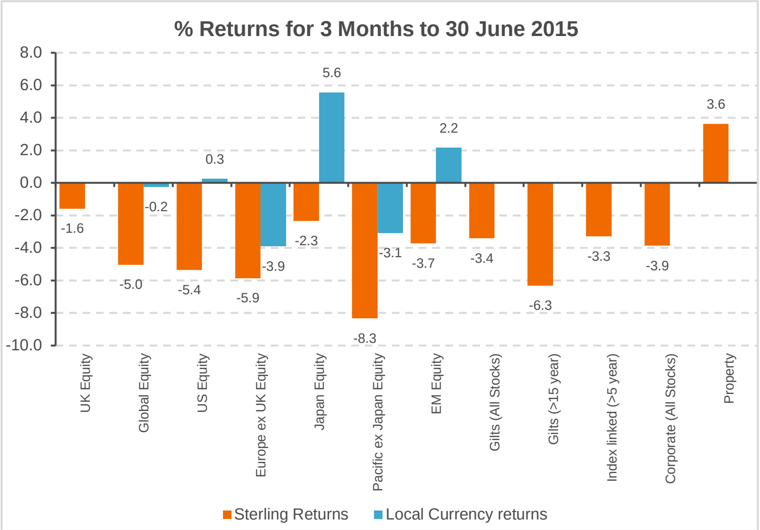
Market Background – Q2 2015



Economic news was mildly positive in most regions over the quarter. The US enjoyed a modest rebound after a disappointing first quarter and data relating to the Eurozone suggested a continuation of the gradual recovery seen in recent quarters.

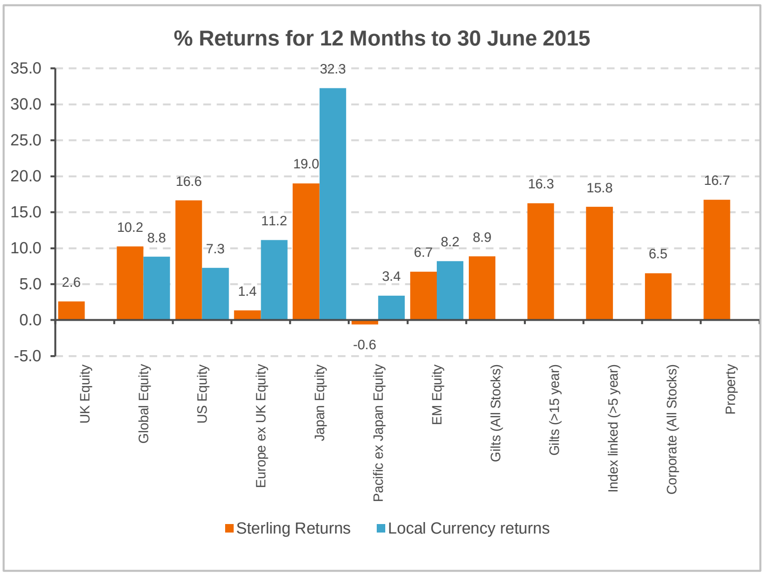
In the UK, economic growth estimates for Q1 2015 were revised upwards from 0.3% to 0.4% and the estimate of growth for 2014 as a whole was revised from 2.8% to 3.0%, the highest rate since 2007.

In local currency terms, Japan was the standout performer, returning 5.6% over the quarter as a combination of government support and a flow through from a weaker Yen pushed the Nikkei index up to its highest level in 18 years. Despite fears of a slowdown in China and the impact of a resurgent US Dollar, emerging market equities managed to keep up the momentum from the turn of the year and returned 2.2% in local currency terms.

Taking account of currency movements during a quarter where Sterling appreciated against all major currencies, returns to Sterling investors were negative across all markets. The worst performing regions for Sterling investors over the quarter were Pacific ex-Japan (-8.3%), followed by Europe ex-UK (-5.9%) and the US (-5.4%). Comparatively strong local currency returns limited the fall in Japanese markets to Sterling investors to -2.3%.

Base rates in the UK, US, Eurozone and Japan remained unchanged over the quarter. However, the US Federal Reserve's Chairman, Janet Yellen, gave her clearest signal yet that US rates may rise this later this year and yield curves followed suit rising sharply, with gilts delivering negative returns as a result.

Having narrowed over the opening quarter of the year, credit spreads widened over Q2 2015, resulting in credit underperforming conventional gilts on a duration-adjusted basis (down 3.9% over the quarter).



Over the last 12 months, global equity markets delivered double-digit returns. Japanese equities have experienced a particularly strong 12 months, up over 32% in local currency terms. In contrast, UK equity markets have lagged somewhat behind, up 2.6%.

Despite rising yields over the quarter, returns on long-dated fixed interest and index-linked gilt indices remain well into double digits over 12 months (up 16.3% and 15.8% respectively). Returns of similar duration corporate bonds were broadly in line with gilt returns, with little change in credit spreads over the 12 months.

Property markets, represented by the IPD Monthly Property Index, returned 3.6% over the quarter and 16.7% over the last twelve months.

