Market Background

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

Chart 1a:

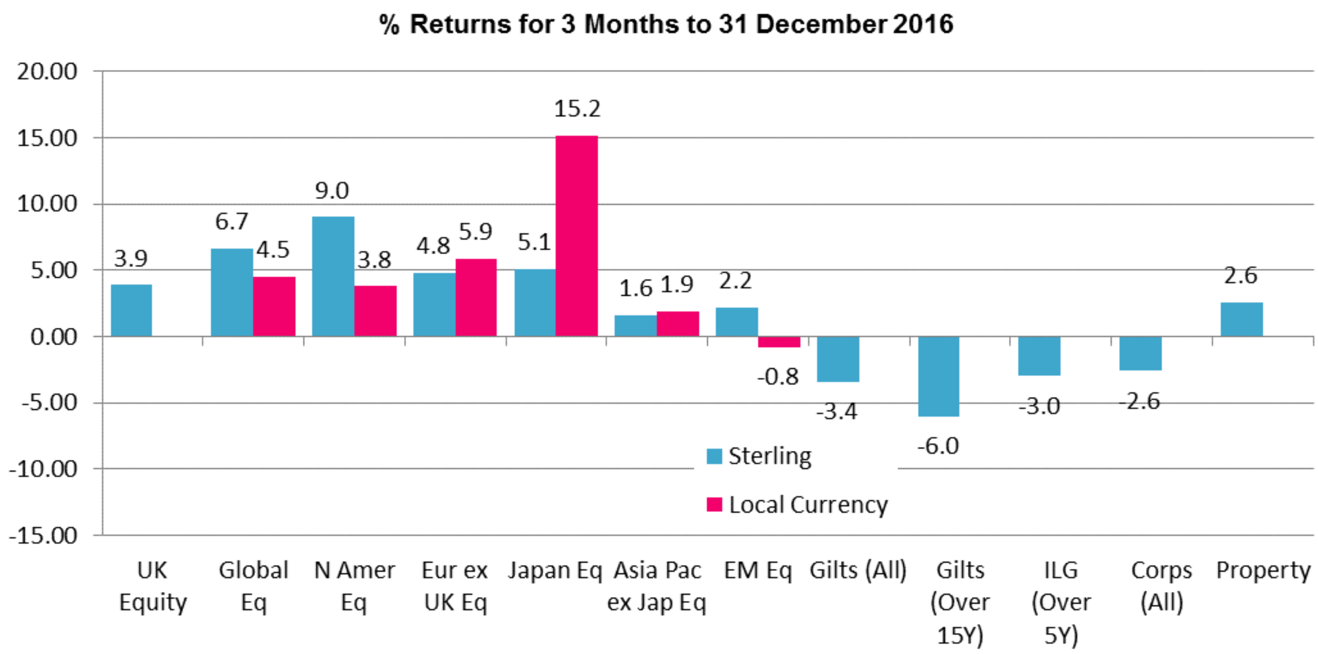
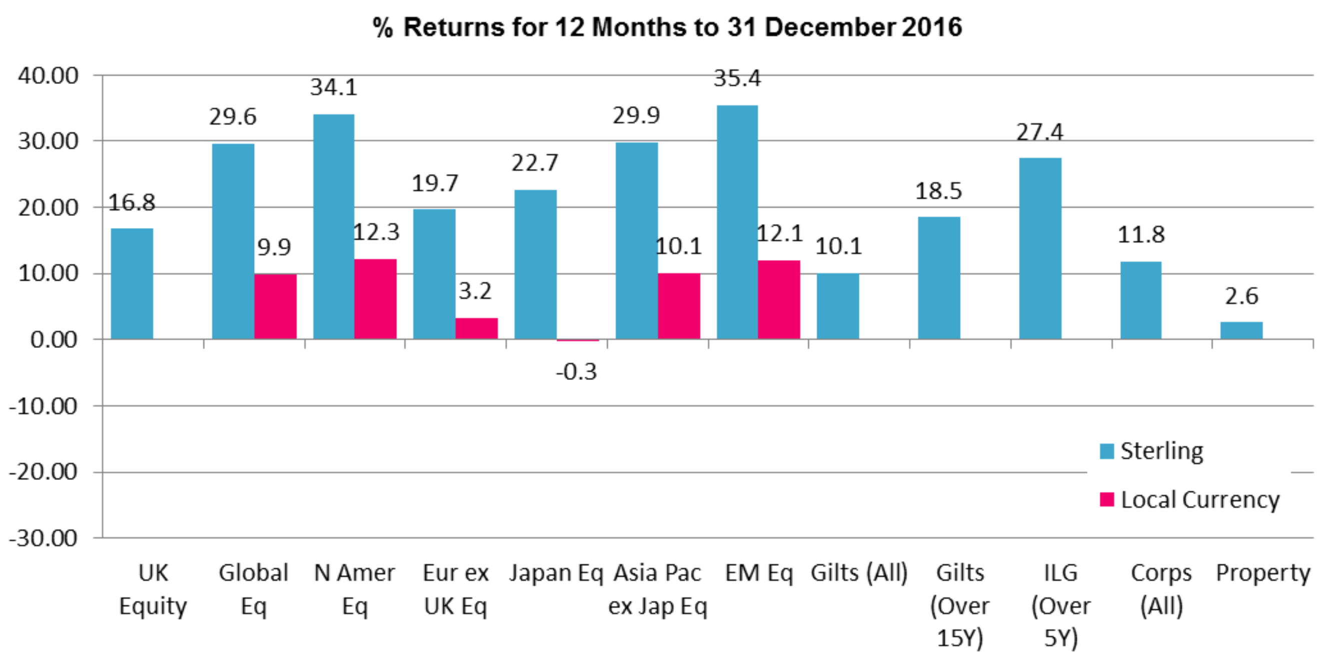


