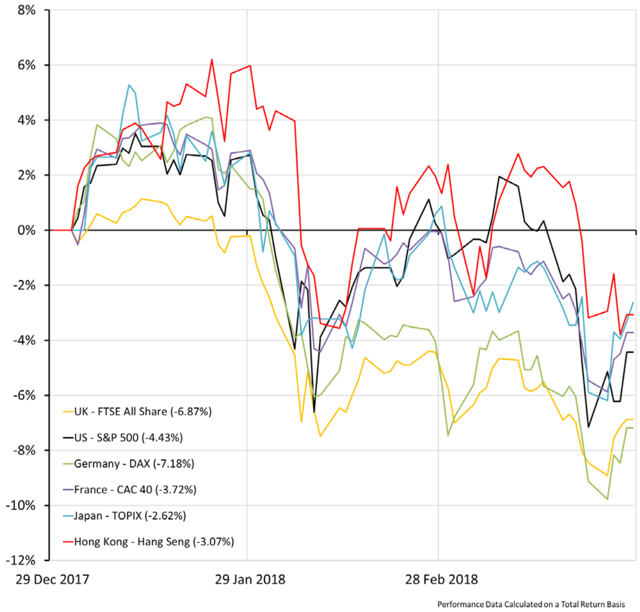
SPRING OUTLOOK

REVIEW OF THE PAST QUARTER:

The year started strongly, with the rapid growth in equity markets that started in December continuing into January. This enthusiasm didn't last and a sharp sell off at the start of February, blamed in part on computer trading and some dodgy derivatives, erased most of these gains. Following this the Bank of England kept interest rates on hold but signalled a faster rate of tightening in the coming months in response to stubbornly high inflation. While it has remained above target, the headline rate fell from 3 per cent in January to 2.7 per cent in February. To end the quarter, the UK and EU finally agreed a 21-month Brexit transition deal, which has provided some assurance that a cliff-edge Brexit will be avoided next year.

On the continent, the European Central Bank also voted to keep interest rates on hold while extending net asset purchases of €30 billion a month until September. Meanwhile, Putin won an uncontested Russian presidential election amid heightening East-West tensions, and Germany's Chancellor Merkel just about managed to hold onto power.

In the US, fears of monetary tightening escalated into a short-lived global market sell-off, just a month before Chair of the Federal Reserve Jerome Powell raised rates by 25 basis points in response to strong growth prospects. This is despite heavy tariffs on steel and aluminium announced in March. The measures have heightened fears of a trade war with China just as President Xi Jinping was reappointed without a term limit.



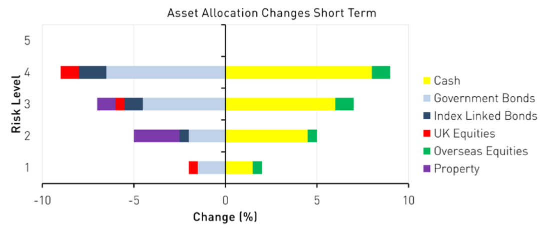
ASSET CLASS RETURNS

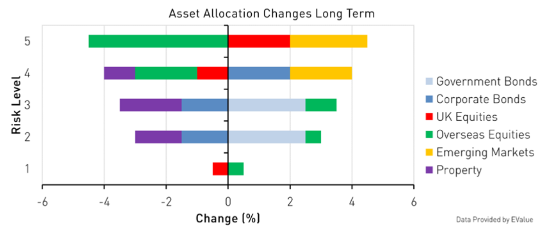
UK	US	Japan	Europe	Emerging Markets	Commodities	Property	Corporate Bond	Gilts	Cash
-6.87%	-4.43%	-2.62%	-4.01%	-2.20%	-1.46%	0.00%	-1.80%	+0.26%	+0.07%

THE ACTUARIAL VIEW:

In general, it has been a case of no news is good news when it comes to the economy, leading to steady growth. This was despite both the Fed and the Bank of England raising interest rates, a piece of news that was so expected by the market that long-term interest rates fell. This has led to the curious situation where short-term interest rates are rising and some long-term ones falling, leading to a flattening of the yield curve. The biggest news story remains the weakness of the US dollar, an event which is still very difficult to explain. One suggestion is that external interest in US assets has now peaked, possibly due to the rise of China, which creeps ever closer to becoming the world's largest economy.

Steady economies mean only modest changes to the asset class model, with only small changes being made to the core asset classes. The outlook for emerging markets is keeping up with prices, meaning expectations have also risen. The reverse is true for property meaning that the outlook for this asset class has fallen.





WHAT TO LOOK FOR IN Q2:

- **UK:** The Bank of England's Monetary Policy Committee is scheduled to review interest rates on 10 May and 21 June. Summaries and minutes will be published the same day. The Bank's quarterly inflation report will also be published on 10 May. Headline inflation data for March, April and May will be published by the Office for National Statistics on 18 April, 23 May and 13 June respectively.
- **US:** The Federal Open Market Committee will meet on 1-2 May and 12-13 June to review interest rates. Minutes from each meeting will be published three weeks after the decision.
- **Japan:** There will be Bank of Japan monetary policy meetings on 26-27 April and 14-15 June.
- **Europe:** Luis de Guindos, Minister of Economy, Industry and Competitiveness for Spain, will take over from Vitor Constancio as European Central Bank Vice-President in June. There will be European Central Bank monetary policy decisions on 26 April and 14 June.
- **South America:** Paraguayan, Venezuelan and Colombian presidential elections will take place on 22 April, 20 May and 27 May respectively.

