

**INVESTMENT MARKETS COMMENTARY
TO 31 MARCH 2019**

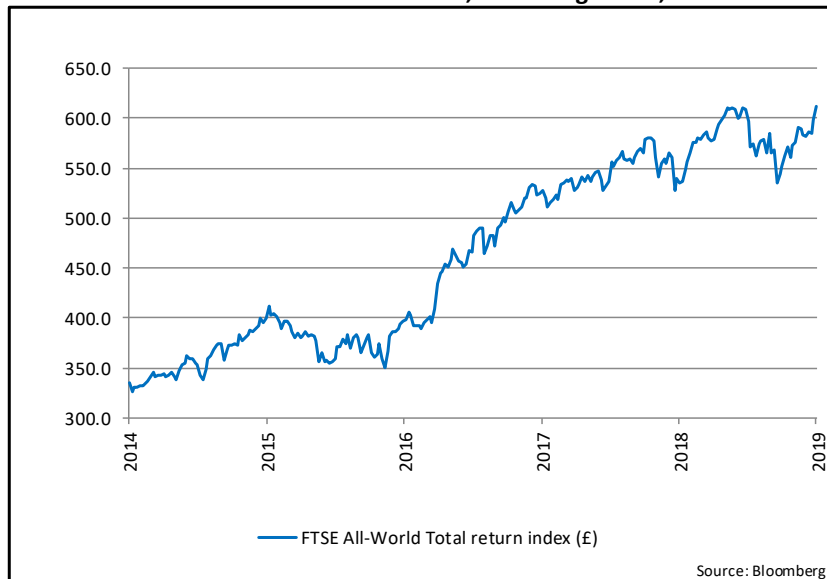
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1. Investment markets commentary to 31 March 2019

Stock markets have recovered their poise so far in 2019, having ended last year in a nervous mood; the World index declined by over 10% in the final three months of 2018 (see Chart 1 below). Some commentators attributed the setback to concerns over slower economic growth in 2019, which were partly provoked by President Trump's trade battles.

Chart 1: FTSE All-World total return index, in sterling terms, over the last five years.



We have not changed our recommended asset allocation, as we continue to believe that investing in strong companies will prove rewarding for long-term investors. It appears the US and China are nearing an agreement on trade (President Trump likes doing deals), but even if not, the IMF is forecasting that a full trade war would only reduce global growth by 0.5% p.a. With China cutting taxes and easing banks' capital requirements, and the US Federal Reserve indicating interest rates will increase by less than previously anticipated, we expect market sentiment to improve in 2019, as observed so far this year.

The stock market declines at the end of 2018 received media attention as they occurred at a quiet time for competing news stories, and as most markets closed lower than at the start of the year. However, as we show in Section 5 ("A brief history of down markets"), the market declines were barely newsworthy; 10% "corrections" occur most years, and annual stock market returns have been negative about once every four calendar years in the past.

A consistent feature of 2018 was the strengthening of the US dollar; Chart 2 overleaf shows that the dollar, weighted by the importance of overseas currencies in American trading relationships, rose by over 10% during 2018.

Chart 2: Trade-weighted US dollar exchange rate over the last five years.



This principally reflected the stronger economic growth enjoyed by the US compared with other countries. US dollar strength has several implications, first and foremost boosting the return from dollar denominated assets for sterling-based investors. However, it also tends to be a negative influence on emerging and Asian economies, as many have US dollar borrowings which cost more to service, and their stock markets suffer as investors are attracted to the higher returns available in the US.

Summary of global market performance

Table 1 shows that, during the twelve months to 31 March 2019, company shares (measured by the FTSE All-World Index) returned 5.9% in local currencies, and 10.7% in sterling. UK Government bonds and UK index-linked gilts rose 4.6% and 5.4%, respectively, while US Treasuries returned 4.3% in local currency and 12.2% in sterling. UK commercial property gained 5.4%.

Table 1: Six and twelve month market returns.

Index	% Total Return			
	Six months		Twelve months	
	local	£	local	£
FTSE All-World	-1.7	-1.9	5.9	10.7
FTSE All-Share (£)	-1.8	-1.8	6.4	6.4
S&P 500 (\$)	-2.0	-2.0	8.8	17.2
FTSE Europe ex-UK	-0.7	-3.6	3.6	2.8
TOPIX (Y)	-11.2	-8.8	-5.0	-1.8
FTSE All-World Asia ex-Japan	1.5	1.4	-0.1	3.7
FTSE Emerging Markets	3.2	3.8	-0.1	1.9
FTSE UK Govt 5-15 years (£)	4.8	4.8	4.6	4.6
FTSE UK Govt I-L 5-15 years (£)	4.3	4.3	5.4	5.4
iBOXX £ Corp Bonds 5-15 years (£)	4.7	4.7	4.5	4.5
ICE US Treasury Index (\$)	4.8	4.9	4.3	12.2
MSCI UK Monthly Property (£)	1.4	1.4	5.4	5.4
Gold Bullion (\$)	9.2	9.3	-2.3	5.3

Table 2 shows returns over the last three and five years. Stock and property markets have generated the strongest returns in sterling terms over the longer term; US company shares have performed particularly well, but the UK has lagged most other major stock markets. Bonds have produced positive returns.