Chart 1b:



Source: Datastream

Market Review – Q4 2016

- A resilient post-referendum performance from the UK economy – Q3 GDP growth was 0.5% – and some fiscal easing in the Autumn Statement has lowered expectations that the Bank of England will cut interest rates again in the short term.
- The US economic background was buoyant – reported GDP growth in Q3 was the strongest for two years. As almost universally expected, the Federal Reserve raised US interest rates in December.
- Brent crude rose from $49 to $57 per barrel over the quarter, as OPEC and non-OPEC oil-producing nations agreed at the end of November to cut production of oil by 600,000 barrels per day.
- Gilt yields rose for most of the quarter as further monetary easing seemed less likely. 30-year gilt yields rose from 1.5% p.a. to 2.1% p.a. in mid-December, before falling a little by the year-end.
- The cost of inflation protection rose a little over the quarter as yields on index-linked gilts proved more resilient than conventional gilt yields. Long-dated index-linked yields ended the year at -1.6% p.a.
- US Treasury Bond yields moved sharply higher following the Presidential election. In mid-December, 10-year yields reached 2.6% p.a., the highest level for over two years.
- In general, yield spreads in global credit markets narrowed further. However, UK investment-grade credit spreads, which had tightened considerably in Q3, were little changed over the quarter.
- Sterling fell another 5% in trade-weighted terms at the start of Q4, but recovered some ground later as an interest rate cut seemed less likely and investors' concerns about a hard Brexit eased a little.
- Higher interest rates supported the US dollar, which was the strongest of the major currencies over the quarter. The yen was the weakest, suffering from a sharp swing in sentiment after the US Presidential election.
- Global equities also responded positively to the election after a subdued start to the quarter. US equities reached new all-time highs, but the strongest local currency performance came from Japan, where the market was boosted by currency weakness and better-than-expected economic growth.
- Emerging market equities bucked the trend – dipping sharply in the wake of the US election and falling over the quarter as a whole – amid concerns over Trump's protectionist stance.
- The strongest performing global equity sectors over the quarter were Financials – viewed as the main beneficiaries of higher rates in 2017 – and Oil & Gas – reacting to rising oil prices. It was a relatively poor quarter for defensive areas such as Healthcare, Consumer Goods and Utilities.
- UK property stabilised after the third-quarter downturn. Capital values, as reflected in the IPD UK Monthly Index, rose a little in October and November.

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

Table 1a:

	31.12.11	31.12.12	31.12.13	31.12.14	31.12.15	31.12.16
UK Equity yield	3.5%	3.6%	3.3%	3.4%	3.7%	3.5%
UK Equity P/E ratio	10.6	12.3	14.9	15.8	17.8	30.3
Over 15 year gilt yield (p.a.)	2.9%	3.0%	3.6%	2.4%	2.6%	1.8%
>5 year index linked gilt yield (p.a.)	-0.2%	-0.1%	0.1%	-0.8%	-0.7%	-1.7%
iBoxx >10 year Non-gilt yield (p.a.)	4.9%	4.1%	4.6%	3.6%	3.9%	2.9%