Key market data

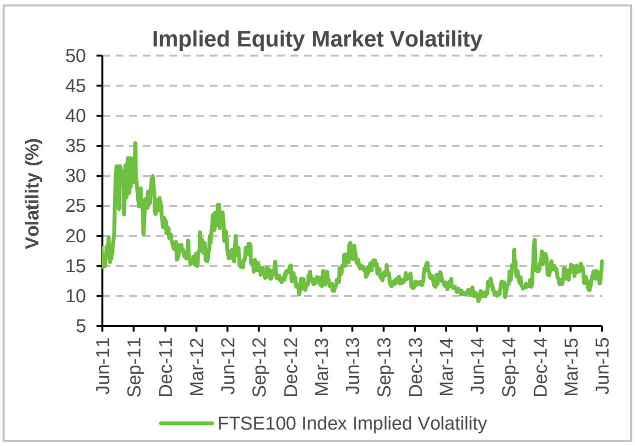
The tables below provide a summary of key financial indicators over recent periods:

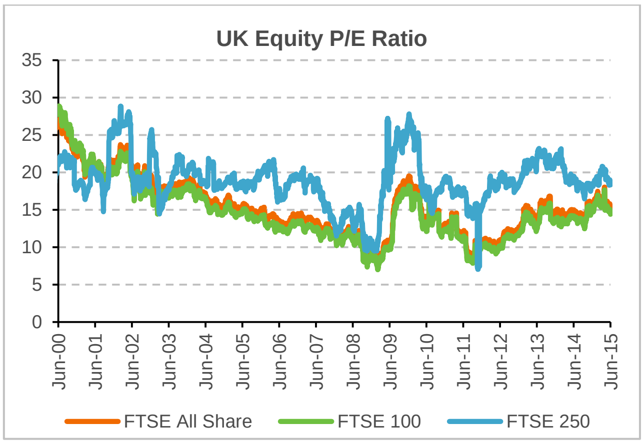
	30.06.14	30.09.14	31.12.14	31.03.15	30.06.15
UK equity yield	3.27%	3.34%	3.37%	3.33%	3.46%
UK equity P/E ratio	14.73x	14.07x	15.82x	16.04x	15.11x
Over 15 year gilt yield (p.a.)	3.34%	2.98%	2.42%	2.23%	2.63%
Over 5 year index-linked gilt yield (p.a.)	-0.10%	-0.35%	-0.75%	-0.91%	-0.75%
iBoxx Over 10 year Non-gilt yield (p.a.)	4.33%	4.04%	3.60%	3.23%	3.85%

	Year to 30.06.13	Year to 30.06.14	Year to 30.06.15	Quarter to 31.03.15	Quarter to 30.06.15
UK equity	17.9%	13.1%	2.6%	4.7%	-1.6%
Global equity	21.4%	9.6%	10.2%	7.7%	-5.0%
Over 15 year gilts	-4.6%	5.3%	16.3%	4.1%	-6.3%
Over 5 year index linked gilts	2.7%	4.3%	15.8%	3.3%	-3.3%
All Stocks Non-Gilts	5.9%	6.8%	6.5%	3.2%	-3.9%
IPD Monthly Index	4.1%	17.6%	16.7%	3.0%	3.6%

UK equity market

Equity Market Data (Source: Datastream)	31 March 2015	30 June 2015
FTSE All Share Dividend Yield	3.3%	3.5%
Dividend growth over the quarter	2.5%	1.3%
Dividend growth over the year	0.6%	4.9%
FTSE All Share P/E Ratio	16.0x	15.1x
Total Return during the quarter	4.7%	-1.6%
Total Return over the last 12 months	6.6%	2.6%



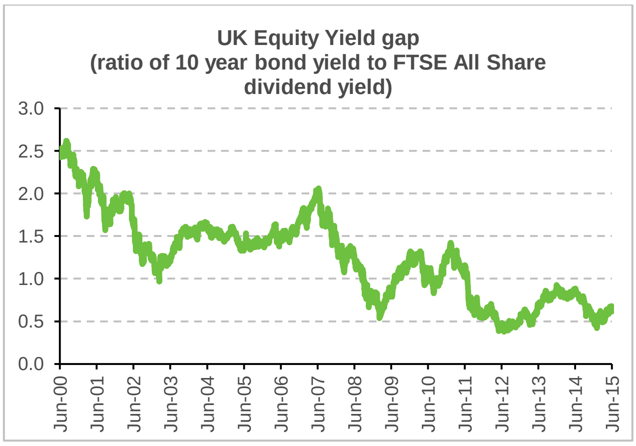


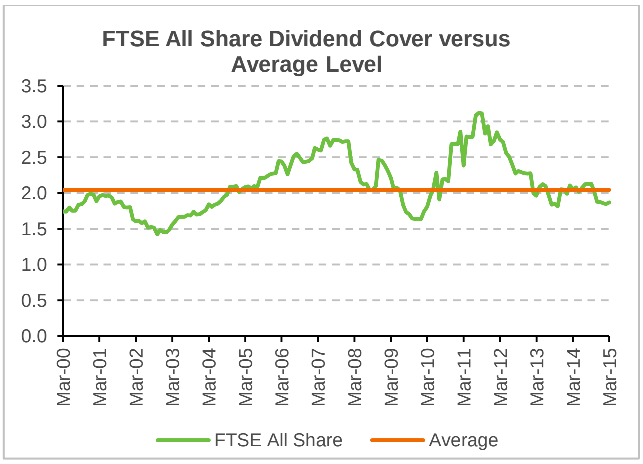
Uncertainty around commodity prices and the Greek debt crisis weighed on investors' sentiment over Q2 2015, with UK equity markets retracing some of the gains made at the start of the year. However, index returns hide a high level of dispersion within underlying sectors: low energy and falling commodity prices saw negative returns in the Oil & Gas (-2.9%) and Basic Materials (-6.5%) sectors, whilst Telecommunications (+6.1%) and Technology (+3.4%) stocks were more bouyant.

Implied volatility rose slightly over the quarter, peaking at 15.8% at the end of June as equity markets sold off. It has subsequently fallen and sits below the average level over the past three years.

Dividends remain an attractive form of income relative to bond markets and, although the pace of growth has slowed somewhat over the quarter, growth over the last 12 months has picked up.

