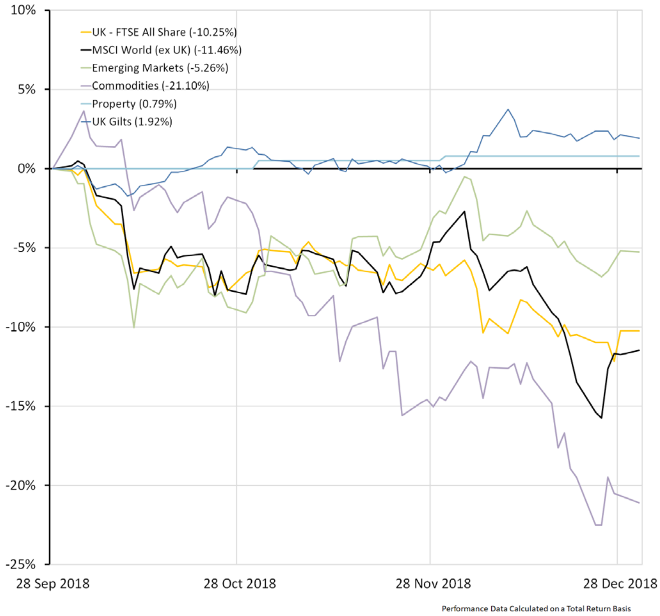
WINTER OUTLOOK

REVIEW OF THE PAST QUARTER:

It proved to be a case of too much good news being bad in October. Strong employment growth, little inflation and, mainly, US Federal Reserve chairman Jerome Powell's "long way" from neutral interest rate comment sparked a treasury yields rally. In turn, bond market contagion spread to the rest of the global markets. Since then, Powell appears to have cooled on further hikes, bringing 'safe-haven' assets back to life. However, one of the key indicators of an upcoming recession - the spread between ten-years and two-year US treasury bonds - has been steadily tightening and is now close to the point of inversion.



Meanwhile, oil prices have been falling after previous fears of limited supply due to Iran's sanctions were eased once the US extended waivers to key importers of Iranian oil. A surplus along with a slowdown in demand caused Opec members and Russia to curb supply in December. Qatar announced it would be leaving Opec next month.

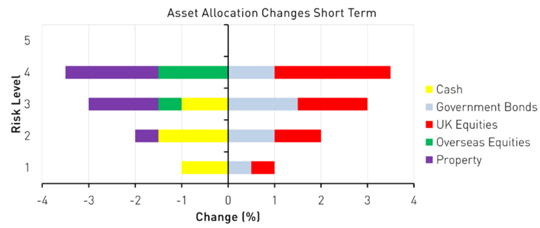
Poor GDP figures have dominated headlines this quarter. The wider eurozone posted unexpected sluggish growth for Q3. Individually, Italy, Germany and Japan's economies all contracted for the same period. Rising protectionism caused by an ongoing trade war between China and the US, and increased market volatility, led to both the Organisation for Economic Co-operation and Development and the International Monetary Fund revising forecasted global growth for this year and the following.

ASSET CLASS RETURNS

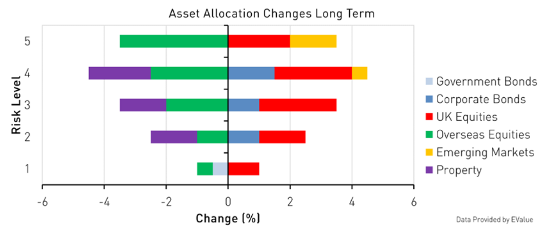
Cash	Government Bonds	Index Linked Bonds	Corporate Bonds	UK Equities	Overseas Equities	Emerging Markets	Property
+0.10%	+1.92%	+1.87%	+0.02%	-10.25%	-11.46%	-5.26%	+0.79%

THE ACTUARIAL VIEW:

With just a few months left before Brexit things are currently no clearer, meaning that political news completely overshadows any economic news. In the UK employment figures are still good and economic growth has slowed less than expected; nevertheless, the UK market has underperformed most other markets. The UK remains a fast moving situation and things could change quickly. Europe remains a mixed bag, with Italian political upheaval a drag. In the US tightening monetary policy, looser fiscal policy plus trade protectionism has meant the country has struck out on its own and has become disconnected from other markets. Emerging markets are all very different but in general face a headwind of a tightening US dollar, trade restrictions and weak Asian growth.



Despite volatility, markets have kept up with expectations, except for the UK, thanks to the Brexit effect. Foreign earnings are likely to provide some protection here, meaning the UK looks slightly better value now than previously. Property, however, is far more susceptible than equities - a hard Brexit is likely to lead to a slash in demand followed by a collapse in rent and values. All this translates into a move away from property into more UK equity and fixed income.



WHAT TO LOOK FOR IN Q1:

- **UK:** Monetary Policy Committee (MPC) announcements and minutes are scheduled for 7 February and 21 March. The UK is due to leave the EU on 29 March.
- **US:** There will be interest rate decisions from the Federal Open Market Committee on 29-30 January. Minutes will be published three weeks after each decision.
- **Eurozone:** Quarterly GDP data is set to publish on 31 January. The ECB Monetary Policy meeting is scheduled for 24 January.
- **Other Data:** Thailand's general election is set to take place on 24 February. China's Trade Balance is expected to be published between 7-15 January.