Table 1b:

	Year to 31.12.12	Year to 31.12.13	Year to 31.12.14	Year to 31.12.15	Year to 31.12.16	Quarter to 31.12.16	31.12.16 to 20.01.17
FTSE All Share	12.3	20.8	1.2	1.0	16.8	3.9	0.8
Global Equity	12.0	21.0	11.3	4.0	29.6	6.7	2.3
Over 15 year gilts	2.9	-5.9	26.1	0.1	18.5	-6.0	-3.6
Over 5 year index linked gilts	0.5	0.6	21.4	-1.2	27.4	-3.0	-2.9
All Stocks Non-Gilts	13.1	0.9	12.2	0.5	10.6	-2.6	-1.1
IPD Monthly Index	2.3	11.0	19.5	13.9	2.6	2.6	-

Equities

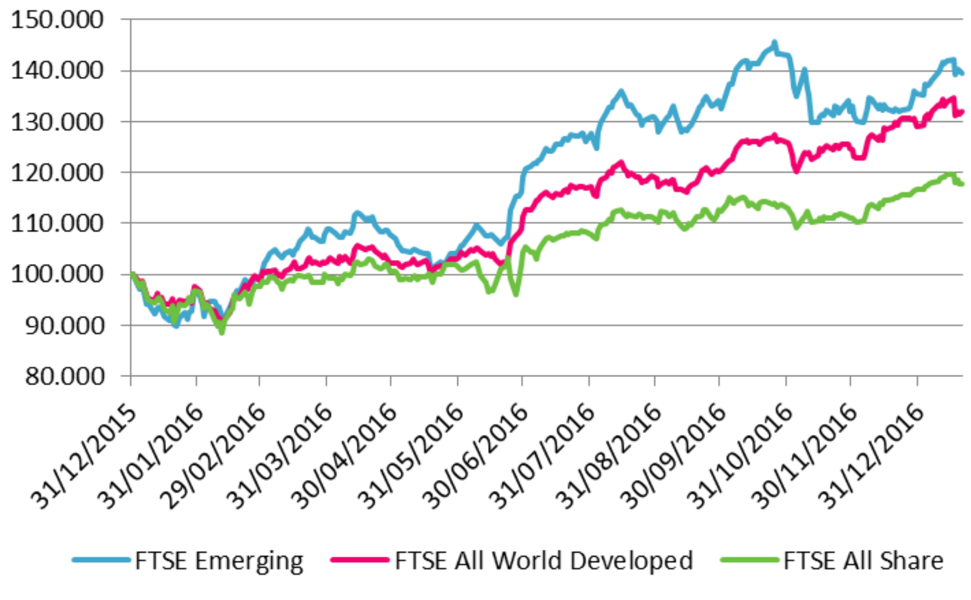
In sterling terms, global equities returned +6.7% over Q4 (as measured by the FTSE All World index). The strongest returns came from North America (+9.0%), whilst in local currency terms the strongest performance came from Japan (+15.2%) partly due to weakening currency. Other major equity markets were also positive, with the UK returning 3.9%. Whilst the Emerging Markets posted negative returns in local currency (-0.8%), when converted back to Sterling they delivered a positive return of 2.2% over the quarter. Over the second half of 2016, weaker sterling has enhanced the returns from overseas equities for UK investors.

Over the 12 month period ending 31 December 2016, global equity returns were strongly positive in sterling terms but more mixed in local currency terms. The Emerging Markets were the strongest performer in sterling terms (+35.4%) followed closely by North America (+34.1%), whilst the weakest region in sterling terms was Europe ex UK (+19.7%). Weak sterling has been a feature throughout the year. UK equities were positive over the year, up 16.8%.

Over the quarter, the strongest sector return relative to the All World index came from Financials - viewed as the main beneficiaries of higher rates in 2017), and Oil & Gas – which saw valuations rise in reaction to rising oil prices. It was a relatively poor quarter for defensive areas such as Healthcare, Consumer Goods and Utilities. Over the 12 months, in local currency terms, Oil & Gas provided the strongest returns (at +30.5%), with Healthcare the weakest (-4.6%). The FTSE All-World Index delivered 9.9% over the 12 month period.

The following chart plots the performance of the global equity market since the end of Q4 2015.

