INTELLIGENTMONEY

IM DEFAULT PORTFOLIO FACTSHEET – OCTOBER 2018

INVESTMENT OBJECTIVE

This portfolio aims to deliver CPI plus 4% to CPI net over the long term in order to provide a lump sum at the end of the accumulation phase for withdrawal or annuity purchase.

The investment manager places each client in a risk adjusted portfolio that reduces exposure to equities and increases exposure to gilts and cash as each client moves closer toward their specified target date in order to manage risk by reducing volatility.

The portfolio provides full risk management and investment management using passive underlying investments, but in order to reduce costs does not offer the same degree of active asset allocation as our Optimum Portfolios.

HISTORIC PERFORMANCE

	Cumulative Performance			Annualised
Portfolio	1yr	3yr	5yr	5yr
IM Default Portfolio	**7.95%**	**48.32%**	**61.40%**	**10.05%**

Please note these returns show the growth phase prior to de-risking and are before charges and based on the underlying assets in this portfolio to 30th September 2018. Investors should remember that the value of investments, and the income from them, can go down as well as up and past performance is no guarantee of future returns. You may not recover what you invest.

INVESTMENT MANAGER

Tim Horrocks

Tim runs the investment management and asset allocation models for Intelligent Management on behalf of Quilter Cheviot, which he joined in 1999.

He has over 25 years of financial services experience having previously worked at Albert E Sharp and Henderson Crosthwaite.

Tim is a Chartered Fellow of The Chartered Institute for Securities & Investment and a Chartered Wealth Manager.

ASSET ALLOCATION/GEOGRAPHICAL LOCATION

Because of the evolutionary nature of IM Default Portfolio it is not possible to show specific asset class/geographic exposure, as by definition this will be different from one investor to another at any given time.

Therefore we show below illustrative asset class/geographic exposure over different cycles based on current market conditions.

Longer Investment Term **Medium Investment Term** **Shorter Investment Term**

Fixed Interest - UK Gilts
Fixed Interest - UK Index Linked Gilts
Other UK Fixed Interest
Fixed Interest - Overseas
Equities - UK Large Cap
Equities - US
Equities - Europe
Equities - Japan
Equities - Far East
Equities - Other
Property Funds
Gold
Cash

MARKET COMMENTARY

Strong global growth, particularly in the US, subdued inflation and accommodative monetary policy remain a supportive backdrop for risk assets. However, over the summer growth momentum has eased – which is characteristic of a maturing economic cycle – and global trade tensions, the stalled Brexit negotiations and political instability in Europe and the US have resulted in higher volatility in most asset classes.

In local currency terms, US and Japanese equities produced the best Q3 and year-on-year returns with both regions seeing above trend economic activity and strong corporate profitability. Europe and the UK have lagged, emerging markets are suffering from capital flows back to the US and dollar strength has impacted economies with high levels of external debt. The gradual withdrawal of quantitative easing and normalisation of US interest rates has led to marginally higher global bond yields, flatter yield curves and wider credit spreads. Apart from the depreciation of the renminbi, currencies have traded within narrow ranges. Commodity prices are weaker on lower Chinese demand but Brent crude has risen 24% to $82 since January reflecting OPEC's adherence to production quotas, new sanctions on Iran and supply disruption.

The US and China remain the largest contributors to global GDP growth. Fiscal stimulus and increased capital investment suggest the US economy will continue to grow around 3% over the next couple of years. Business and consumer sentiment are close to historical highs while rising mortgage rates have constrained housing activity. Jobs are plentiful and the unemployment rate is expected to fall below 3.9%. There is some evidence that wage pressures are building so, although productivity gains are keeping unit labour costs in check for now, the Federal Reserve is likely to raise rates from 2.25% to 3% by the end of next year. With consumer price inflation around 2%, it means the Fed is the first major central bank to re-introduce positive real interest rates which – combined with scaling back quantitative easing – represents a tightening of monetary policy. The extent to which the economy will benefit from higher trade tariffs is hard to quantify. While some manufacturing is expected to return to the US, a shift from low to high capital intensity is economically inefficient long-term as it reduces wealth creation and shareholder returns. Comments from a range of companies indicate the more likely outcome is higher inflation – as cost increases are passed through the supply chain to consumers - pushing up interest rates and the cost of capital.