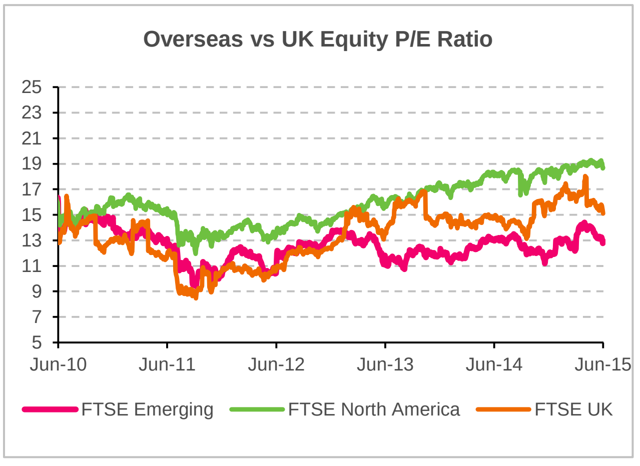
Levels of dividend cover provided by earnings remain adequate and, with falling prices, P/E ratios fell over the quarter. Over the last 12 months, prices haven't pushed too far ahead of earnings growth. Any excessive revaluation in future, however, may be difficult to justify unless earnings growth continues.

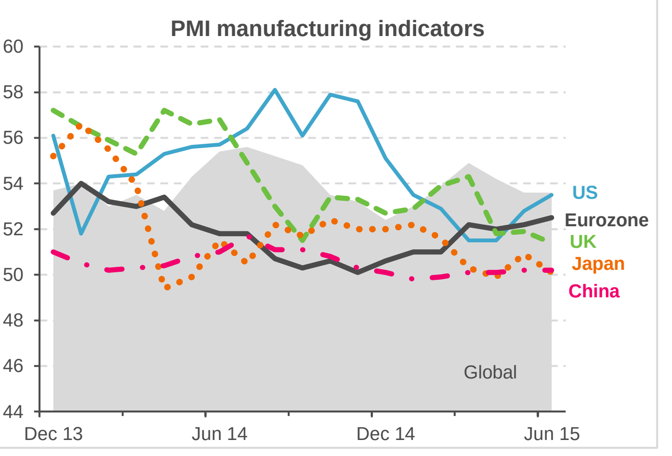




Overseas equity markets

Equity Market Data (Source: Datastream)	31 March 2015	30 June 2015
Dividend Yield	2.3%	2.5%
Total Return during the quarter (£)	7.7%	-5.0%
Total Return during the quarter (Local)	5.0%	-0.2%
Total Return over the last 12 months (£)	19.2%	10.2%
Total Return over the last 12 months (Local)	14.3%	8.8%





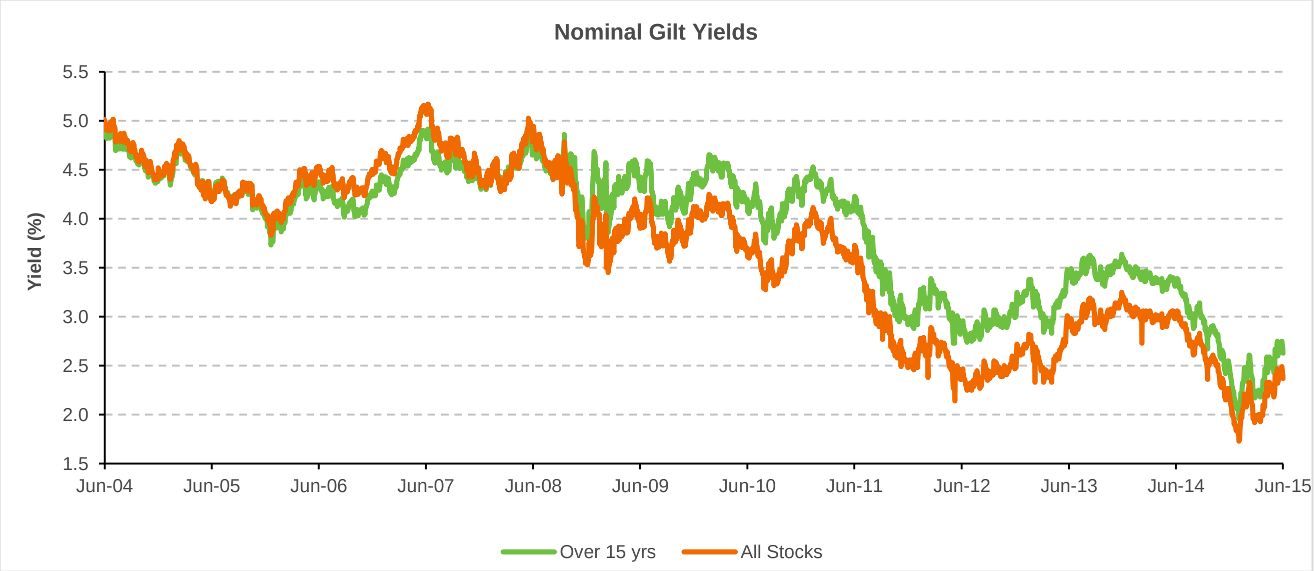
Global equities were broadly flat over the quarter in local currency terms, although a significant appreciation in the value of Sterling saw returns to Sterling investors coming in around -5.0%. There was a great deal of dispersion between regions, with Japan (+5.6%), Emerging Markets (+2.2%) and the US (+0.3%) all delivering positive returns, with Europe (-5.9%) and Asia (-8.3%) struggling.

