

Conventional

Managed Portfolio Service - Portfolio 4

Quarterly Update - Q2 2019



In brief

- ▶ Equities continued to advance over the quarter, with the US the strongest market.
- ▶ Alternative investments – global listed infrastructure and global real estate investment trusts – performed solidly.
- ▶ With US interest rates on pause, emerging market debt, in both hard and local currency, posted strong returns.

Global overview

Our portfolios enjoyed a solid quarter, as risk assets like equities continued to rally. Lower-risk assets also produced solid gains, as global central banks turned dovish on monetary policy, and sentiment shifted towards interest rates being cut.

Equities were a significant contributor to the performance of our portfolios over the period, with US equities again the best performers. Since the start of the year, the S&P 500 Index is 18.5% higher (to end June), while the more technology-driven Nasdaq is up an astonishing 21.3%. Both UK and European indices delivered solid returns. Surprising, perhaps, given the political upheaval in the UK and the notable downturn in Germany's fortunes. Conversely, Japan and most Asia-Pacific indices suffered small losses, as sentiment on the US-China trade war see-sawed on President Trump's twitter output.

Yet there seems a discord between the recent strength of investment markets, and the more gloomy prognosis from economic data and geopolitics. Furthermore, we can question investment markets themselves. Risk-off investors have bought up sovereign debt, sending yields ever lower. But at the same time, risk-on investors have bought equities, sending many indices to year-to-date peaks. Bond markets point to lower growth, lower inflation and lower interest rates, while equity markets remain buoyant.

On the positive side, global financial conditions have remained relatively loose. The US Federal Reserve (Fed) is edging towards cutting interest rates. At the same time, US consumer confidence is close to all-time highs and unemployment is near all-time lows. Meanwhile, the European Central Bank (ECB) reiterated its stance on monetary policy, stating "we will use all the flexibility within our mandate to fulfil our mandate". While not quite the "whatever it takes" speech of July 2012, ECB President Mario Draghi still seems unequivocal in his role.

On the negative side, trade tensions have re-escalated. Geopolitical developments in the UK, Italy, Argentina, Turkey and Iran have also taken a less positive direction. Global manufacturing sentiment, meanwhile, hit a 6.5-year low in May. The rapid shift in the trade-policy environment is perhaps the most difficult to forecast. On the US-China question, negotiations have waxed and waned between positivity and downright hostility all year. In addition, President Trump turned his ire on Mexico for a brief time, before seemingly

being reassured on border-control issues. In addition, the US is still considering whether to impose tariffs on auto imports from Europe and Asia.

Our forecasts no longer incorporate a quick resolution to the US-China dispute. We do, however, envisage a greater chance of resolution regarding tariffs on Mexico. Nonetheless, Mr Trump will continue to use his twitter account and affect investor sentiment.

Along with most market analysts, we now expect the Fed to cut US interest rates twice in 2019. While on his campaign trail in 2016, President Trump commented that the previous Fed Governor should be "ashamed" of her handling of monetary policy. He accused her of artificially keeping interest rates low to boost President Obama. As such, when Trump assumed office, he replaced her with Jerome Powell, commenting that "he's strong, he's committed, he's smart". Fast forward eighteen months and Mr Trump is openly scathing of the Fed's policies and agitating for rate cuts. The market has already priced in such moves, which opens a 'tail wagging the dog' question. Is the Fed being pushed into policy by President Trump and the investment markets, and just how independent is it now? Furthermore, since the financial crisis of 2008, the prevailing assumption is that central bankers will come to the rescue when markets become violent. That central bankers are alive to the threats is not the issue as such. Rather, it is the complacency that this breeds among investors. Nonetheless, it is this central bank response that leads us to forecast a broadly flat and tepid global economy for the coming months.

It is worth noting that US consumer confidence is near all-time highs. The last time it hit this level was in 1998-1999. That was just before the technology crash wiped 50% off the S&P 500 over the following three years. Indeed, as one would expect, consumer confidence does tend to peak just before a market correction. Previous highs were reached in 2007, 1987-1988 and 1978-1979. Looking at the world's dominant equity market, the S&P 500 has added 18.5% year-to-date. This brings its annualised return over 10 years to an astonishing 14.7% per annum. Clearly, such a return is not sustainable. Indeed its 20-year annualised return, a period which encompasses the 2008 crisis, is a more sober 5.9% per annum. Surely we need some lean years to bring returns back down to their long-term average. We should also bear in mind that US earnings forecasts are decreasing, while share buybacks are increasing. One has to consider just how shaky the ground is to justify the market's return thus far in 2019.

Meanwhile, bond markets are, at best, pricing in a stagnant future. At worst, they are downright pessimistic. Much has been written over the last year about the increasing flatness of the US yield curve. That is, short-term borrowing rates being similar to long-term borrowing rates. In a normal environment, one would expect long-term rates to be higher. Investors would require a higher rate of return for lending longer term than shorter term. Many City scribes warned on the inverted yield curve, where short-term borrowing rates are higher than long-term borrowing rates. An inverted yield curve has almost always led to a US recession within 12-18 months.