Chart 2: Global equity markets

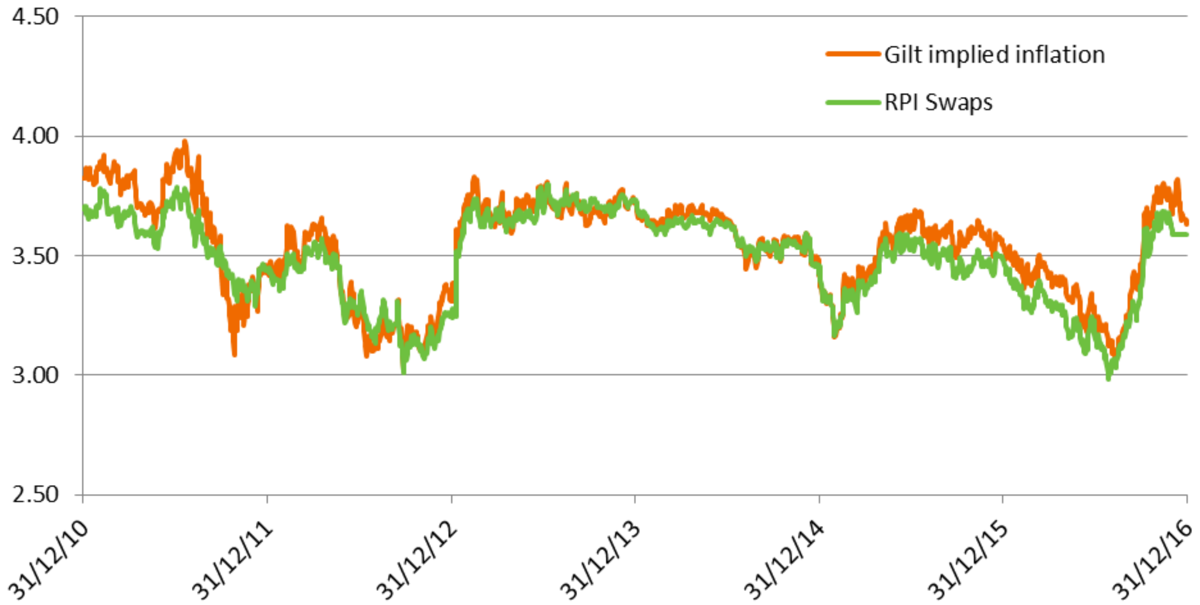


Source: Datastream

Fixed Income

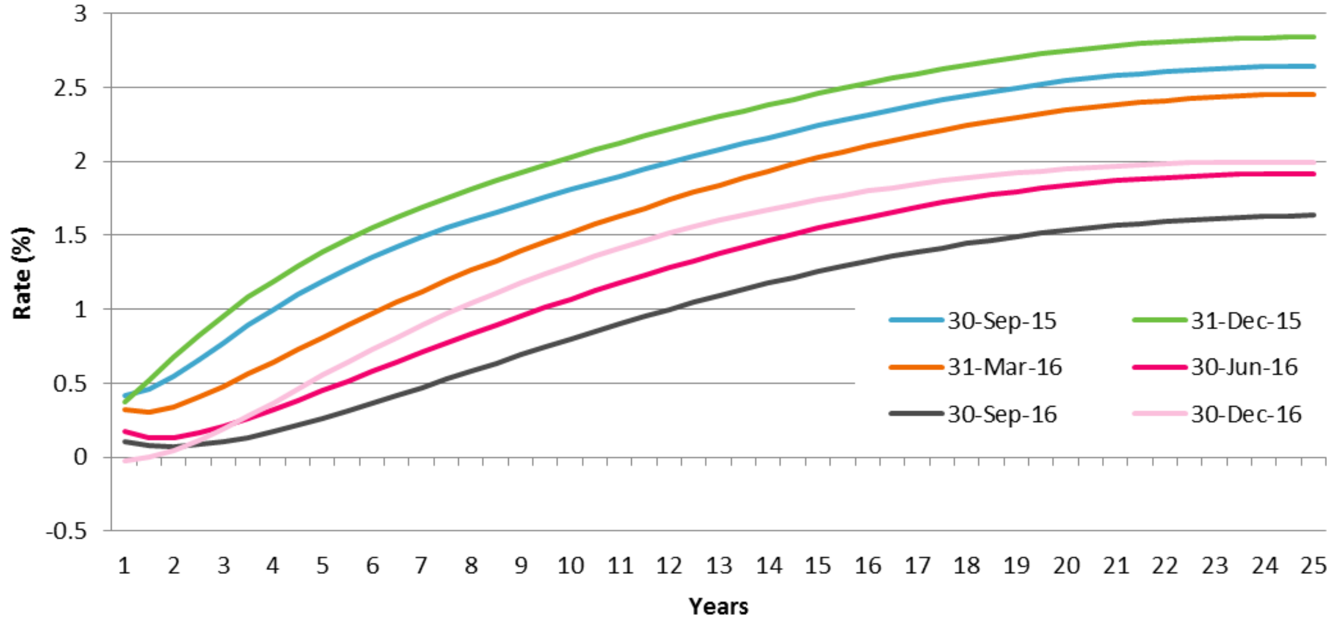
Long term inflation expectations had generally declined since 2015 but have spiked upwards in the second half of 2016, reaching levels previously seen in 2013.