Table 2: Three and five year market returns.

Index	% Total Return			
	Three years		Five years	
	local	£	local	£
FTSE All-World	39.4	51.6	52.5	79.8
FTSE All-Share (£)	31.3	31.3	34.5	34.5
S&P 500 (\$)	43.6	58.4	62.7	108.2
FTSE Europe ex-UK	28.8	37.8	34.9	41.4
TOPIX (Y)	26.2	41.4	47.1	75.1
FTSE All-World Asia ex-Japan	37.8	49.5	41.9	64.7
FTSE Emerging Markets	39.0	50.2	46.2	59.3
FTSE UK Govt 5-15 years (£)	8.5	8.5	25.3	25.3
FTSE UK Govt I-L 5-15 years (£)	16.3	16.3	26.0	26.0
iBOXX £ Corp Bonds 5-15 years (£)	16.8	16.8	33.2	33.2
ICE US Treasury Index (\$)	3.3	13.9	12.2	43.6
MSCI UK Monthly Property (£)	21.7	21.7	61.1	61.1
Gold Bullion (\$)	4.8	15.6	-0.4	27.4

Notes:

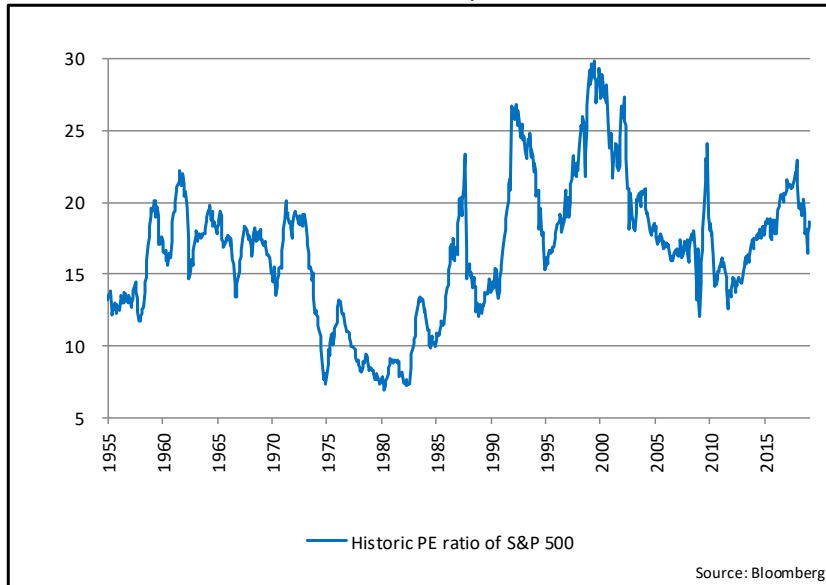
1. Figures as at 31 March 2019.
2. All figures include income reinvested.
3. Local currency indicated in index name, for single country indices.
4. MSCI UK Monthly Property (previously called IPD) Index may be subject to retrospective revision.
5. Source: FE Analytics.

2. Stock market outlook and approach

We continue to believe that the world economy is in a prolonged era of expansion, which should ensure high quality companies can prosper and grow. Uncertainties provoked by Brexit and President Trump's trade battles may challenge corporate, consumer and investor confidence in the short term, but the company share funds that form the foundation of your portfolio are focused on resilient businesses, which should be able to thrive despite such concerns. Our favoured funds have a negligible weighting in those automotive, agricultural and airline stocks which could suffer from a no-deal Brexit and / or higher trade tariffs. We continue to expect company shares to deliver the strongest returns for long-term investors and our recommended asset allocation favours stocks in preference to bonds.

Our positive long-term stance has been reinforced after the market declines in late 2018, as most stock markets are now valued below their long-term averages. The one index which could not previously have been considered to be good value was the US stock market, but as Chart 3 below shows, the historic PE ratio of the S&P 500 index is no longer stretched.