Long periods of economic expansion invariably result in too much debt; people borrow excessively as the good times roll. This is followed by a correction and usually a recession. Consider that there is now more debt in the world than in 2007 and that a record \$13 trillion of it is priced at negative yields. Non-financial US corporate debt has now exceeded previous peaks. However, buoyed by a solid global economy and accommodative central banks, default rates remain at low levels. In the current environment, it is difficult to justify a sizeable fixed income position. Late in the quarter, the five-year German bund yield hit a new record low of -0.7% (yields move inverse to prices). Indeed, Germany, France, Japan, Sweden, the Netherlands, Switzerland, Spain and Portugal all have their sovereign debt trading on negative yields at the five-year maturity. It's worth remembering that it was only seven or eight years ago, when the Eurozone debt crisis was at fever pitch. Portugal had to go cap in hand to the ECB, and there were concerns that Italy and Spain would follow. Nowadays, investors are paying Portugal for lending it money over five years!

Performance

Overall returns were solid this quarter, with a variety of asset classes delivering positive contributions. This justified the underweight exposure to cash/money-market funds and the tilt towards risk assets.

Equities continued to advance over the quarter, with the US the strongest geographic area. As such, the portfolio benefited from an overweight position in US equities. However, the allocation to the Vanguard US Equity Index and THB US Opportunities Funds, both of which are tilted towards small and micro-cap companies respectively had a negative impact. These areas of the market considerably underperformed over the quarter and this weighed heavily on the portfolio's overall performance. The Invesco European Equity Income Fund also disappointed, with subdued returns against the broader index. However, this was offset to a large extent by strong performance from the Schroders European Fund, the Fidelity European Fund and the Baring European Select Trust (which has a small and mid-cap tilt). The Majedie UK Equity Fund suffered over the quarter, with its value-tilt proving to be a considerable headwind to relative returns. The Artemis Global Emerging Markets Equity and Pictet Japanese Equity Opportunities funds fared considerably better though, outperforming their underlying benchmarks.

Global infrastructure as an asset class was resilient, with the First State Global Infrastructure Fund comfortably outperforming its underlying index.

Fixed income overall was a reasonable contributor to the portfolio's return. With US interest rates on pause, emerging market debt, in both hard and local currency, posted very strong returns. The Standard Life Investments Emerging Market Debt Fund (our preferred fund within the hard currency asset class) performed exceptionally well over the quarter, considerably outperforming its benchmark.

Activity

We adjusted our fund selection within European equities over the quarter. We reduced our position in the Schroder European Equity Fund and the Invesco European Equity Income Fund, and increased the weightings in the Fidelity European Fund and Barings Europe Select Trust. Our aim is to navigate the current environment with a wider range of investment styles within Europe. From a tactical asset allocation perspective, we retain our neutral weighting in this asset class.

Global real estate investment trusts (REITs) enjoyed a strong quarter and have performed extremely well over the year. Our holding in the Schroder Global Cities Real Estate Fund posted significant gains and we took the opportunity to take profits. We allocated the proceeds to the iShares Global Property Securities Fund, which more closely follows the index.

Outlook

We have downgraded our global growth forecasts amid subdued economic data and increasing policy uncertainty. While we had long anticipated a slowdown in the latter half of 2019, and into 2020, we had expected a coordinated central bank response to ensure any dip would be temporary. We no longer expect a bounce back in global growth, more a slowdown, rather than a recession. The portfolios were well served over the quarter by maintaining a pro-risk stance, with a tilt towards equities and light to neutral weightings in fixed income. As we enter the third quarter, we shall re-visit this positioning.

Performance

Portfolio performance is based on Aberdeen Standard Capital MPS hosted on the Standard Life WRAP platform.

Please note: portfolio constituents and performance may vary on other platforms.

The portfolio has not been available on all platforms since inception.

Performance figures are net of the Aberdeen Standard Capital Discretionary Management Charge. However they do not include the deduction of product and adviser specific charges. The effect of these charges would be to reduce the performance levels shown. In addition, MPS portfolios are subject to fund level annual management charges, which vary over time in line with the

composition of the portfolio. Please refer to the relevant Managed Portfolio Service Annual Charges Summary for more information on charges.

ARC Private client indices ARC private client indices are based on actual client portfolio returns provided by various investment management companies. These portfolio returns are allocated to one of four categories based on the volatility of their returns relative to world equities, and an average return is calculated for each category. Grouping portfolios by their volatility differs from the traditional approach, which compares portfolios which have similar asset allocations. Instead, investment managers may use whatever asset allocation they consider appropriate to achieve the desired levels of return and volatility.