The S&P 500 achieved a new all-time high over the quarter, in part due to the impact of a resurgent US Dollar on corporate earnings and further strong merger & acquisition activity. Improving macroeconomic data, boosting hopes that the first-quarter GDP contraction was a temporary blip, helped boost sales and increase consumer confidence going into the third quarter of the year.

New heights were also reached in Japanese equity markets, where the Nikkei index reached 20,868 in late June as markets reacted positively to corporate results announcements and economic data suggested that inflation was finally starting to tick upwards.

Closer to home, European equity markets struggled as investors nervously watched events surrounding the Greek debt crisis and consequent negotiations around a third bailout package unfold.

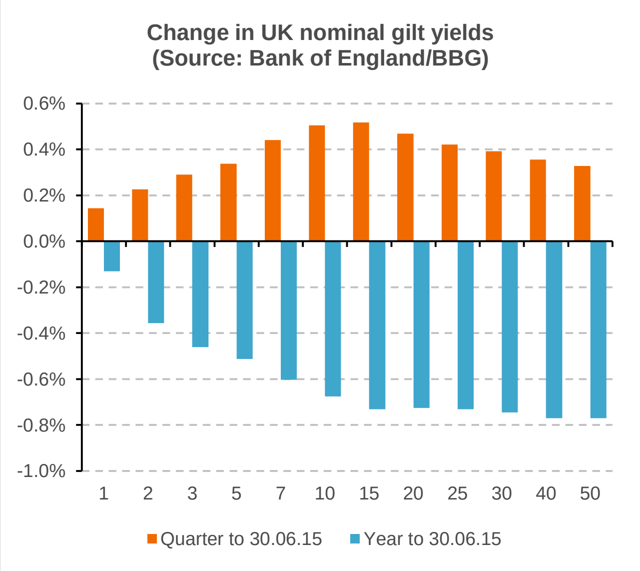
UK interest rates

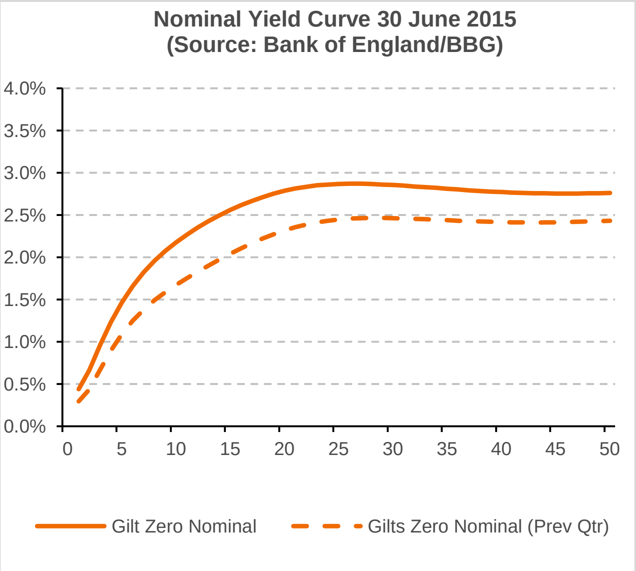


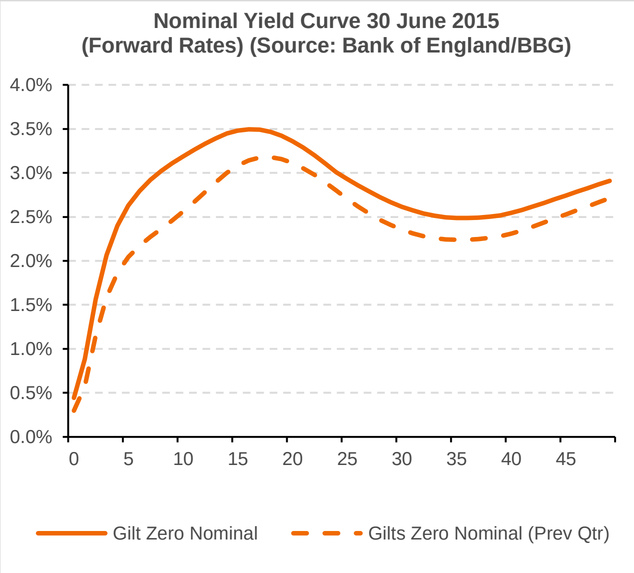
Gilt yields in the UK followed their European counterparts higher over the quarter as markets reacted to unfolding events surrounding the Greek debt crisis and consequent negotiations.

By the end of the quarter, nominal gilt yields had risen by around 20-40 basis points across the curve. However, despite this, yields still sit significantly below where they were this time last year and are far from the highs of even relatively recent history.