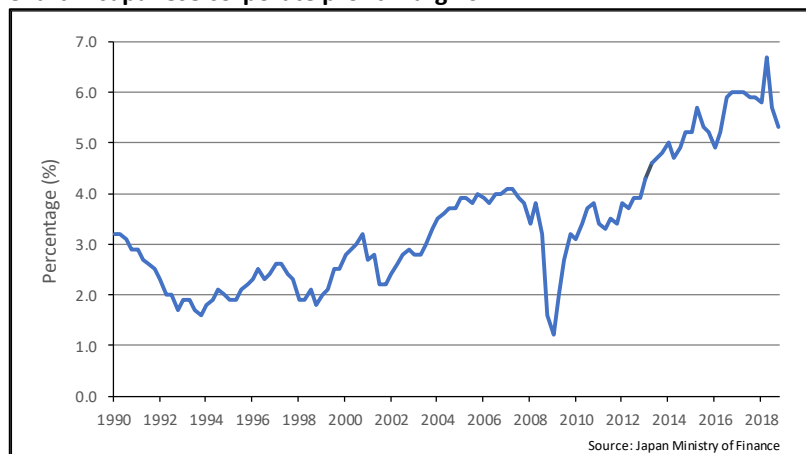
Chart 3: Historic PE ratio of S&P 500 index, 1955 to 2019.



While we do not recommend US company share funds in isolation, the global funds in our models have a heavy allocation to the country, as this is where the fund managers tend to find investments in which they have high confidence; the valuation message from Chart 3 is therefore reassuring for our strategy.

Another geographic feature worth highlighting relates to two areas that are only modestly represented in these global funds; our global managers typically have a low allocation to companies listed in Japan and Asia. This is largely because the companies located there do not yet have the financial track-record to justify inclusion in portfolios of the highest quality, long-established global businesses. For instance, many Japanese companies have first-class products, but without the strong profit performance of their Western peers. This matter has been recognised by the Japanese government and their corporate governance initiatives are proving to be successful in raising the profitability of Japanese businesses, as shown in Chart 4 below. As this improvement in corporate performance is recognised by investors, we expect Japanese share prices to perform strongly, hence including an allocation to Japan to complement the global company share funds.

Chart 4: Japanese corporate profit margins.



There are also an increasing number of Japanese companies challenging traditional business practices in the country and innovation is appearing across a range of sectors, such as robotics and factory automation, which should provide attractive long-term opportunities for investors.

We also recommend clients have a meaningful allocation to emerging markets and / or the Asian region to benefit from the increasing expenditure of middle-income consumers. Our global funds invest in companies such as Unilever and Colgate-Palmolive, which have operations there, and for higher risk models we also include funds investing directly in these regions. The funds we recommend often find the most attractive opportunities to take advantage of this trend are in India; the country has a long-established stock market and a reforming and modernising government, which is improving the environment for the corporate sector. In addition, the demographic benefits of a young and expanding population should ensure that consumer spending growth is strong, and that the country grows materially faster than the developed world.

The table below shows some long-term population and economic growth projections for India, together with a sample of other key nations.

Table 3 – Population and economic growth forecasts – 2016 to 2050.

	Population growth (p.a.)	Average real GDP growth per person (p.a.)	Average GDP growth (p.a.)
India	0.7%	4.1%	4.9%
China	-0.1%	3.1%	3.0%
United States	0.5%	1.3%	1.8%
United Kingdom	0.4%	1.5%	1.9%