Chart 3: Long term implied inflation



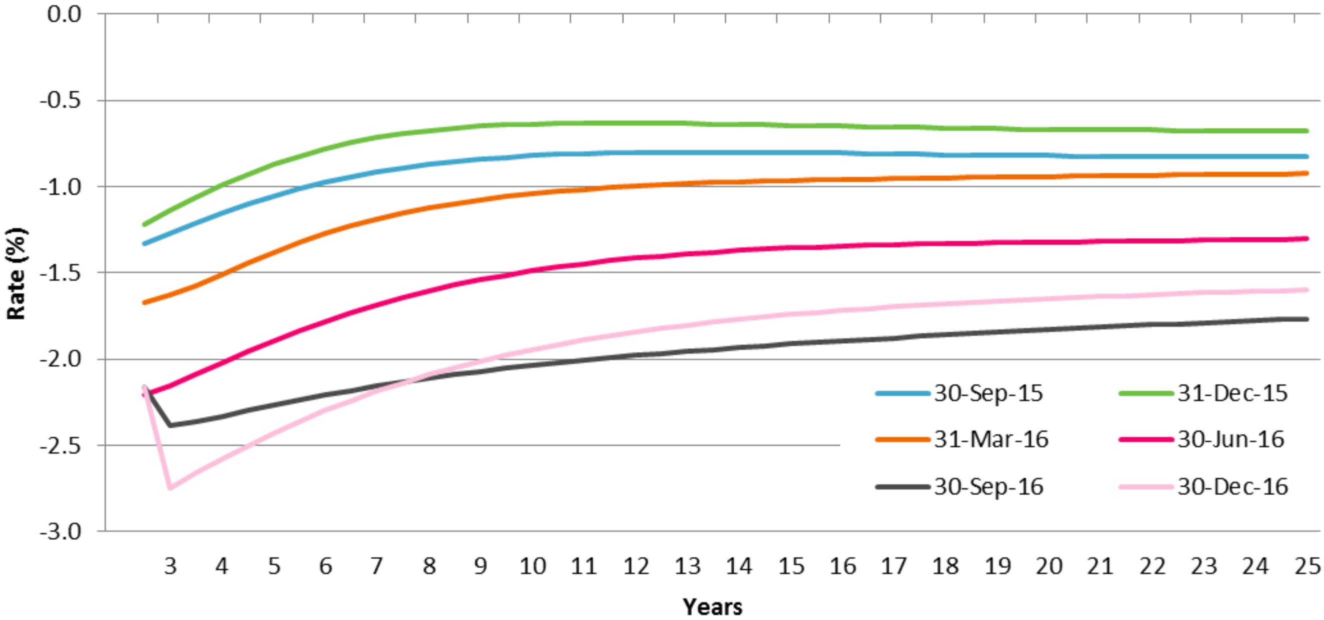
Prices of conventional gilts fell over the quarter as yields rose, with the All-Gilts index returning -3.4% and the long-dated index returning -6.0%. Index-linked gilts also posted negative returns, with the >5yr Index Linked index returning -2.6%, as real yields rose marginally. Over the 12 month period ending 30 June 2016, the All-Gilts index returned 10.1% and >5yr index-linked gilts delivered 27.4%.