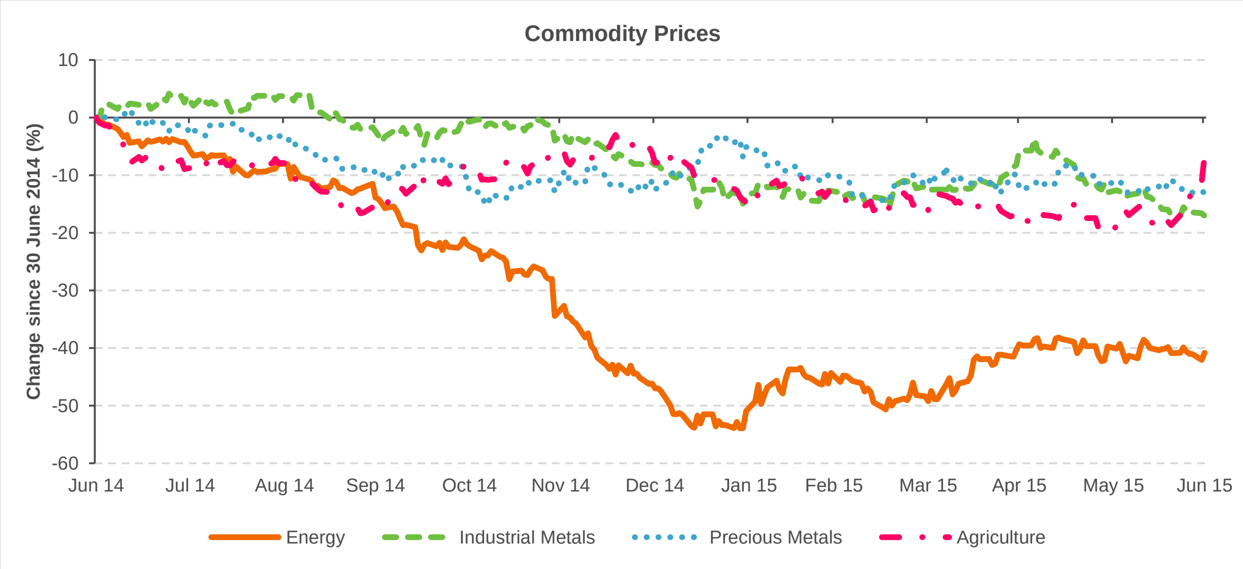
Movements in forward rates were more pronounced at the short-to-medium end of the curve. As a result, forward rates on gilts at the end of the quarter were expected to reach 3.2% p.a. in ten years.



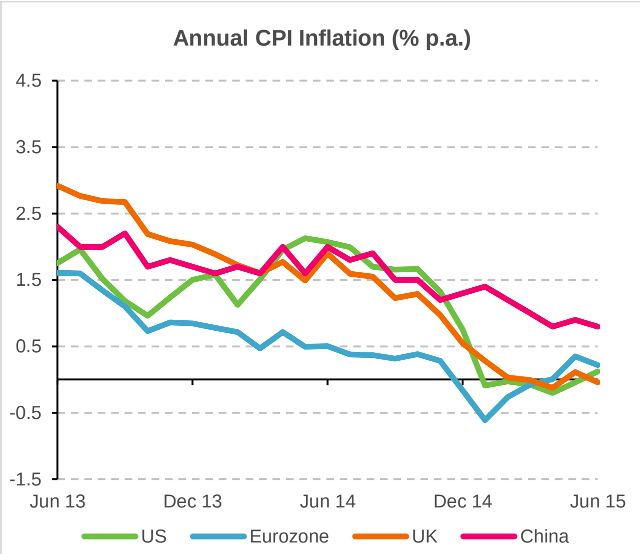




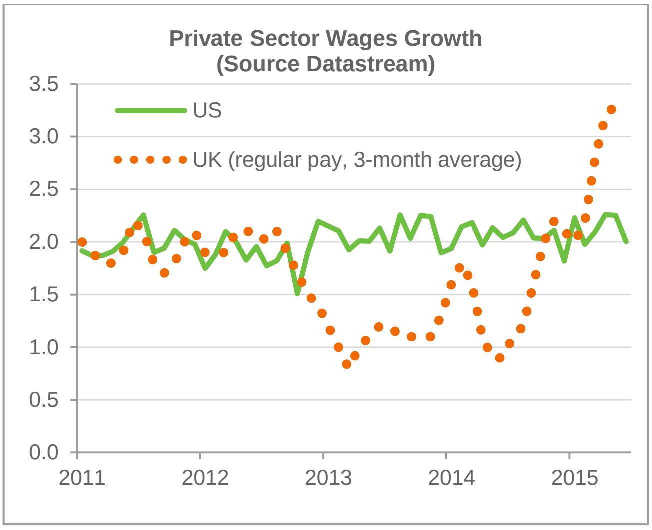
Inflation and real rates



After bottoming out at the turn of the year, oil prices continued to recover early on in the quarter and traded within a range between $62-64 a barrel throughout the remainder. However, prices remain comparatively weak and some downward pressure has been evident following the end of the quarter as negotiations with Iran to uplift sanctions edged closer to a conclusion and emerging market demand remains subdued.



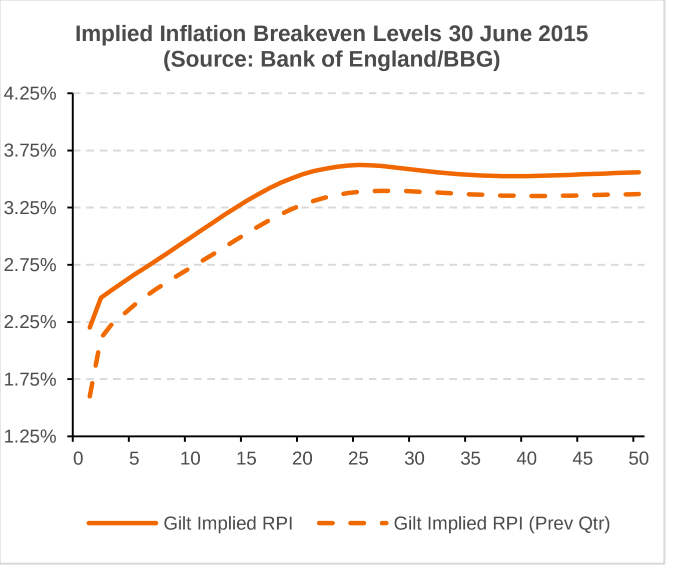
Downward pressure on food prices eased off a little over the quarter and, combined with rising energy prices, helped lift domestic inflation back out of negative territory – UK CPI inflation rose to 0.1% in May having turned marginally negative (-0.1%) in April for the first time in 50 years.