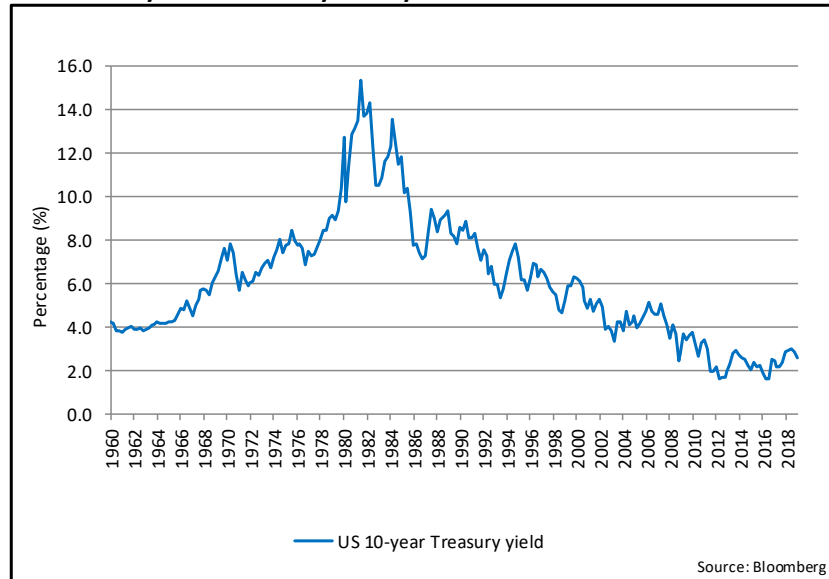
Source: PWC

In summary, we continue to base recommended portfolios on funds seeking to invest in high quality businesses worldwide, together with (i) global specialist investment trusts that invest in high growth companies in areas such as technology and healthcare, (ii) targeted regional company share allocations (i.e. Japan and Asia / Emerging Markets), and (iii) selected investments in listed private equity and smaller companies.

3. Bonds and cash

We continue to be cautious about bonds. The asset class is likely to generate only modest performance as yields are low, and prospective returns are unlikely to match inflation. The valuation argument against bonds also appears strong. Chart 5 overleaf shows the yield on 10-year US Treasury bonds since 1960; with yields near the bottom of their historic range, we think that bond markets remain poor value for money and prices could decline.

Chart 5: 10-year US Treasury bond yields since 1960.



We believe company shares, listed infrastructure and UK commercial real estate should deliver superior returns to bonds over the medium and long term and currently bonds should only be held as insurance against unexpected adverse events; we continue to recommend clients should have the lowest bond allocation appropriate for their circumstances. We also recommend clients seek the highest quality insurance, i.e. government rather than corporate bonds. For clients who require bonds to provide portfolio protection, we currently advocate a mix of UK index-linked gilts and US Treasuries.

3.1. Index-linked bonds

Index-linked gilts should provide a low positive return if held to redemption, based on current inflation rates and forecasts. UK index-linked gilt redemption values and coupons are adjusted using the RPI measure of inflation. The Office for Budget Responsibility has typically expected RPI to be c.1% per annum higher than the CPI measure of inflation, due to differences in the way the two series are calculated. The Government's target for CPI inflation is 2% p.a., implying that RPI would average c.3% p.a. With real yields on our recommended index-linked gilts close to -2%, the prospective return to maturity would therefore be c.1% p.a. We are mindful, however, of suggestions to change the way RPI is calculated and we are reviewing the merits of holding index-linked gilts.

Gilts are exempt from capital gains tax, so we recommend index-linked gilts with low coupons; these are more efficient for taxable accounts as a larger share of the return is earned in tax-free capital gains, rather than taxable income.

3.2. Conventional bonds

While index-linked gilts offer a modest degree of protection against an unexpected increase in inflation, conventional bonds should provide a defence against an economic recession; interest rates are usually cut in response to an economic downturn and this generally supports bond prices. We are currently advocating a minimal allocation to conventional bonds as yields and prospective returns are low and we are not expecting an imminent recession. Our preferred conventional bond market is in the US where Treasuries offer the highest yield of any G7 country (apart from Italy, which would not be appropriate insurance).

3.3. Cash

UK interest rates have been 0.75% since August 2018 and returns from cash are likely to remain below the Government's CPI inflation target of 2% p.a. for the foreseeable future. We recommend that long term investors remain fully invested, with cash weightings as low as practicable.

4. Real assets

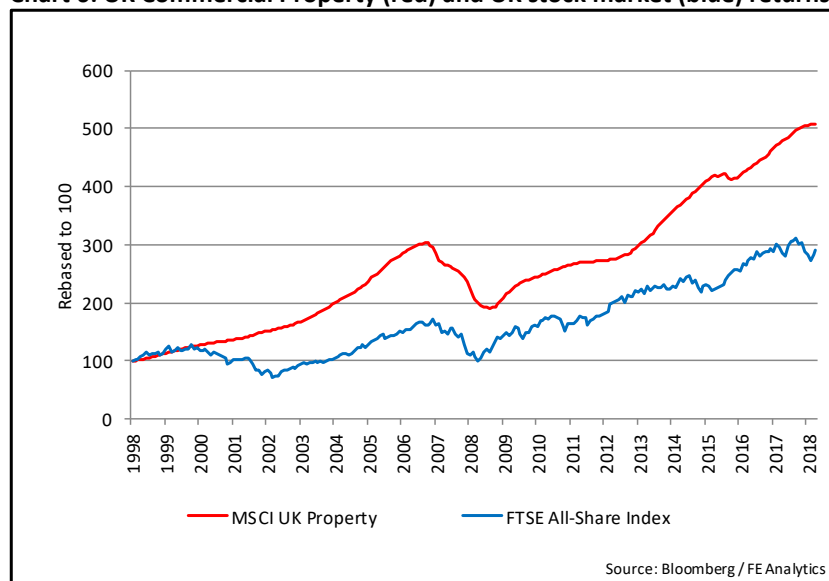
We continue to recommend allocations to UK commercial property and global infrastructure. We expect these real asset investments to outperform cash and bonds, as well as provide portfolio diversification. With UK real estate yields in some market segments exceeding 5%, and a tight supply / demand balance in many sectors, commercial property should continue to offer attractive real returns. Selected infrastructure investments should also outperform inflation, providing operators of such assets continue to meet customers' and regulators' expectations.

