constrained investment and growth is now being almost exclusively driven by consumer spending.

The UK economy remained resilient after the Brexit vote in 2016 but this year the data has been less positive. Manufacturing, industrial production and business investment remain weak. Consumers have been diligently supporting the UK economy by continuing to spend – in fact Gross Domestic Product (GDP) growth was almost entirely driven by household spending in Q1:

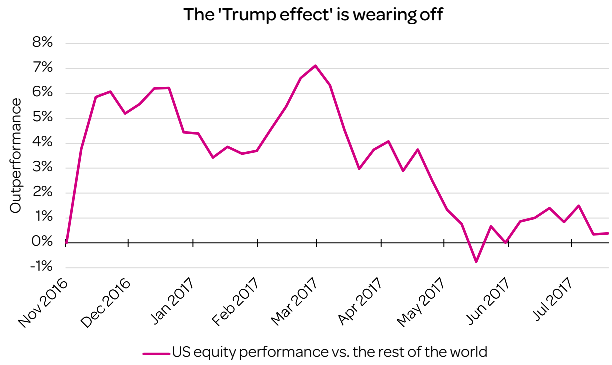


But the UK consumer is now looking strained: real wages are falling and the Bank of England has voiced concerns about the rate of consumer credit growth. If consumers have been borrowing to spend but going forward borrow less, they will start spending less too. From this perspective UK growth looks quite fragile.

North America

Investors continue to question whether Donald Trump really can deliver on his campaign trail promises. This is damaging investor sentiment towards US equities.

US equities initially performed strongly in the wake of Trump's victory, in anticipation of pro-growth policies and deregulation. However, these policy promises have not yet materialised and US equities have underperformed non-US equities year to date. Only recently the long-awaited healthcare bill failed, causing investors to further reassess Trump's chances.



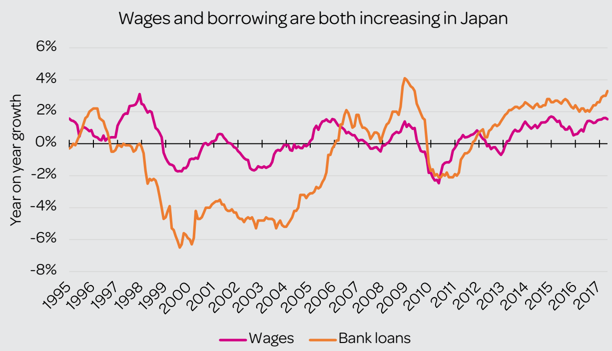
If Trump fails to deliver we could see a variety of US equity sectors underperform. In addition, the US economy isn't growing quite as well as it was a couple of years ago and they are the only major economy hiking interest rates. We remain underweight US equities, finding better opportunities elsewhere.

Japan

We have a positive view on Japanese equities. Years of economic hardship will take some time to get over but there are signs of positivity in the Japanese economy. Corporates are benefiting from this as demonstrated by strong earnings growth.

Real GDP rose at a rate of 1% (annualised) in Q1. This makes 5 consecutive quarters of growth in Japan, the longest run in 11 years. Given such a prolonged period of economic hardship, it's unsurprising that it has taken a little while for Japanese households and corporates to start behaving in a more pro-growth way. We are however starting to see such developments in the form of wage growth and corporate borrowing.

We maintain a positive view on Japan due to strong earnings growth, meaningful economic improvement and reasonable valuations.



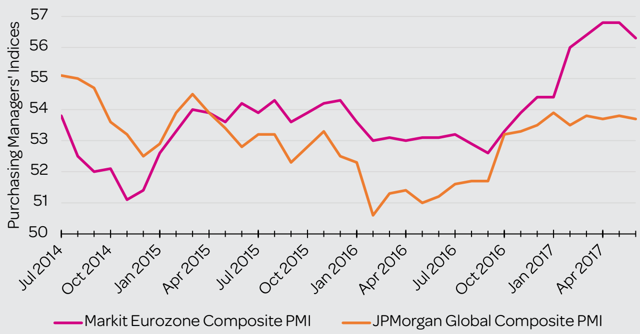
Europe

European equities have moved from the least to most attractive developed world market in the last 18 months. The European growth story has become a consensus market view very quickly and we are wary of excessive investor optimism.

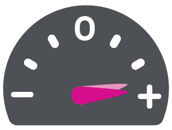
A combination of weak growth and political risks made European equities very unpopular at the start of 2016. Sentiment has changed dramatically since the French election. A more united Europe has emerged and economic growth is strong. This has drawn a lot of money back in to Europe.

While European growth is certainly encouraging we are also wary of consensus positioning. If the excellent data we've seen over the last few months starts to weaken slightly there is a risk that the flows into European equities over the last few months could reverse. This would create a lot of sellers and potentially few buyers causing prices to fall. While we don't expect this to happen, we are not moving too heavily overweight Europe because of this risk.

