

Investment Committee Update

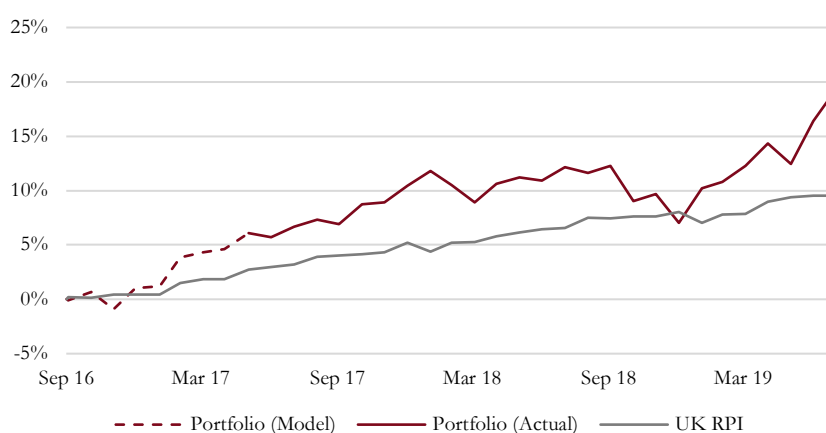
August 2019

AT A GLANCE

- While maintaining our overall asset allocation (reflecting an unchanged central scenario), we have taken several steps to adopt a more defensive stance in portfolios.
- We have rotated our equity exposure by reducing our allocation to higher beta emerging markets and diverting capital to higher-quality US assets.
- We have further sold out of our position in Asia ex Japan equities due to increased geopolitical risks (protests in Hong Kong, trade spats between Japan and South Korea or tariffs between the US and China).
- We have built some downside protection into portfolios through a put option strategy.
- Currency continues to be a focus of volatility and consequently we have moved our Japanese equity exposure to be entirely unhedged given the safe-haven status of the yen.
- We have bought call options on sterling to protect GBP portfolios from a sharp rise in the currency (however unlikely this may seem).
- Diversification remains a key tactical approach for us and portfolios continue to hold an unusually high proportion of alternative assets, reflecting the challenges facing conventional asset class returns.
- We continue to hold a significant allocation to gold in portfolios, which has recently reached a six-year high.

Performance (28 September 2016 to 31 July 2019)

Multi-asset strategy (sterling moderate risk)



Source: Saranac Partners.

MARKET PERSPECTIVES

Despite a central scenario of continued subdued but stable growth, we have rotated to a more defensive stance in portfolios. Global monetary policy has shifted to a more supportive stance and while this may struggle to stimulate faster growth, it should perpetuate this economic cycle further still. At the same time, US–China trade woes and a global slump in manufacturing has reduced our expectation of a global recovery in the second half. Furthermore, geopolitical tensions in Asia and recent volatility have highlighted the vulnerability in markets.

Zeitgeist: the long-term context

We have not changed our view on the overarching economic context. The investment environment is characterised by subdued economic growth, low inflation, and an unstable political background. We continue to believe that the economic cycle has further to run.

In this context we forecast modest equity growth and record low fixed income yields. We view alternative investments as an important diversification tool and believe gold will continue to perform as a safe-haven asset.

Macro drivers: medium-term environment

There has been a significant easing of the monetary environment, with 80% of central banks loosening monetary policy. In this supportive policy environment, we do not expect a significant correction.

Signals: short-term indicators

Recent volatility together with the deteriorating picture around US–China trade talks has highlighted the vulnerability of markets. We have therefore taken a more defensive positioning in portfolios while not changing our fundamental view on the medium-term market environment.

ASSET ALLOCATION

For a moderate risk portfolio, we hold around 40% in fixed income (with an emphasis on higher yielding markets), 35% in equities and 25% in alternative assets (gold and hedge funds).

For us this is a record high exposure to alternative assets but one we believe is justified given the need for diversification in an ultra-low yield environment.

EQUITIES

Our overall allocation to equities is unchanged given our central scenario of ongoing subdued growth. However, within our equity allocation we have adopted a more defensive stance in portfolios. This follows near-term volatility and the deterioration of prospects for improved growth trajectory driven by ongoing US–China trade tensions and a global slump in manufacturing.

We have reallocated capital to developed markets (away from developing markets), and in particular the US. Emerging markets are more sensitive to cyclical trends and therefore will underperform in more challenging markets. Our US allocation, with its bias towards high-quality growth stocks, is expected to perform better in this modest growth environment.

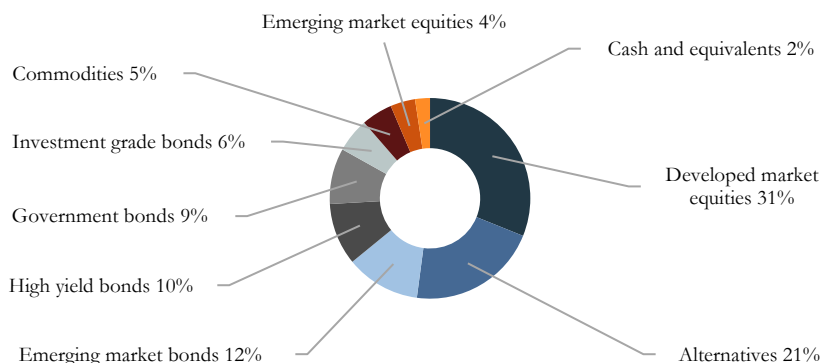
Furthermore, we have cut our allocation to Asia (ex Japan), with geopolitical issues in the region acting as a net-negative to growth. In addition to US–China trade tensions, the dispute between Japan and South Korea and the protests in Hong Kong impact the prospects for the region.