4.1. UK commercial real estate

The UK commercial real estate market delivered stronger returns than most other asset classes over the last year, due to its high yield and capital gains from the industrial and office sectors. The retail sector has recently declined in value due to the bankruptcies of several high street chains, and the adverse impact of the growth of on-line shopping.

The past twelve month's performance builds on the competitive long-term gains delivered by the asset class, as shown in Chart 6 overleaf.

Chart 6: UK Commercial Property (red) and UK stock market (blue) returns since 1998.



UK commercial property is the main element of our recommended portfolios which could be vulnerable to a no-deal Brexit; should the UK's trading arrangements deteriorate materially in future the domestic economy will probably suffer, to the probable detriment of occupier demand and rental growth prospects. Conversely, however, should the resolution of the Brexit conundrum lead to improved corporate confidence and stronger sterling, UK commercial property would most likely deliver the strongest returns. Whatever the short-term situation, we remain confident in the long-term prospects, not least because the supply / demand balance in the market favours investors.

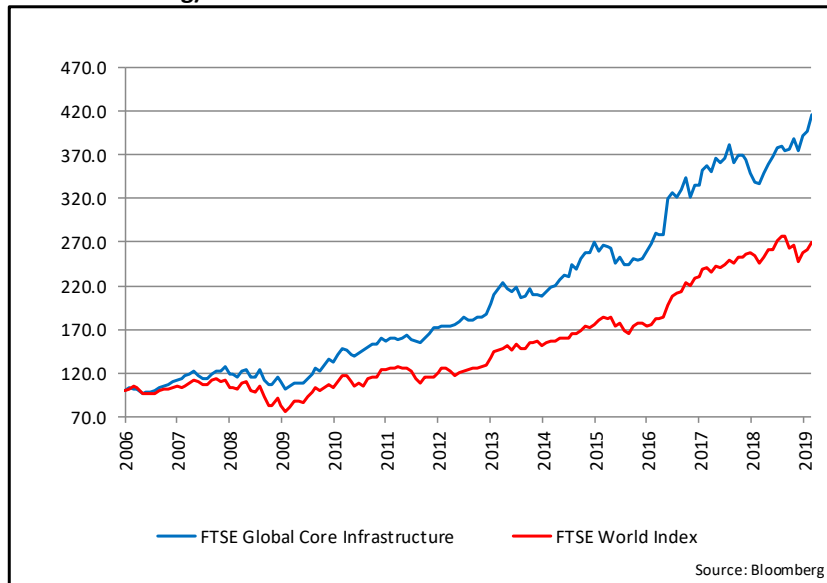
4.2. Infrastructure

Infrastructure companies operate long life assets such as ports, airports, gas, water and electric utilities, pipelines and tolls roads. Their profits tend to be unaffected by economic cycles and given this recession-resistance, infrastructure is usually regarded as a defensive asset class. Many infrastructure assets are insulated from inflation by regulation, concession terms or contracts that are explicitly linked to a relevant inflation rate.

Infrastructure assets generally have long lives and stable cash flows, which support their long-term value, especially as few have material maintenance requirements. Infrastructure companies also rarely have competitors and therefore can be subject to government regulation; we advocate taking a global approach to investing in listed infrastructure to diversify regulatory risk across different jurisdictions.

Listed infrastructure companies have delivered competitive returns over the long term as shown in Chart 7 overleaf; since 2006 the FTSE Global Core Infrastructure index (blue) has outperformed the FTSE World index (red), and it also declined less during the GFC of 2008 / 2009.

Chart 7: FTSE Global Core Infrastructure index (blue) and World index (red) since 2006 (total return in sterling).