Chart 4: Nominal gilt yields



Source: Bank of England

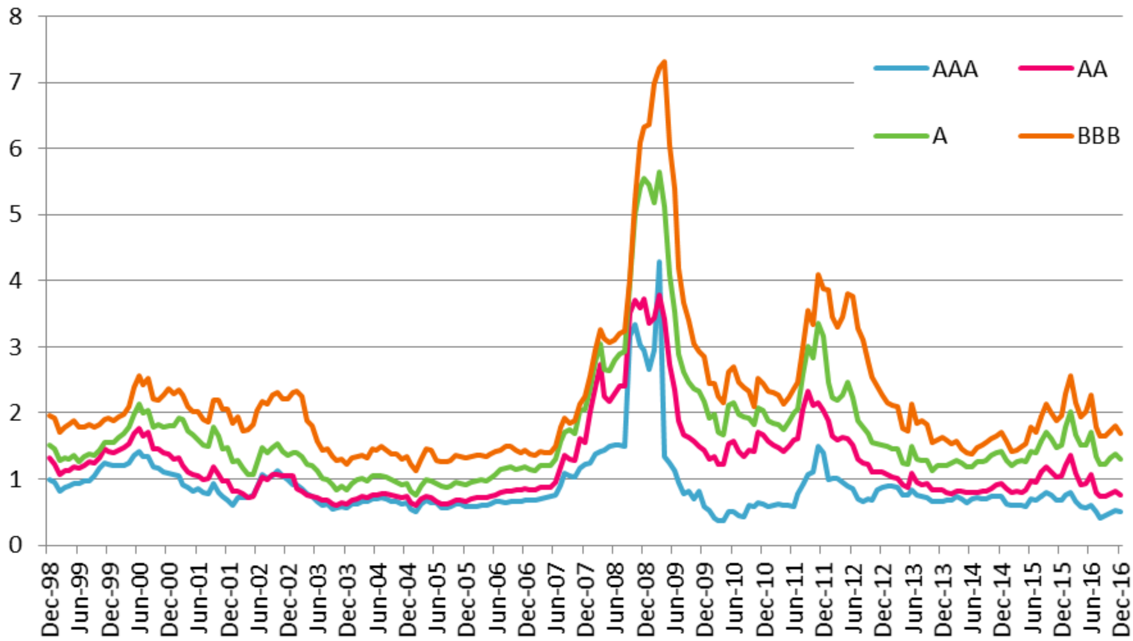
Chart 5: Real gilt yields



Source: Bank of England

Corporate bond prices outperformed gilts over the quarter although both performed negatively (-2.6% v -3.4%). The strongest area within corporates was BBB-rated issues (-2.1%). Corporate bonds returned 11.8% over 12 months, with AAA-rated issues producing the strongest returns (17.1%).

Chart 6: Corporate bond yield spreads over gilts (% p.a.)



Source: Datastream

Currency

Over the fourth quarter of 2016, sterling has continued to weaken against the dollar and euro, but has strengthened against the yen.

Chart 7a: Sterling performance to 20 January 2017 (%)