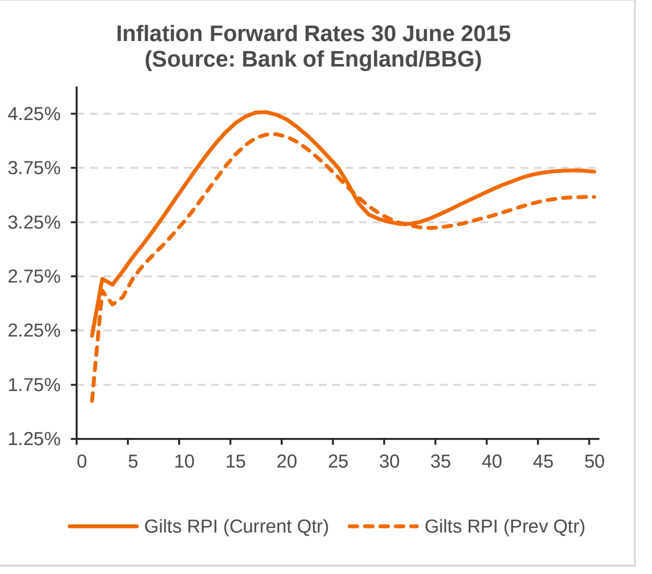


Excluding the impact of volatile food and energy prices, core CPI inflation continues to sit higher at around 0.8%. However, it has been slowly ticking down over much of the last year, with the downward trend continuing over the quarter.

With the near-term domestic and global inflationary outlook looking subdued, any pressure for the Bank of England ("BoE") to raise interest rates still looks far off.

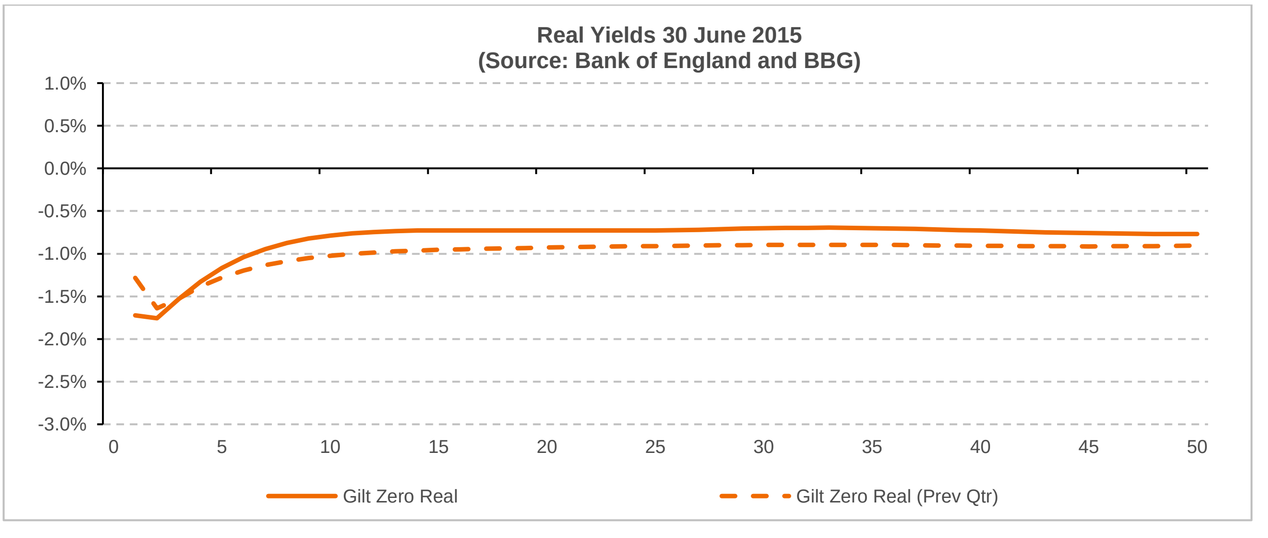
Counter to this, UK wages are rising strongly relative to US wage growth. This may begin to fuel some element of domestic inflation.





Market-implied inflation levels followed nominal yields higher, albeit to a lesser extent. However, short-term inflationary pressures remain subdued and markets are still not pricing in RPI inflation to rise beyond 3% for another five years.

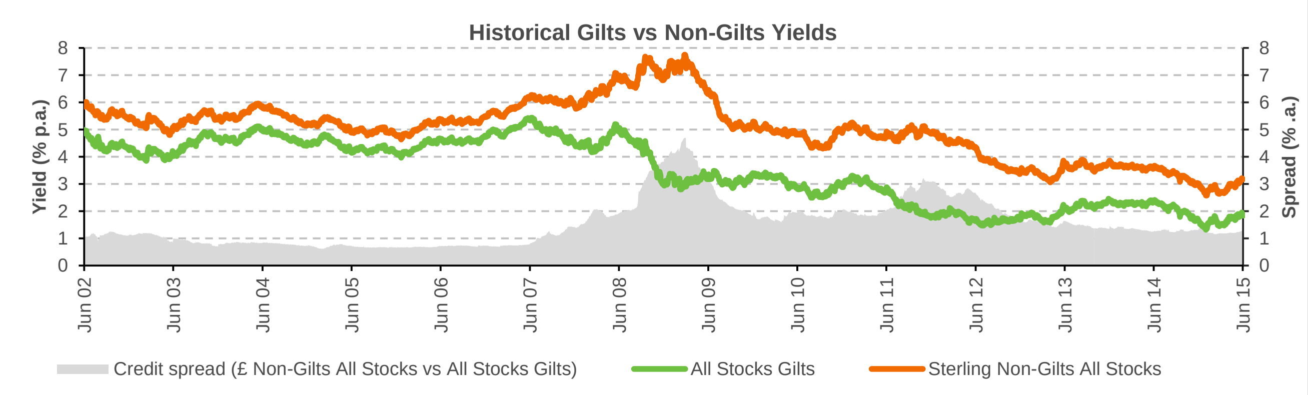
With nominal yields rising by more than expected inflation, real yields ticked up slightly to around -0.75% at maturities beyond five years.