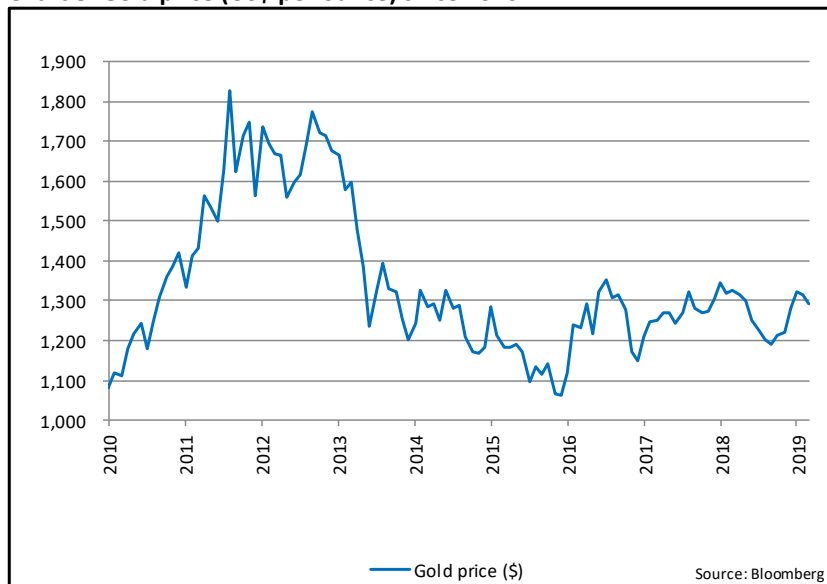


4.3. Gold

Gold gained 5.3% in sterling terms in the last twelve months. Over the last five years its increase of 27.4% in sterling terms has been lower than that of company shares and property.

Some investors hold gold in the expectation that it should increase in value during times of stress in other financial markets. We prefer to recommend conventional and inflation-linked government bonds for portfolio protection, as they offer a guaranteed redemption value and an income, which gold does not. The gold price remains materially below its all-time high reached in 2011, during the European sovereign debt crisis, as shown in Chart 8 below.

Chart 8: Gold price (US\$ per ounce) since 2010.



5. A brief history of down markets.

We noted our opinion, above, that the stock market declines towards the end of 2018 received undue attention in the media. This view is based on analysis from JP Morgan Asset Management, who have collated data on down markets in the US over the last 100 years and the UK since 1986. Their work shows:

- market corrections happen most years (a correction is defined as a stock market setback of over 10%);
- markets often register a negative return on a rolling 12-month basis;
- bear markets have occurred every ten years on average (a bear market is defined as a stock market setback of over 20%);
- 8 out of 10 bear markets have been accompanied by recessions (i.e. bear markets can happen without an economic downturn);
- there have been more recessions than bear markets (i.e. economic downturns don't necessarily cause a stock market setback); and
- the initial valuation of the stock market does not indicate the likely near-term performance of the market (i.e. bear markets are not necessarily signposted by expensive share ratings).

5.1. Market corrections

JPMorgan's analysis on market corrections is based on data on the UK's FTSE All-Share index from 1986 until 2018. There have been market corrections in 25 of these 33 years, and since 2006 it was only in 2017 that the UK market didn't register an intra-year decline of more than 10%.

Table 4: UK stock intra-year declines since 1986.

<i>Year</i>	<i>Intra-year decline</i>	<i>Year</i>	<i>Intra-year decline</i>	<i>Year</i>	<i>Intra-year decline</i>
1986	-9	1997	-10	2008	-43
1987	-37	1998	-25	2009	-23
1988	-9	1999	-11	2010	-17
1989	-14	2000	-12	2011	-19
1990	-22	2001	-30	2012	-12
1991	-12	2002	-31	2013	-12
1992	-18	2003	-17	2014	-10
1993	-4	2004	-6	2015	-15
1994	-18	2005	-7	2016	-12
1995	-4	2006	-10	2017	-4
1996	-6	2007	-13	2018	-17

Source: JPMorgan Asset Management

We would note that despite these setbacks, the UK stock market has returned 9.2% p.a. from 1986 to 2018, while money held in the bank would have earned 5.1% p.a.

5.2. Negative returns over rolling 12 months.

The FTSE All-Share index delivered a negative total return in 8 of the 33 calendar years since 1986, i.e. 24% of the time. In the US, since Warren Buffett took charge of Berkshire Hathaway in 1965, the S&P 500 index has produced a negative return in 12 out of 54 years, i.e. 22% of the time. If history is any guide, this suggests investors should expect to see a negative return from company shares once every four years.

5.3. Bear markets and recessions.

JPMorgan's analysis and comments on US bear markets in the last 100 years is summarised in table 5 below:

Table 5: US bear markets since 1919.