Performance: Conventional MPS Portfolio 4

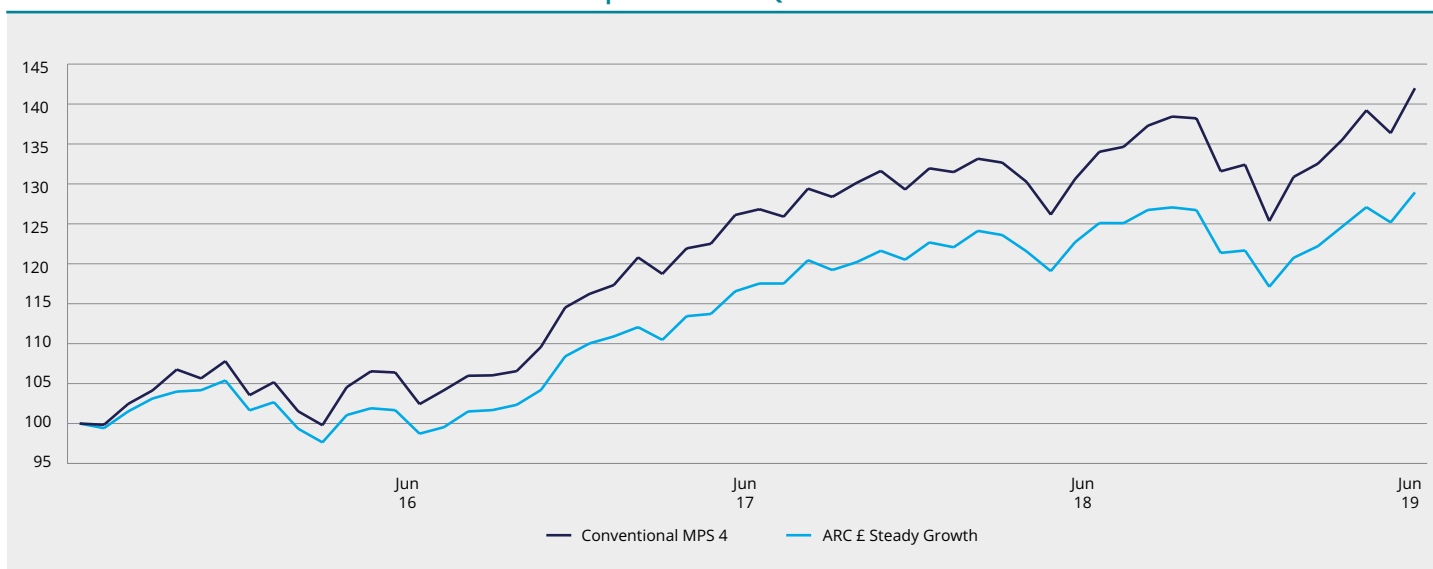
	Performance (%) 2nd Quarter 2019	Performance (%) 3 years	Performance (%) Since Inception ¹	Volatility Since Inception (%)
Conventional MPS Portfolio 4	4.77	29.56	41.98	8.63
ARC £ Steady Growth	3.28	23.73	28.94	6.45

The performance figures may vary due to product specific charges and should be viewed on an indicative basis.

¹30/11/2014 - 30/06/2019

Volatility calculated using monthly returns. Any holdings referred to relate to the Aberdeen Standard Capital MPS hosted on the Standard Life WRAP platform. Differences in holdings may occur on other platforms due to fund and shareclass availability.

Performance: Conventional MPS Portfolio 4 Inception to end Q2 2019



Asset allocation: Conventional MPS Portfolio 1

Asset allocation	MPS Model Strategy 4 as at end March 2019* (%)	MPS Model Strategy 4 as at end June 2019* (%)	Change +/-
Global High-Yield Bonds	6.0%	6.0%	0.0%
EM Debt Hard Currency	3.8%	3.8%	0.0%
EM Debt Local Currency	3.8%	3.8%	0.0%
UK Equities	19.9%	19.9%	0.0%
North American Equities	31.6%	31.6%	0.0%
European Equities	7.8%	7.8%	0.0%
Developed Asian Equities	4.0%	4.0%	0.0%
Japanese Equities	4.9%	4.9%	0.0%
Emerging Market Equities	1.5%	1.5%	0.0%
Global REITs	6.0%	6.0%	0.0%
Global Infrastructure	2.8%	2.8%	0.0%
Absolute Return Funds	7.5%	7.5%	0.0%
Cash	0.5%	0.5%	0.0%
Total	100.0%	100.0%	

Portfolio performance is based on Aberdeen Standard Capital MPS hosted on the Standard Life WRAP platform.

Please note that portfolio constituents and performance may vary on other platforms.

The Portfolio has not been available on all Platforms since inception.

* The data is rounded to 1dp and small variances to totals may occur.

This data is based on Aberdeen Standard Capital MPS hosted on the Standard Life WRAP platform.

The figures shown here refer to the past. Past performance is not a reliable guide to future performance. As with any investment, the value of your fund can go down as well as up and may be worth less than you invested.

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