Credit markets

ML Non-Gilts Spreads over Gilts (Source: Datastream)	Sterling Non-Gilts (bps)	Sterling Non-Gilts Over 10 Years (bps)	Global Broad Market Corporate (bps)
31 March 2015	118	105	126
30 June 2015	134	126	150
Median since 2 April 2002	131	114	141
Average since 2 April 2002	154	132	173

Note: Spreads on financials, non-financials and the broad corporate market are calculated using iBoxx indices. All other spreads are calculated using Merrill Lynch indices.



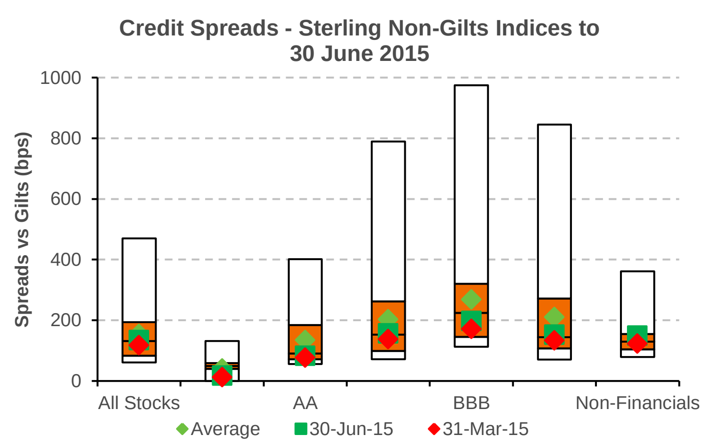
On a like-for-like basis, i.e. taking account of duration, credit markets underperformed gilts over the quarter as credit spreads widened.

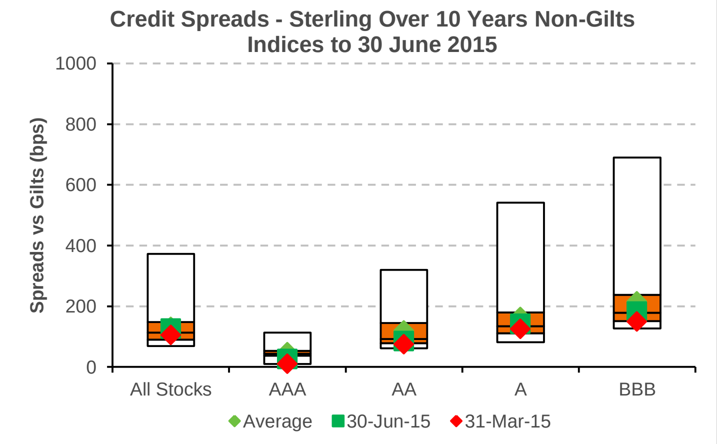
As a result, spreads on the All Stocks index are sitting broadly in line with the median level witnessed over the last 13 years and around 20bps lower than the average. Spreads on the longer-dated Over 10 Year index are now sitting slightly above the median level but broadly in line with the average.

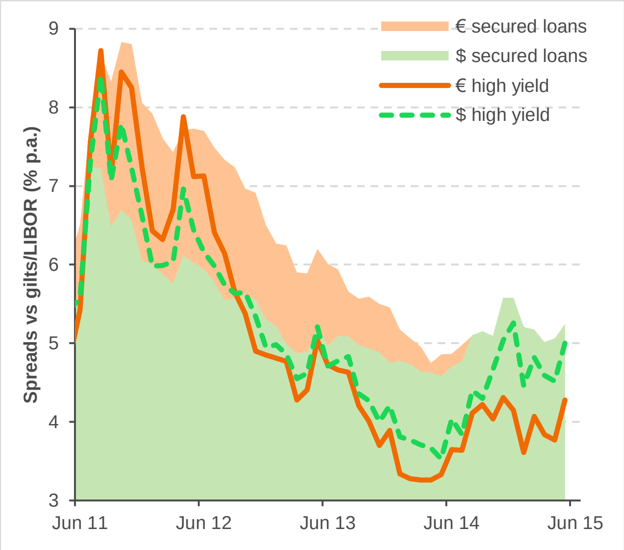
Current spread levels remain supported by the availability of cheap money, a lack of Sterling issuance and accommodative monetary policy. Further yield compression remains possible, especially if corporate newsflow remains positive.

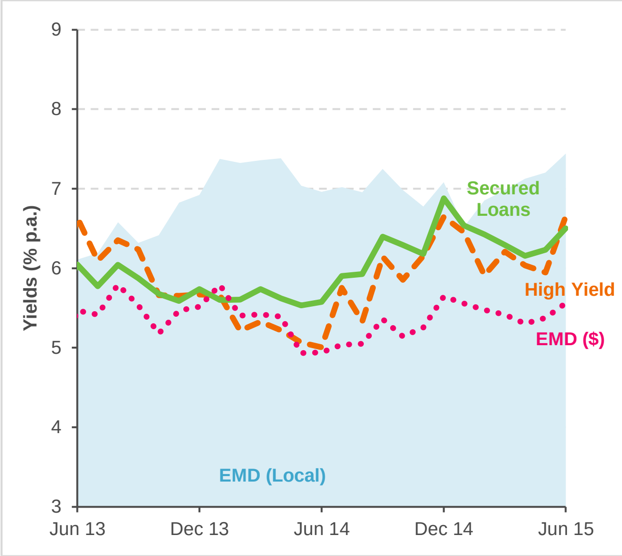
With no significant changes over the quarter, we continue to see the primary use for corporate bonds as a strategic yield enhancement to gilts rather any tactical short-term capital.

