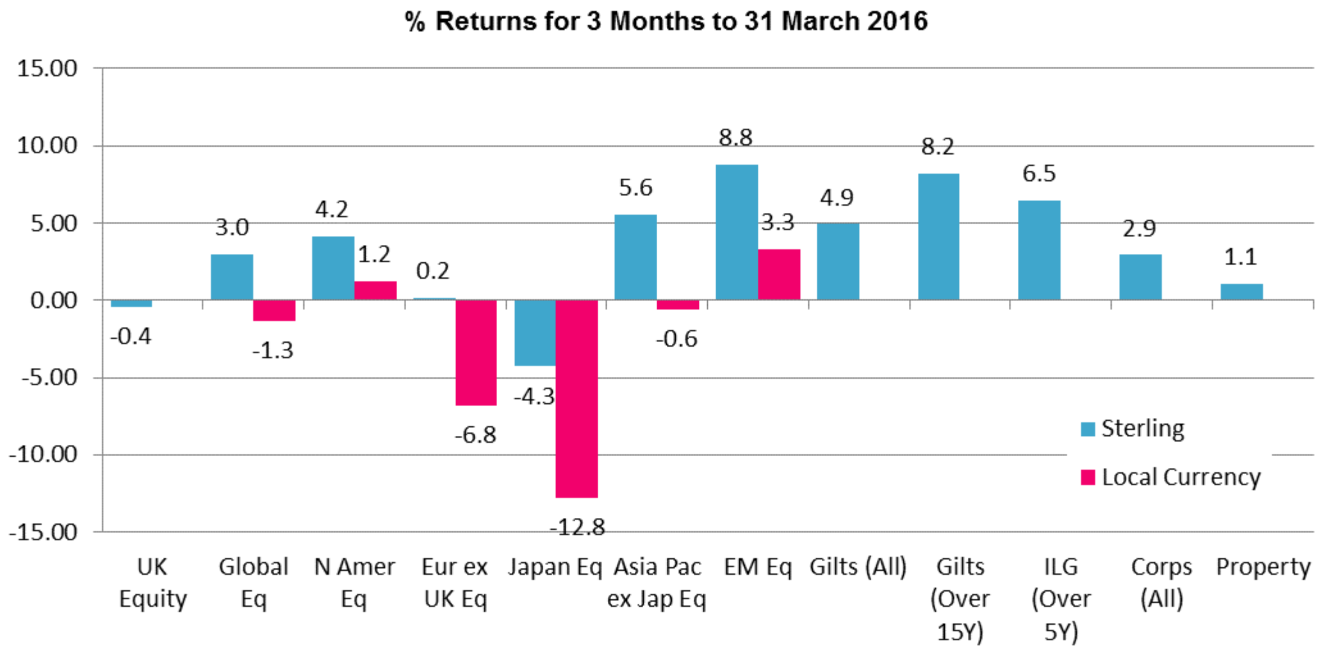
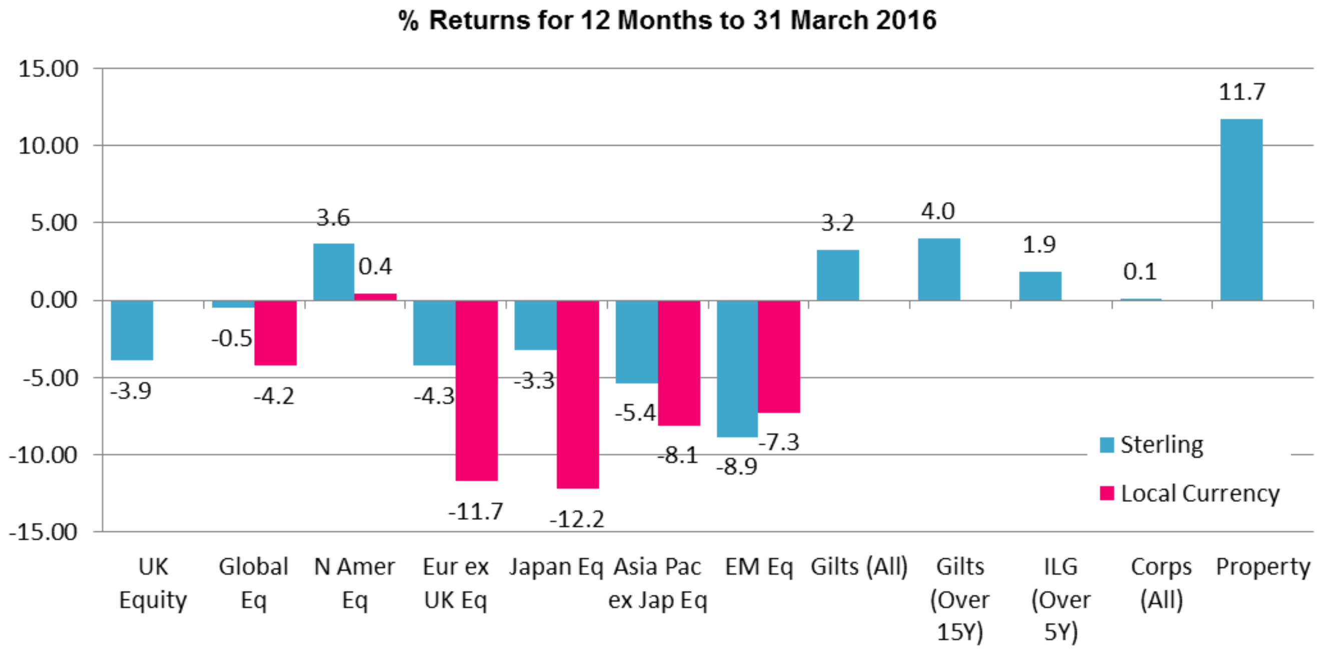
Market Background – Q1 2016