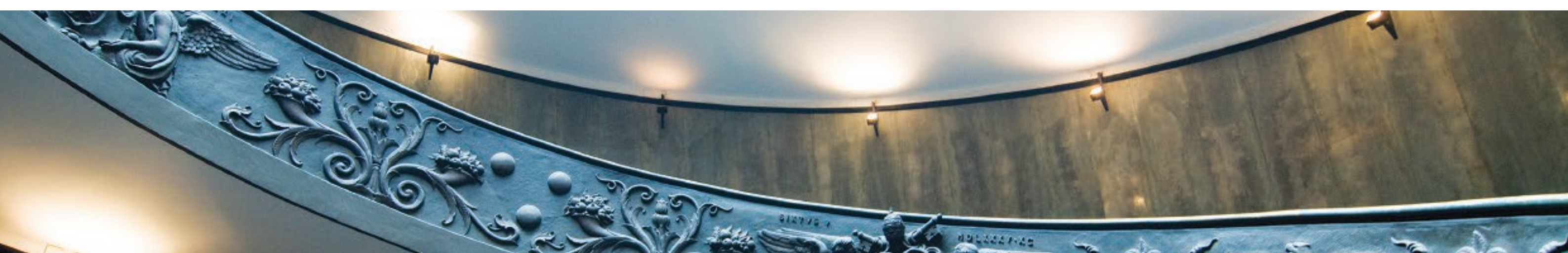
It is possible that US tariffs will have a more limited impact on the Chinese economy than expected. Even before these, monetary policy was tightened to calm the housing market and this move, combined with lower infrastructure investment, has led some commentators to question whether 6.5% GDP growth could continue. The additional 25% tariff to be implemented in January on approximately 6,000 items is estimated to reduce the value of China's £250bn exports to the US by 2.7% and GDP by 0.5%. This would not be life threatening in monetary terms but there are wider structural implications - particularly for the pace at which an economy reliant on exports and state investment can transition to one with more emphasis on self-sustaining growth. So far, the authorities have responded with measures to stabilise the renminbi and reduce income tax. Other Asian economies continue to grow at a reasonable rate.

Rising tariffs have yet to bite and the export/technology cycle is experiencing an upturn helped by US corporates plans to increase IT capex. Economies with export capabilities – notably Vietnam, Malaysia, Thailand and Taiwan – could also benefit from potential diversification and/or opportunities to relocate production to fill the gaps left by China. Japan has suffered short-term from a number of natural disasters but reconstruction activity and construction work for the 2020 Tokyo Olympics will help Q4 GDP rebound to an above trend rate of just over 1%. Despite the economy's vulnerability to US auto tariffs, business investment appears resilient with increases in manufacturing capacity and upgrades of old facilities to incorporate robotics and other labour-saving processes. Core inflation will nudge up to 1% but sluggish consumption, manufacturing automation and measures to offset next year's consumption tax rise – such as cheaper mobile phone charges –suggest it could fall back to around 0.5%. This means the Bank of Japan is likely to be the last central bank to withdraw quantitative easing.

After a soft start to the year, Eurozone growth appears back on track at around 1.8%. Although Spain remains strong and France is stable, Germany has lost momentum as a result of the slowdown in China, emerging market turbulence and the impact of political gridlock on government spending. The Italian economy is also sensitive to global trade and this, combined with a lack of budgetary discipline since the appointment of a populist government in May, has led to a collapse in business confidence and GDP growth being downgraded to just 1%. Leaving aside its Brexit vulnerability, Ireland has benefitted from a sharp pick-up in exports that has boosted employment and domestic consumption of goods and services.

UK economic activity continues to falter as Brexit affects business investment and consumer confidence. Given most of the Eurozone is facing political challenges, EU negotiators have little choice other than to pursue the freedom of goods, capital, services and labour enshrined in the Treaty of Rome or postpone a decision. UK politicians have even less idea of their preferred outcome and opposing ideologies are getting in the way of a pragmatic deal. It seems increasingly possible that the only decision by 29 March 2019 will be that EU and UK negotiators agree to disagree. This would leave Europe in a state of extreme uncertainty and, were it to happen, exchange rates and bond yields are likely to come under greater pressure than global equities.

We continue to favour risk assets over bonds or cash albeit our exposure has been trimmed recently. For sterling-based investors, international markets appear to offer better opportunities. Although UK corporate profitability – excluding commodities – is a notable laggard, 2018 is shaping up to be another bumper year and the outlook for 2019 is also positive. Corporation tax cuts and regulatory changes have boosted US equities but the performance differential with other markets is expected to narrow. Global dividends are well covered by earnings and higher profits have in many cases been accompanied by share buybacks and a more disciplined approach to capital spending. Merger and acquisition activity has picked up as business confidence improves. Share prices have lagged corporate earnings this year as investors discount the prospect of slowing growth in 2020 and beyond which means prospective valuations are towards the lower end of the 12 month range. Companies with visible growth prospects and strong free cash flows continue to outperform value.



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