Start of bear market	JPMorgan's description	S&P 500 decline	Longevity* (months)	Recession Y/N?
October 2007	Global financial crisis – leverage/housing. Lehman collapse.	-57	17	Y
March 2000	Tech bubble – extreme valuations/dot com bust	-49	31	Y
August 1987	1987 crash – programme trading, overheated markets	-34	3	N
November 1980	Volcker Tightening – campaign against inflation	-27	21	Y
January 1973	Stagflation – OPEC oil embargo	-48	21	Y
November 1968	Tech crash of 1970 – economic overheating, civil unrest	-36	18	Y
December 1961	Flash crash of 1962	-28	7	N
May 1946	Post WWII crash – post-war demobilisation, recession fears	-30	37	Y
March 1937	1937 Fed tightening – premature policy tightening	-60	63	Y
September 1929	1929 crash – excessive leverage, irrational exuberance	-86	33	Y

* Longevity relates to the period of the S&P 500 decline, from peak to trough.

Source: JPMorgan Asset Management

We note:

- 8 of the bear markets occurred during a recession; it is notable that these bear markets lasted longer than those which occurred without an economic downturn.
- There have been 15 recessions in the US since 1919 – only 8 of these have coincided with a bear market.
- Many of these bear markets have been preceded by intense investor optimism. The average annual return in the year before each bear market started was 27%, a considerable return to miss, if investors sell too early before a bear market begins.

5.4. Valuation alone doesn't predict a bear market.

The two charts below compare (i) the initial valuation of the S&P 500 index with (ii) its subsequent performance, using monthly data since 1988 (each blue dot represents a month). Both charts use the forward PE ratio as the valuation measure, but the subsequent performance outcome is over different time periods: the first chart uses the subsequent short-term one-year total return, and the second chart uses the longer-term ten-year total return (annualised).

Chart 9 below confirms valuation has been a poor predictor of short-term market returns. While lower valuations have resulted in better short-term returns on average, there is no strong pattern linking the initial valuation with the subsequent one-year market return, and even when the market starts with a high forward PE ratio, the next year's move is as likely to be up as down.

Chart 9: S&P 500 forward PE ratio and subsequent 1-year total return.

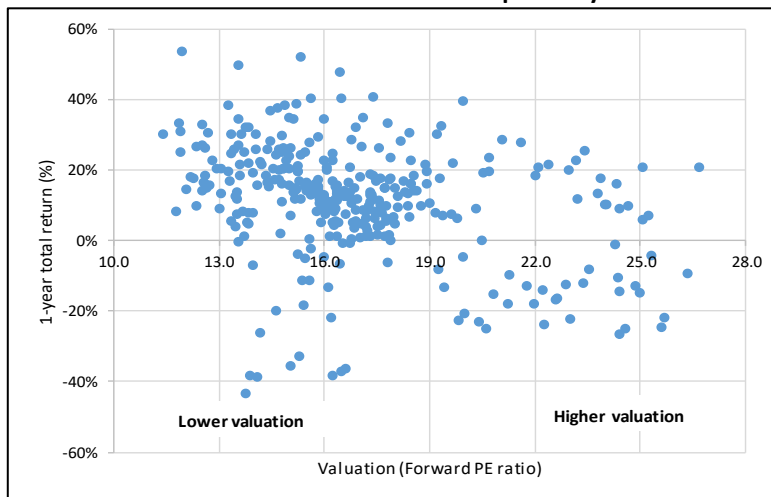
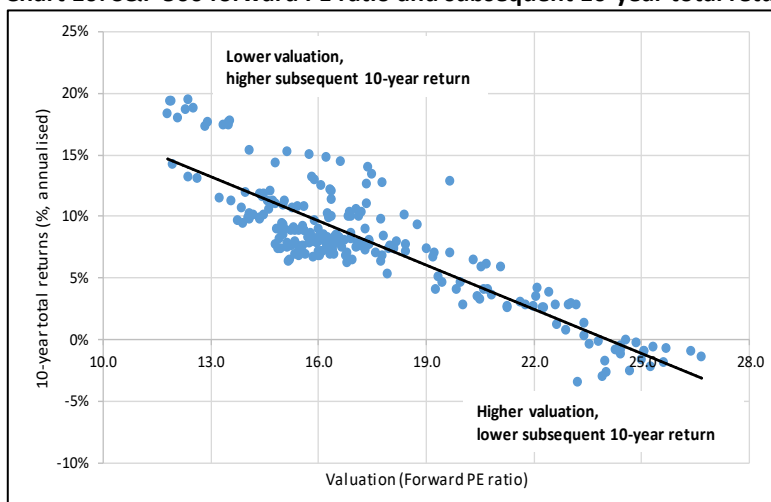


Chart 10 below uses the same valuation data but tracks the subsequent returns over ten years (shown in annualised form). This chart does demonstrate a clear pattern – the higher the initial valuation, the lower the subsequent 10-year market return.