Market Background

The following chart shows the market returns over periods to 31 March 2016:





Source: Datastream

Macroeconomic background

It was a turbulent first six weeks for equity and credit markets. The FTSE All World index plummeting over 12%, before rebounding impressively to finish the quarter down 1.3%. As a result of continued weakness in sterling, returns to unhedged UK investors were around 4.3% better. The defensive qualities of government bonds were in demand and they delivered positive returns over the period.

Investors' panicky start to 2016 reflected various global economic concerns– slowdown in China and US and the continuing oil price collapse. This anxiety abated as the quarter wore on, with sentiment buoyed in part by some signs of stabilisation in China.

But, once again, central banks did a lot to calm nerves. The European Central Bank cut its overnight deposit rate from -0.3% p.a. to -0.4% p.a. The Bank of Japan surprised markets by following the ECB in cutting interest rates below zero. Despite further strength in the US labour market, the US Federal Reserve left interest rates unchanged, citing risks posed by weaker global growth and financial market turmoil. And its latest forecasts were more cautious than before, suggesting that rates might rise by only 0.5% p.a. in 2016. In the UK, the latest Inflation Report from the Bank of England suggested a slower return to the 2% p.a. inflation target, further bolstering market conviction that UK interest rates will not be rising soon.

Key events during the quarter included:

Global Economy

- Japan followed Europe by cutting interest rates below zero; in the UK and US rates were unchanged.
- UK's current deficit reached a post-war high, widening to 7% of GDP in Q4 2015.
- Brent crude fell to a 12-year low of $28 per barrel before rebounding to just under $40.
- The Bank of England expects headline CPI inflation to stay below 1% p.a. throughout this year.
- China's PMI manufacturing index rose to above 50 in March, for the first time since July 2015.

Equities

- The strongest sectors relative to the FTSE All World Index were Utilities (+8.8%) and Telecommunications (+6.7%); the weakest were Health Care (-6.5%) and Financials (-5.3%).
- Emerging Markets outperformed their developed counterparts, reversing a little of the 30% underperformance of the last three years.

Bonds and currencies

- Sterling weakened against the euro, dollar and yen.
- UK gilt yields fell (prices rose), with nominal yields falling further than real yields.