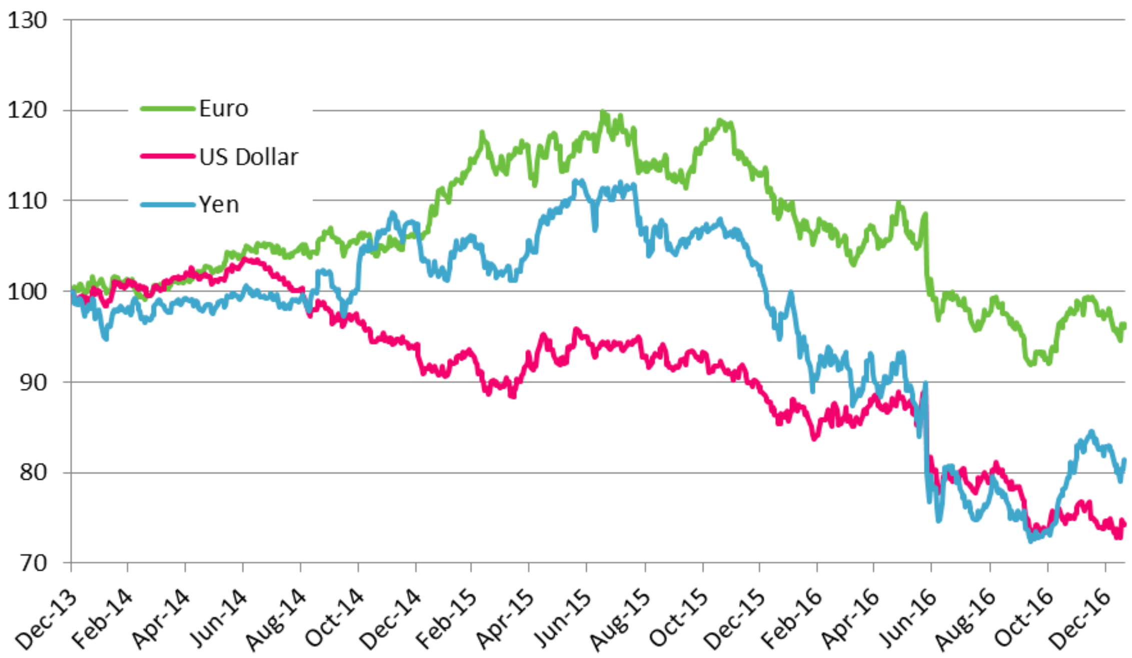
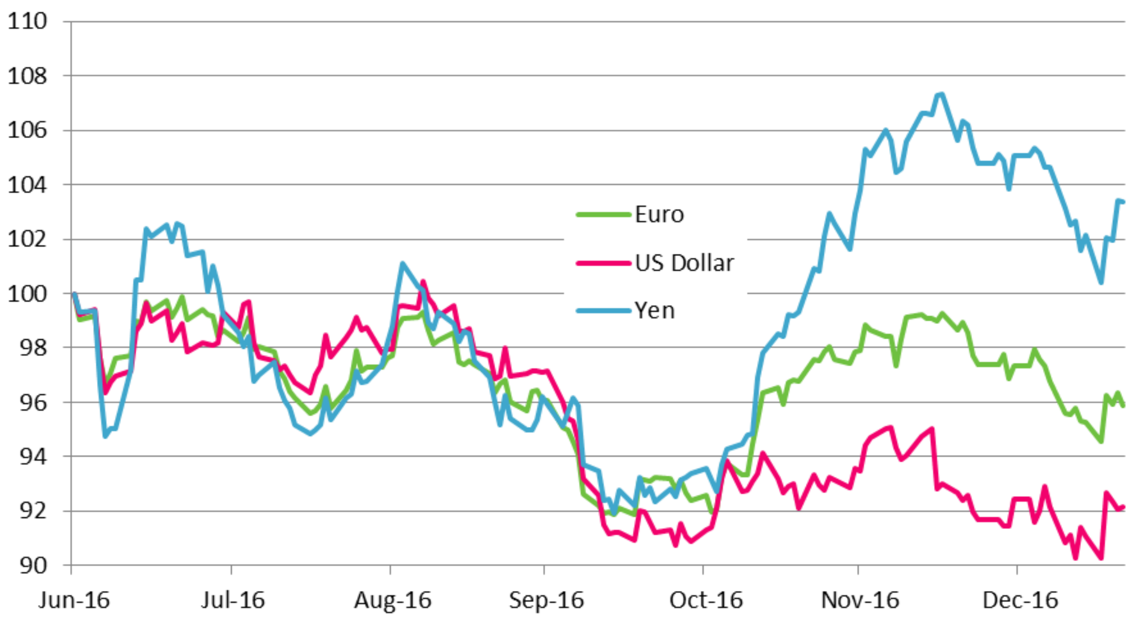


Chart 7b: Sterling performance since 30 June 2016 (%)