ASSET CLASS SCENARIOS:

UK EQUITY

Most Likely: The signing of the Brexit transition agreement was largely positive for UK sterling, whilst holding back larger overseas earners. However, the risk is for UK sterling to surprise on the down side, with large caps likely to reduce the gap with recent outperforming smaller companies. Coming off the back of recent strength and continued supply constraints, we would expect oil and commodities to trade sideways which is profitable and positive for stocks within these sectors.

Worst Case: Geopolitical tensions across the globe continue to escalate, creating a large headwind for risky assets. US-led trade wars are also another increasing risk for global equity assets. Negative Brexit details weaken UK sterling as real wages continue to fall and inflation bites. Any imported inflation will raise borrowing costs, with further rate rises from the BoE dragging sensitive stocks lower.

Best Case: Geopolitical tensions and trade-war risks subside to allow global growth to continue. Progress in Brexit talks encourages businesses back into capital investment that begins to stimulate productivity. Stronger Sterling is a drag on exporting stocks and expect domestic companies to outperform. Softer Chinese monetary policy will have a positive effect on commodities and oil stocks as OPEC cuts are maintained.

GLOBAL EQUITY

Most Likely: The economic expansion is likely to continue over the quarter, but we expect less room for growth surprises, therefore limiting the upside potential in equities. It is unlikely that a meaningful sell-off will occur without a significant deterioration in growth or fundamentals. We expect corporate earnings to drive global equities but if companies fail to meet their high expectations, particularly in the US, markets could see further volatility.

Worst Case: The return of volatility to markets provoked by higher inflation expectations have subsided but fears of a trade war have surfaced, which can hurt global equities, particularly export-oriented companies. Facebook's recent data breach could lead to pressure on regulating the tech giants that currently enjoy monopolistic market shares, and any regulation aimed at reducing their dominance could hurt US equities.

Best Case: US equities would benefit if stock buybacks increase as companies look to return profits from tax cuts and repatriation of overseas cash earnings. Policy divergence between the Bank of Japan and the rest of the world should remain beneficial for Japanese equities. Domestic activity remains robust and valuations appear attractive relative to the rest of the developed world.

EMERGING MARKET EQUITY

Most Likely: Emerging markets are likely to continue to generate positive returns, thanks to the improving environment in developed trading partners, a weaker US dollar and domestic companies' earnings on an upward trajectory. They should outperform developed markets, with the best returns likely to come from sectors and countries which lagged in 2017's bull market.

Worst Case: A downturn in the US economy would cause serious knock-on effects in emerging markets, particularly if global investors sought refuge in the US dollar and US treasuries. Much of the inflows into the region last year came through passive exchange traded funds (ETFs) and this money could be quickly withdrawn, resulting in significant, swift falls in equity prices.

Best Case: The best returns will likely come if political events favour markets in key geographies, giving further impetus to confidence in those economies. Market friendly developments in South Africa and Brazil could give impetus to equities there, while a decrease in tension with Russia would help that market regain the momentum it lost following the recent Salisbury poisoning case in the UK.

CASH

Most Likely: The Bank of England raises interest rates by 25 basis points to 0.75 per cent in May and inflation falls more gradually towards the Bank's 2 per cent target. This will boost real returns to cash. The asset class will maintain its appeal as a safe haven for investors as political and economic uncertainty mounts and interest rates across the world are raised from historic lows.

Worst Case: The worst scenario for cash investors is that interest rates are kept on hold while inflation rises. More tariffs and other protectionist measures from the US and retaliation around the world could add substantial inflationary pressure. This would work to erode real returns to cash over the coming quarter.

Best Case: The best scenario is that interest rates are raised in June as well as May and inflation continues to fall faster than expected, as it did between January and February. This will boost real returns to cash. Some reduction in inflation is likely as the depreciation of the pound following the Brexit vote loses its bite and the pound recovers. Inflation is likely to strengthen somewhat in the US in response to the expansionary fiscal reforms.

FIXED INCOME

Most Likely: The Bank of England is likely to raise rates in May, although we expect the effect on gilt yields to be slight. With negotiations with the EU seeming to proceed steadily, it is likely that UK gilt yields will be driven by global yields, chiefly US treasuries. With the UK economy in decent shape, corporate and high yield bond spreads should be supported, although rising gilt yields will likely lead to small losses.

Worst Case: With yields still low by historic standards, an increase in positive economic data and rate rises in other key developed markets could have a significant upward effect on gilt yields. The other thing to watch is the Brexit negotiations. If it seems likelier that the UK will not leave the EU or will leave on 'softer' terms, gilt yields could rise as investors become more optimistic about the economy's prospects. Corporate and high yield will likely do worse if economic data deteriorates, however.

Best Case: A collapse in the Brexit talks could see a fall in gilt yields as investors again prepare for the UK economy to run over a cliff edge in 2021. However, a more likely positive scenario is a downturn in UK economic data, although it is mostly good at the moment. Both scenarios are unlikely to be positive for corporate bonds, which are most likely to do well if US yields fall slightly.

PROPERTY

Most Likely: Expectations for commercial property have not changed. Money has slowly come back to the sector. Performance last year has gone beyond expectations in some segments of the market as some investors chased yields, and capital growth is now more than limited in many areas. Income should not disappoint, though, and will continue supporting the asset class total return.

Worst Case: Rapidly rising rates are a threat to property markets as they reduce the yield gap between bonds and property, and makes the asset class less attractive. This is a risk for US real estate investment trusts (REITs) in particular as the Fed shows confidence in the strength of the economy's growth. In the UK, the outlook is pretty much the same as before, but any hiccup in Brexit negotiations or any sort of bad news will likely depress investors further.

Best Case: Early progress on a new trade agreement with the EU in favour of the UK would lift investor sentiment and help companies plan for office space requirements. This would be supportive of capital values. Low interest rates for longer also support the attractiveness of the asset class, and Europe is well positioned in this respect.