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

	31.12.11	31.12.12	31.12.13	31.12.14	31.12.15	31.3.16
UK Equity yield	3.5%	3.6%	3.3%	3.4%	3.7%	3.8%
UK Equity P/E ratio	10.6	12.3	14.9	15.8	17.8	24.3
Over 15 year gilt yield (p.a.)	2.9%	3.0%	3.6%	2.4%	2.6%	2.2%
>5 year index linked gilt yield (p.a.)	-0.2%	-0.1%	0.1%	-0.8%	-0.7%	-1.0%
iBoxx >10 year Non-gilt yield (p.a.)	4.9%	4.1%	4.6%	3.6%	3.9%	3.6%

	Year to 31.3.12	Year to 31.3.13	Year to 31.3.14	Year to 31.3.15	Year to 31.3.16	Quarter to 31.3.16	31.3.16 to 14.4.16
FTSE All Share	1.4	16.8	8.8	6.6	-3.9	-0.4	2.8
Global Equity	-0.2	17.1	6.8	19.2	-0.5	3.0	3.2
Over 15 year gilts	22.6	8.1	-3.1	27.0	4.0	8.2	-0.4
Over 5 year index linked gilts	21.1	11.7	-4.4	21.1	1.9	6.5	-0.6
All Stocks Non-Gilts	8.8	12.0	1.6	13.1	0.4	3.2	0.2
IPD Monthly Index	6.6	2.5	14.0	18.3	11.7	1.1	-

Equities

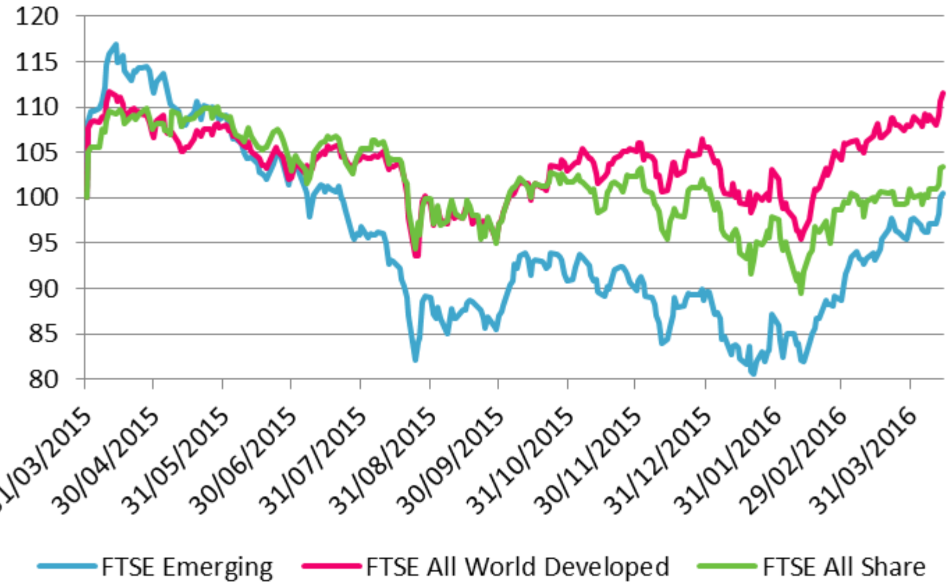
In sterling terms, global equities returned +3.0% over Q1 (as measured by the FTSE All World index). The strongest returns came from Emerging Markets (+8.8% in sterling terms) followed by Asia Pacific ex Japan (+5.6%) and North America (+4.2%). Other major equity markets were more mixed with the UK and Europe ex UK fairly flat (-0.4% and +0.2% respectively) but Japan posted a more negative return (-4.3%). In local currency terms, returns were mixed with sharp falls in Japan (-12.8%) and Europe ex UK (-6.8%). In contrast Emerging Markets and North America posted positive returns (+3.3% and +1.2%). Weaker sterling enhanced global equity returns for sterling investors.

Over the 12 month period ending 31 March 2016, global equity returns were modestly negative. North America was the only major equity region to post a positive positive return (+3.6% in sterling terms). Emerging Markets were the poorest performers in sterling terms (-8.9%). Due to the significant influence of North America on the composition of the index, this limited the fall in the FTSE All World Index to -0.5% in sterling terms. Again, over 12 months, sterling weakness meant better returns for sterling investors in contast to local currency returns.

Over the quarter, the strongest sector return relative to the All World index came from Utilities (+8.8% relative). The weakest relative sector return came from Health Care (-6.5% relative). Over the 12 months, Utilities also provided the strongest returns (at +9.6%), with Basic Materials the weakest (-10.4%). Globally, value stocks underperformed growth over the quarter (-0.2% v +0.7%).