Chart 10: S&P 500 forward PE ratio and subsequent 10-year total returns (annualised).



The forward PE ratio of the S&P 500 index was 14.6x at the end of December 2018, indicating, perhaps, that investors can expect a c.10% p.a. return over the next decade.

5.5 What we monitor to assess the likelihood of a bear market.

We analyse a broad range of indicators to assess the likely possibility of a future bear market. Among the items our Investment Committee studies regularly are:

- The strength of corporate balance sheets;
- The state of credit markets;
- Changes in short and long-term interest rates;
- The levels of corporate profitability and capital investment;
- Takeover activity and the number of new issues;
- Investor fund flows and sentiment measures; and
- Valuation measures.

We also bear in mind the observation from Sir John Templeton, that “bull markets are born on pessimism, grow on scepticism, mature on optimism and die on euphoria”. If investors are euphoric, companies are taking on excessive debt and bidding for each other, and stock markets are dear, we would expect to become cautious about share prices. We don’t currently see such a situation, but will be in touch with appropriate recommendations if this changes.

Our natural attitude is to be optimistic and to recommend, financial planning circumstances permitting, that clients seek to take advantage of the attractive long-term returns that we expect company shares to continue to deliver.

To discuss this note, or any other matter, please contact Nick Fletcher on 020 3696 6801, or any member of the London Wall Partners investment team on 020 3696 6805.

Appendix - Regulatory Information and Disclosures

Table 6 – Discrete twelve-month total returns in local currency.

Index	Return (%) for the 12 months to:				
	31.03.19	31.03.18	31.03.17	31.03.16	31.03.15
FTSE All-World	5.9	11.7	17.9	-4.3	14.3
FTSE All-Share (£)	6.4	1.3	22.0	-3.9	6.6
S&P 500 (\$)	8.8	13.3	16.4	1.1	12.0
FTSE Europe ex-UK	3.6	4.6	18.8	-11.2	17.9
TOPIX (Y)	-5.0	15.9	14.7	-10.8	30.7
FTSE All-World Asia ex-Japan	-0.1	16.9	18.6	-9.6	14.4
FTSE Emerging Markets	-0.1	19.4	16.6	-7.3	13.4
FTSE UK Govt 5-15 years (£)	4.6	-0.9	4.6	3.8	11.2
FTSE UK Govt I-L 5-15 years (£)	5.4	-0.7	11.2	0.9	7.4
iBOXX £ Corp Bonds 5-15 years (£)	4.5	1.6	10.0	0.8	13.2
ICE US Treasury Index (\$)	4.3	0.5	-1.5	2.4	6.2
MSCI UK Monthly Property (£)	5.4	10.3	3.8	11.8	18.5
Gold Bullion (\$)	-2.3	6.1	1.1	4.1	-8.7

Table 7 – Discrete twelve-month total returns in sterling.

Index	Return (%) for the 12 months to:				
	31.03.19	31.03.18	31.03.17	31.03.16	31.03.15
FTSE All-World	10.7	2.9	33.1	-0.5	19.2
FTSE All-Share (£)	6.4	1.3	22.0	-3.9	6.6
S&P 500 (\$)	17.2	1.0	33.8	4.5	25.8
FTSE Europe ex-UK	2.8	4.3	28.5	-3.9	6.8
TOPIX (Y)	-1.8	8.2	33.0	-1.7	26.0
FTSE All-World Asia ex-Japan	3.7	6.0	36.8	-7.8	20.0
FTSE Emerging Markets	1.9	8.8	35.6	-8.9	16.3
FTSE UK Govt 5-15 years (£)	4.6	-0.9	4.6	3.8	11.2
FTSE UK Govt I-L 5-15 years (£)	5.4	-0.7	11.2	0.9	7.4
iBOXX £ Corp Bonds 5-15 years (£)	4.5	1.6	10.0	0.8	13.2
ICE US Treasury Index (\$)	12.2	-10.4	13.3	5.8	19.2
MSCI UK Monthly Property (£)	5.4	10.3	3.8	11.8	18.5
Gold Bullion (\$)	5.3	-5.5	16.2	7.5	2.6

Notes:

1. All figures include income reinvested.
2. Local currency indicated in index name, for single country indices. The returns of non-sterling assets may increase or decrease as a result of currency fluctuations.
3. MSCI UK Monthly Property (previously called IPD) Index may be subject to retrospective revision.
4. Source: FE Analytics.

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