European businesses sentiment is riding high



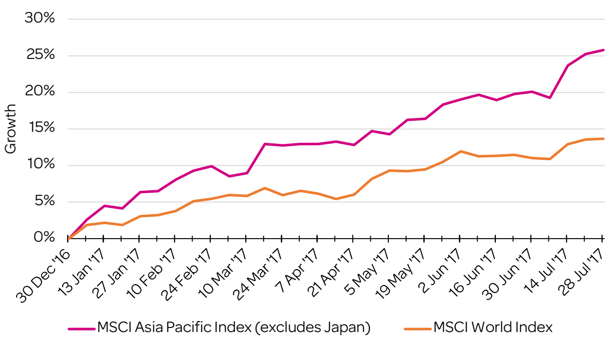
Asia Pacific



Reasonable global growth and steady rate hikes create a good climate for Asian equities.

Asian equities have performed well since Trump's election, buoyed by improved global growth, steady rate hikes and stability in China. This is a marked improvement from a few months earlier, when investors were concerned Asian economies would buckle under the weight of rate hikes and US protectionism. We view this period as confirmation that Asian equities can perform well in the current market, and are maintaining our exposure.

Asian equities continue to outperform

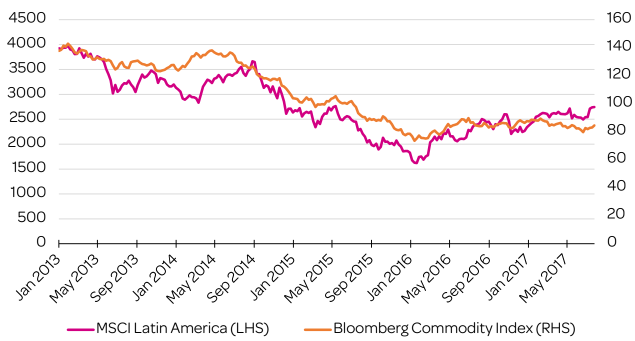


Emerging Markets

We are cautious about the commodity reliance of some Latin American economies so are reducing our exposure.

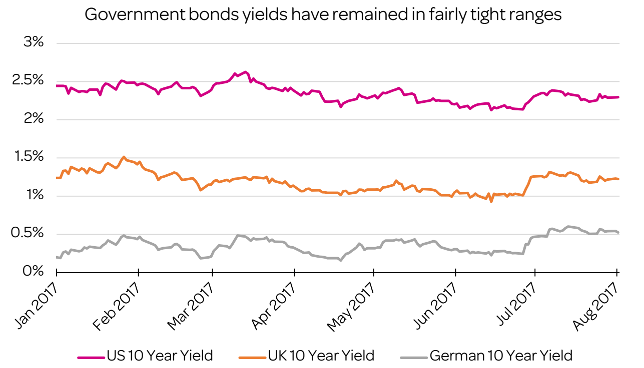
Brazil exports significant amounts of soy beans, iron ore and oil. Mexico, while less commodity dependent, exports large amounts of oil. In Chile (the third largest country in the MSCI Latin America Index) energy and metals contribute around 80% of exports. As such, if the price of agricultural commodities, metals or oil falls, this would hurt Latin American economies and equities. In addition, Brazilian politics continue to be volatile, with president Michel Temer under investigation for corruption charges. Considering these risks, we are underweight emerging markets.

Latin American equities are influenced by commodity prices

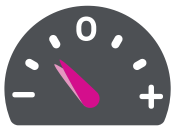


Bonds

We still hold a slightly negative view on government bonds, and remain slightly more positive on high yield bonds.



Government bonds



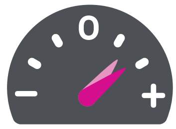
After falling sharply in the wake of Donald Trump's election, government bonds haven't done much in 2017. UK, US and European yields have moved up slightly when fears of rising inflation or policy normalisation took hold and fallen away when those fears proved overdone, but have remained in fairly tight ranges. We find UK and European bonds to be substantially overvalued. US government bonds are more fairly valued but the Federal Reserve seems set on a path of rising interest rates and may begin quantitative tightening (the opposite of quantitative easing, which is likely to put upwards pressure on bond yields and downwards pressure on prices) later this year. This really is uncharted territory so we remain cautious.

Corporate bonds

We see both high yield and investment grade bonds as expensive versus history and so are slightly negative on both asset classes. We marginally prefer high yield bonds as they offer greater yields than government bonds and have a lower sensitivity to interest rates.

Alternatives

We are overweight alternatives, mainly due to our negative views on other asset classes.



We see risks to many equity and bond markets, and could even envisage a situation where both move down together. Given these concerns, we're maintaining a higher allocation to alternatives, which typically exhibit a low correlation to conventional asset classes.

Property

Our view on property is broadly neutral.

Although we have concerns about the trajectory of the UK economy, the yield on property is attractive relative to other asset classes.

Commodities

We have limited exposure to energy equities.

Industrial metals and energy performed very well in 2016 as the oil market recovered and China extended their fiscal stimulus. However, OPEC have now begun to increase supply and oil stocks are high. In addition, Chinese investment is no longer growing at such a high rate, which could damage industrial commodity demand. We remain neutral on commodities.

For the latest information on our market views and positioning please visit:

eqinvestors.co.uk

Please remember that past performance is not a guide to future returns. The value of investments and income derived from them can fall as well as rise, and you may get back lass than you originally invested.

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