The following chart plots the performance of the global equity market since the end of Q1 2015.

Chart 1: Global equity markets

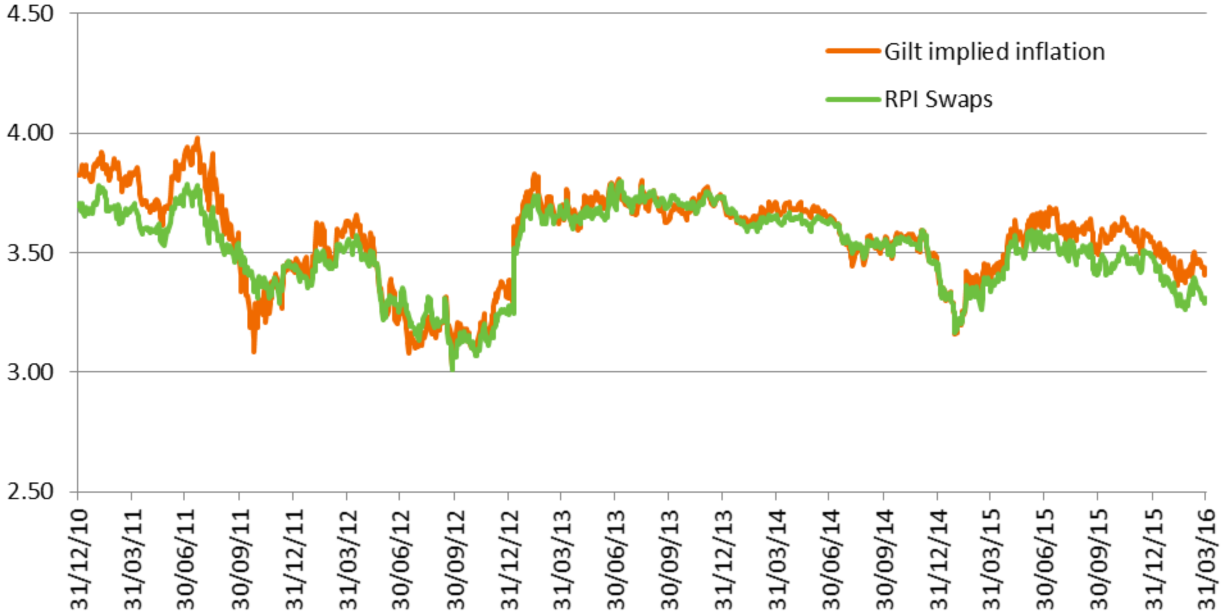


Source: Datastream

Fixed Income

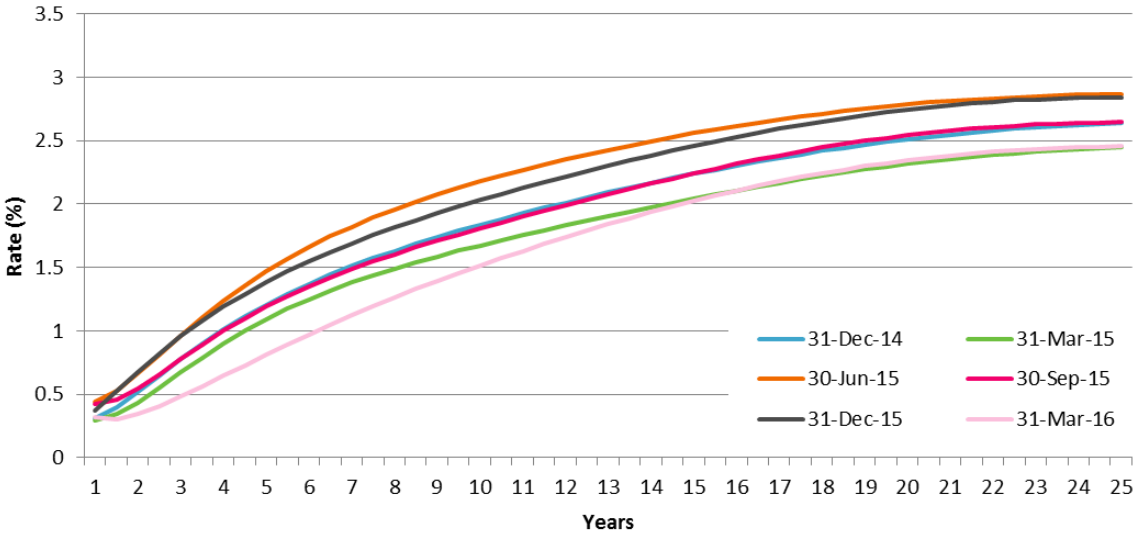
Long term inflation expectations have risen from a low point at the end of January 2015 but have generally declined over the second half of 2015 and first quarter of 2016.