UK Property

Chart 8a: Breakdown of returns on property

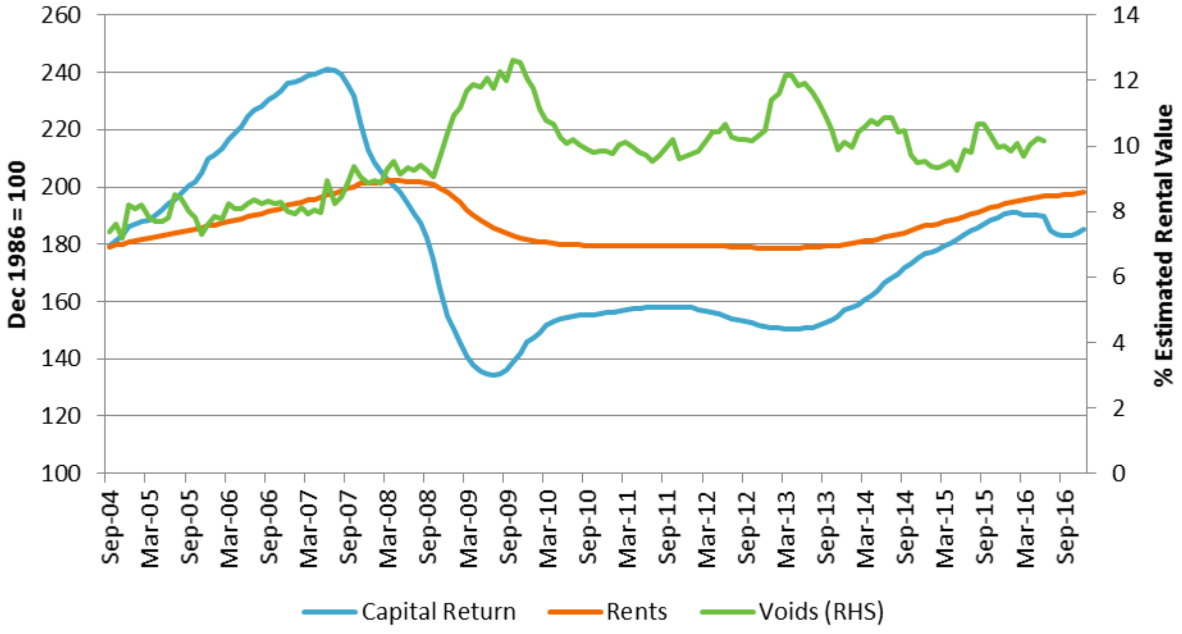
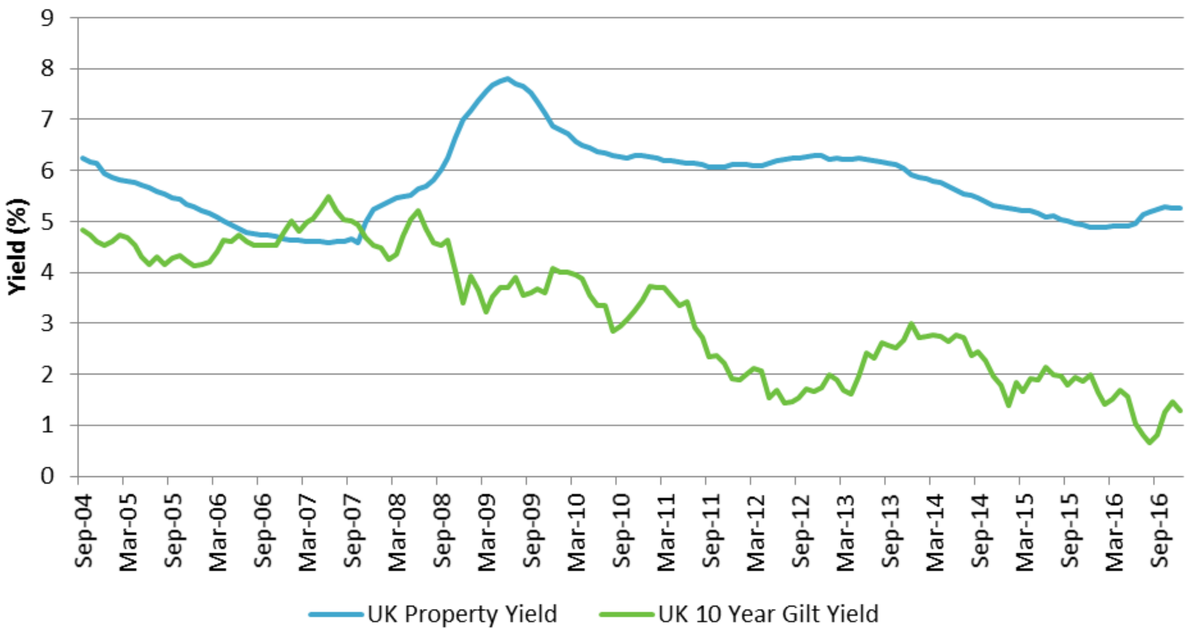


Chart 8b: UK Property yield vs UK gilt yield



- Following the result of the Referendum, property valuations were being caveated by valuers in light of the short-term uncertainty and lack of transactional evidence, suggesting they are a less reliable indicator of the price that could be achieved. These caveats have now, in the main, been removed, and the property market seems to be showing some signs of stabilisation.

- UK property delivered a return of 2.6% over the quarter. Over the last 12 months the overall property return was also 2.6%.

- Over the 3 months to end December 2016, returns were positive across all sectors (Retail 1.9%, Office 2.2% and Industrial 4.2%). Over the twelve month period, Industrial (+7.0%) outperformed Retail (+1.1%) and Office (+1.0%). Returns over 12 months have been impacted by market reaction to the EU referendum, but are showing signs of recovery.
- Over the quarter, total returns from property were derived from the income return, respresenting 1.4%, and capital growth, respresenting 1.1%.

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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.