Excluding defaults, current spreads on the All Stocks Non-Gilts index continue to provide a buffer to support a spread widening of c.17bps over one year without capital loss. This reduces to c.10bps for the Over 10 Year index.







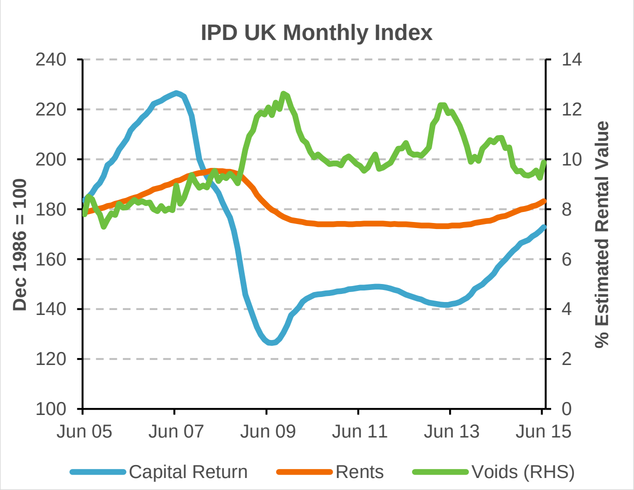


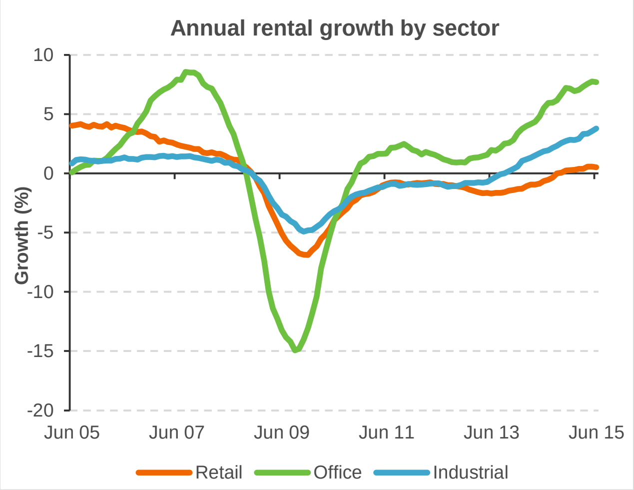
Yields on high yield debt and loans rose over the quarter. However, spreads on loans were more resilient – spreads on high yield debt rose by around 20bps whereas spreads on loans rose by around 5bps. As a result, the yield premium on syndicated loans relative to high yield debt is as narrow as it has been for some time.

Relative valuations in these markets remain at the cheaper end of where they have been over the last eighteen months or so. However, we note that relative to only two or three years ago, yield spreads are still low and there has been some general easing in covenants on new issues in the last couple of years. Valuations are only cheap in an absolute sense to the extent that central bank interest rate policy keeps yields on all bonds below historic levels.

Emerging market debt yields continue to offer value, although concerns around slowing growth in China, a stronger US Dollar and lower commodity prices continue to create a challenging environment in the short term.

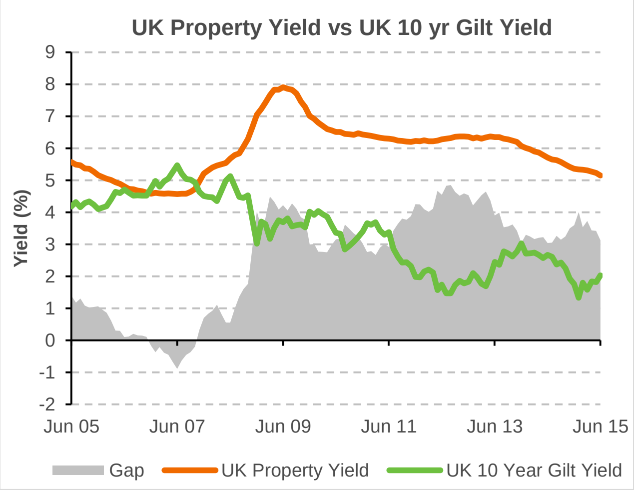
UK property





After a strong start to the year, commercial property continued to push ahead over Q2 2015, with total returns of 3.6% over the quarter bringing returns over the last 12 months to 16.7%.

Total returns of 3.6% were attributed to further capital growth of 2.2% and income of 1.4%, although the retail sector continues to lag somewhat behind. The relative strength of the office sector can be seen in the continuing strong rental growth, with rents on average some 7.7% ahead of levels just 12 months ago.



With capital values continuing to push ahead of rental growth, the yield on property continued to fall. As at the end of Q2 2015, the yield on commercial property stood at 5.15% and with gilt yields rising over the quarter, the gap closed by around 60bps. However, it still remains at over 3%, offering investors a reasonable buffer against any further rise in yields.

There is a danger that investors are over-paying for expectations of future growth. However, this can perhaps be countered by the fact that capital values remain considerably below their 2006/07 peak in nominal terms. We would, however, note that this disguises regional differences, with London remaining the principal driver of property returns.

Notes and Risk Warnings

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets.

Exchange rates may also affect the value of any investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.

Private equity investments, whether held directly or in pooled fund arrangements carry a higher risk than publicly quoted securities; the nature of private equity pooling vehicles makes them particularly illiquid and investment in private equity should be considered to have a long time horizon.

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