Chart 2: Long term implied inflation



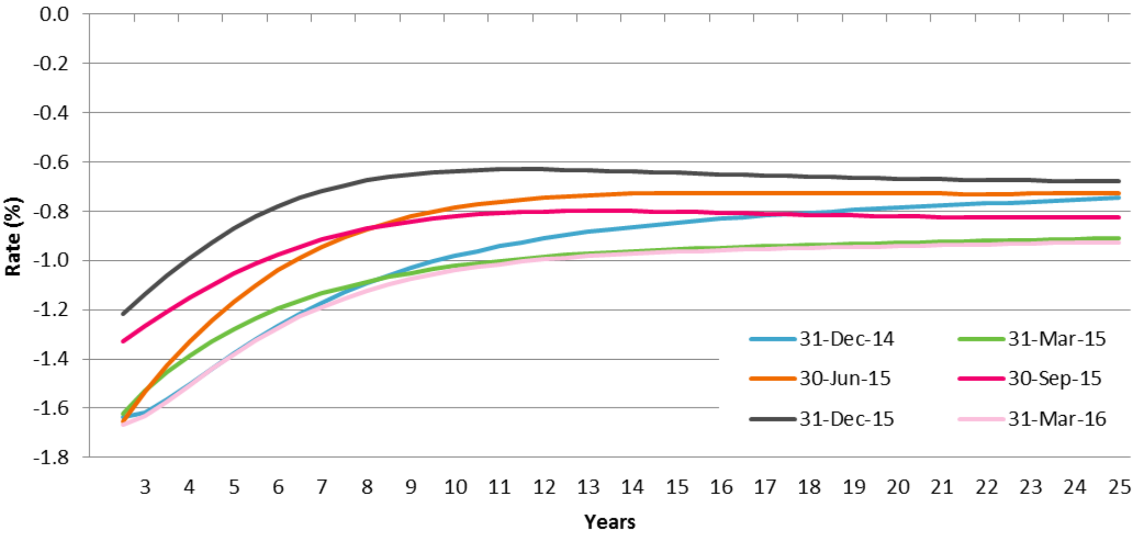
Prices of conventional gilts increased over the quarter as yields fell, with the All-Gilts index returning 4.9% and the long-dated index returning 8.2%. Index-linked gilts also provided positive returns, with the Over 5 yearr Index-Linked Gilt index returning 6.5%, as real yields fell. Over the 12 month period ending 31 March 2016, the All-Gilts index returned 3.2% and the Over 5 year Index-Linked Gilt index delivered 1.9%.