We have also taken the step of converting any Japanese exposure in portfolios to an unhedged allocation. The Japanese yen traditionally performs strongly against all other currencies (including the US dollar) in risk-off periods, including the most recent episode of market volatility. We have therefore positioned to take advantage of this currency strength as and when volatility arises.

We have implemented these allocation changes in equities through buying S&P

Asset allocation

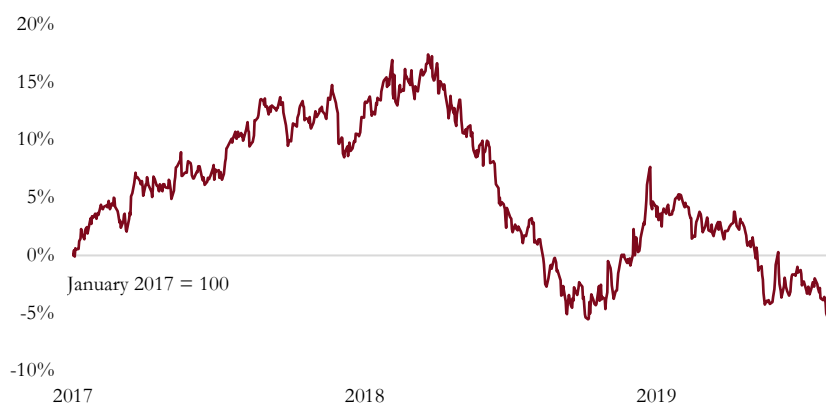
Multi-asset strategy (sterling moderate risk)



Source: Saranac Partners.

Relative performance of MSCI Emerging Markets vs MSCI World

Emerging market equities have underperformed global equities over the past few months (indicated in the chart below when the line falls below 0%).



Source: Saranac Partners, MSCI.

to effect quick and effective exposure. We will seek to divert our S&P 500 ETF allocation into direct equity holdings as opportunities arise.

Our bottom-up equity selection has performed well this year and added returns over and above our asset allocation decisions. Winners so far this year include Airbus (+60.4%), Facebook (+54.5%), LVMH (+50.7%), Discover Financial Services (+43.2%) and Visa (+37.3%).

Lastly, we have taken steps to add downside protection into the portfolio. In recent weeks we closed out the call option we had initiated earlier in the year on the Eurostoxx equity index at a gain of 2.6x invested capital. We have now

put option strategy into the portfolio to protect against potential falls in market while maintaining core equity exposure.

FIXED INCOME

Government bond yields have fallen to record lows and over \$15 trillion of bonds worldwide offer negative yields. One of the few government bond markets that provides some yield is the US (US 10-year Treasuries yield 1.7%).

In the event of a global slowdown and/or recession, European or UK government bonds will not provide much protection as their yields are already so low. The US bond market has the potential to see yields fall much further and as a result offer better

protection in portfolios against an extreme outcome.

On a hedged basis, US Treasuries offer a similar yield to UK gilts or European government bonds. Consequently, we are looking at the possibility of switching our long-dated gilts and European government bond exposure into similar, long-dated US Treasuries and hedging the currency.

To maintain portfolio yield we have held relatively high allocations to high yield and emerging market debt. Most portfolios have held more than 10% in EM bonds over the course of the year and benefited from the collapse in developed market yields and resulting search for yield by markets.

ALTERNATIVE INVESTMENTS

Over the last 12 months, we have increased our gold positions from a 3% weight to a 5% to 6% position at the end of 2018. Gold recently broke out of its five-year resistance level of \$1,350, breaching \$1,500 per ounce on 7 August – a six-year high.

Given continued monetary easing from central banks, we think bond yields are likely to remain low and the momentum for gold should be positive. However, gold has already risen 16% this year and we are uncomfortable increasing the allocation at this time. We are therefore considering developing a call option strategy to participate in any ongoing upside in gold for a minimal capital outlay.

Portfolios currently have around a 20% allocation to alternatives. We consider this to be a high allocation, but justifiable given the uncertain outlook for many conventional asset classes. This allocation consists of a combination of hedge fund and alternative risk premia managers, both of which have low correlations with conventional asset classes. These investments have been accretive to returns in 2019.

CURRENCIES

Brexit continues to be a meaningful geopolitical event for sterling investors.

Earlier in July, as sterling fell sharply on the appointment of Boris Johnson as the new Prime Minister, we put in place a hedge against a strengthening in sterling for sterling portfolios. While such an outcome seems unlikely at this point, sterling portfolios have benefited significantly from the currency diversification inherent in the portfolio as sterling has fallen to new lows and would be vulnerable to a reversal in the currency.

While Brexit risks remain high, it is plausible that a hard Brexit may be avoided and if this were the case, we would expect to see sterling rise sharply. We were able to put in place protection that was cost neutral and which protects portfolios from a rise in the pound beyond \$1.28, while foregoing any further benefit if sterling falls below \$1.17.

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