Chart 3: Nominal gilt yields



Source: Bank of England

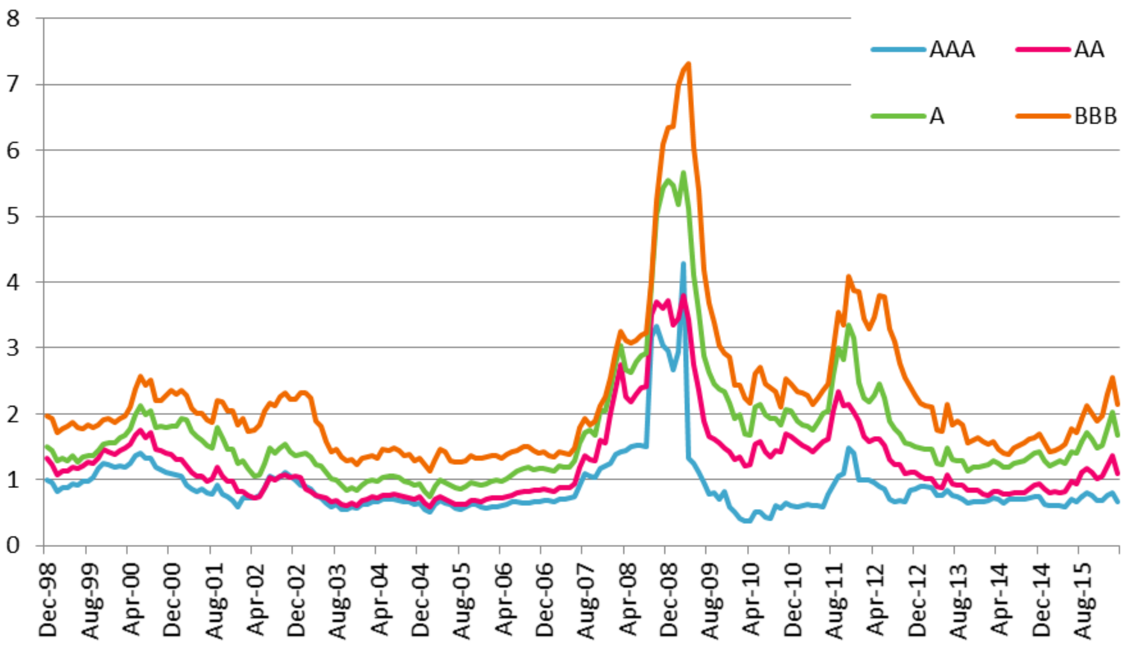
Chart 4: Real gilt yields



Source: Bank of England

Corporate bond prices underperformed gilts over the quarter (2.9% v 4.9%). The strongest area within corporates was AAA-rated issues (7.0%). Corporate bonds returned +0.1% over 12 months, with AAA-rated issues producing the strongest returns (+3.3%).

Chart 5: Corporate bond yield spreads over gilts (% p.a.)

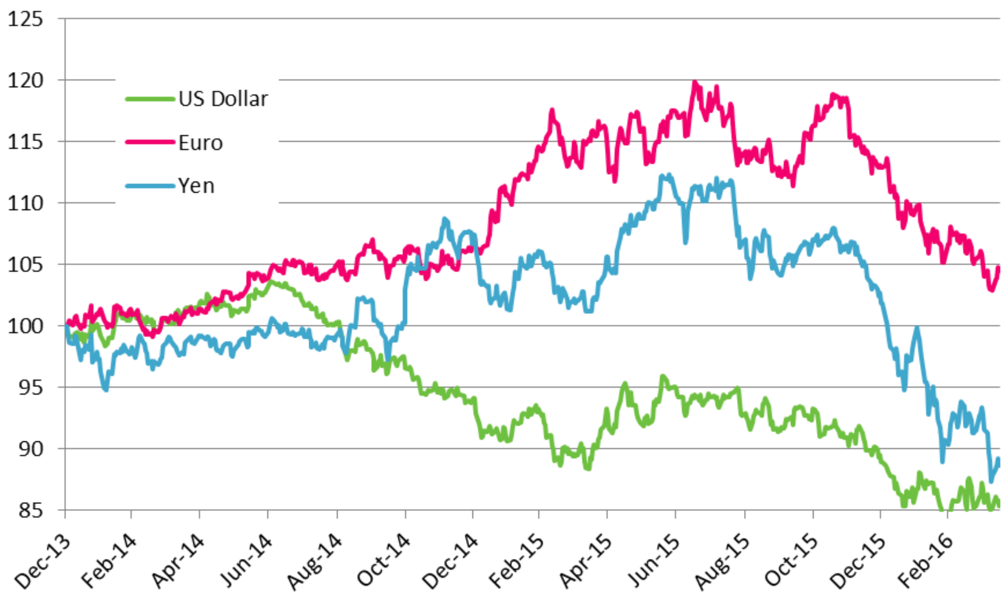


Source: Datastream

Currency

Over the first quarter of 2016, sterling weakened against the dollar, euro and yen. This weakness has continued post quarter-end.

Chart 6: Sterling performance to 14 April 2016 (%)



UK Property

UK property delivered a return of 1.1% over the quarter. Over the last 12 months the overall property return was 11.7%. Over the 3 months to end March 2016, returns were positive across all sectors albeit weaker than recent quarters (retail +0.6%, office +1.3% and Industrial +1.5%). Over the twelve month period, office (+15.2%) and industrial (+15.0%) outperformed Retail (+7.5%). However, all sector returns remain particularly strong.

Over the quarter, total returns from property were derived from the income return with capital growth being marginally negative.

Chart 7: UK property capital returns vs. rental value

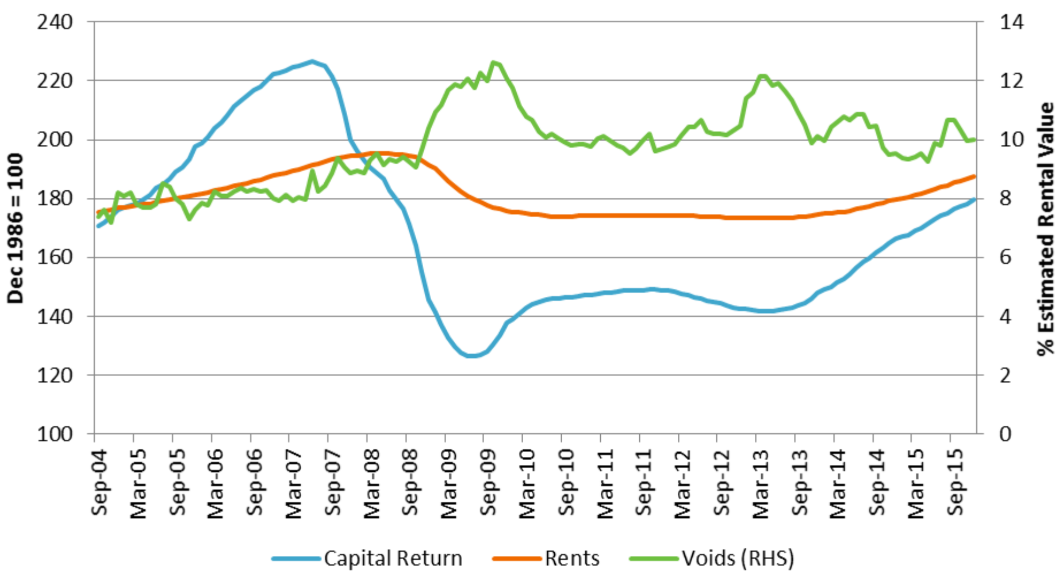
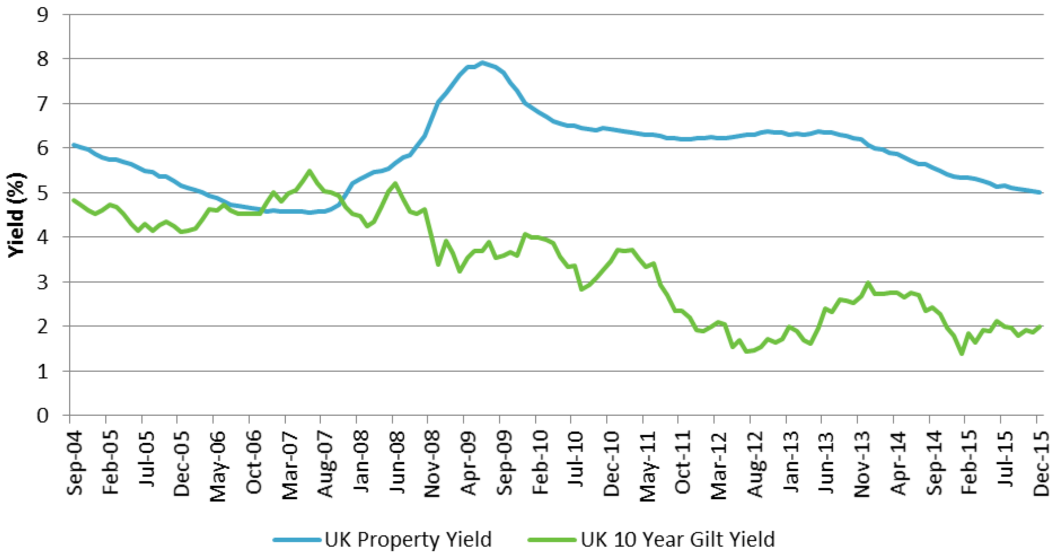


Chart 8: UK property yield vs. UK 10 year gilt yield



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For and on behalf of Hymans Robertson LLP

General Risk Warning

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 an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.