ASSET CLASS SCENARIOS:

UK EQUITY

Most Likely: Approaching the final stage of Brexit negotiations with little clarity will heighten uncertainty, increasing the probability of no deal. The pound weakens and negative sentiment hurts equities to a limited extent, given already low valuations. Parliament may buckle under pressure and approve the deal, providing the market with respite and seeing equities rally, driven by smaller companies benefiting from a stronger pound.

Worst Case: Parliament rejects the proposed deal and the EU rejects the backstop issue. A general election ushers in a Labour government. The short-term impact would be damaging, with the pound weakening and UK equities selling-off. The Bank of England may hike interest rates sooner than expected to curb inflation, which would be negative for gilts and provide an additional headwind for equities.

Best Case: Parliament approves the deal, resulting in higher growth expectations fuelling the economy over the longer-term. Over the next quarter results will be less positive for equities: a stronger pound would boost smaller companies but be negative for equities overall as over 70 per cent of firms' revenues are generated outside the UK. The Bank of England may hold off on interest rates hikes, providing some respite for equities and gilts.

GLOBAL EQUITY

Most Likely: US markets will have increased sensitivity to the Federal Reserve's rate decisions with an increase in month-on-month volatility; however, economic fundamentals remain robust. The European Central Bank plans to keep rates low for the foreseeable future, supporting growth. Despite these positives, the escalating trade tensions between the US and China continue to increase uncertainty in the market and will likely dampen global growth in the coming quarter.

Worst Case: The trade spat between China and the US keeps equities on the defensive and investors on the sidelines. US outperformance is unlikely to persist through 2019 as the effect of the tax cuts wears off. The stand-off between Brussels and Rome escalates and Italy distances itself from the EU, creating further uncertainty across the region. Slower global growth could lead investors to the Japanese yen, which is traditionally negative for the Japanese equity market.

Best Case: The recent collapse in the oil price is supportive for Europe as an importer of the commodity, and consumers are still showing an appetite to spend, which should help to narrow the gap between the US and European markets. Trade tensions ease and President Trump adopts a new outlook, reducing uncertainty and supporting the global economy.

EMERGING MARKET EQUITY

Most Likely: Emerging market equities are likely to be volatile, with sharp market moves reacting to tweets rather than actual macroeconomic data, continuing until the 1 March 'hard deadline' for a trade deal. If the risk-off sentiment continues, emerging markets are likely to generate negative returns. Trade tensions and tightening financial conditions are likely to be the key risks for the region.

Worst Case: Emerging markets would struggle if the US dollar strengthens or if the Federal Reserve surprises the market with more rate hikes. If a US-China trade deal is not reached, emerging markets could get hurt as supply chains get disrupted, particularly for more trade-reliant economies such as South Korea, Thailand and Vietnam.

Best Case: A reversal of the broad US dollar appreciation would be a much-needed tailwind for emerging markets. Earnings growth in emerging markets could take a lead over the US, where earnings are expected to slow as the effects of the US tax reform moderate.

CASH

Most Likely: Following the Bank of England's decision to hike rates, the return from cash has slightly improved. Core inflation should remain within the 2 per cent-2.5 per cent range, which means returns from cash remain negative. Headline inflation is unlikely to come down significantly over the coming quarter due to cost pressures from a range-bound oil price.

Worst Case: The worst-case scenario for cash savers is that inflation continues to rise with cost-push pressures at the fore. Another likely headwind is UK sterling weakness as Brexit negotiations turn sour and imported inflation compounds woes, with the Bank of England refraining from further tightening for the already weakened consumer.

Best Case: Any progress in Brexit negotiations could well be taken by the Bank of England as a signal to continue tightening, especially if wage growth surprises and tends to the upside. In such a scenario, returns to cash would improve despite staying negative. Similar to government bonds, cash could also act a safe-haven with recession kicking in for the US.

FIXED INCOME

Most Likely: Bond markets will navigate troubled waters, as market participants try to guess the Federal Reserve's next move. As Jerome Powell said, the Fed's benchmark interest rate is near the neutral rate and investors might be tempted to move back into government bonds. UK fixed income markets are expected to stay immune from these headwinds as the Bank of England would prevent itself from interfering in the Brexit debate.

Worst Case: After several years of monetary stimulus, we might have reverted to a normal situation where any sign of wage growth and inflation is bad news for bond markets. If a Brexit deal is reached before the deadline, the Bank of England might trigger an unexpected rate hike. The cost of financing for companies should increase, pushing bond investors to reconsider their investments in debt issued by companies.

Best Case: Bond markets might have already priced in negative news – as such the downside is now limited. Political uncertainty will continue to act as a drag on bond yields, anchoring investors' expectations to lower levels from current ones. Companies might further delay their capital expenditure decisions and lower their debt level. The low level of debt supply relative to demand from institutions might drag yields lower.

PROPERTY

Most Likely: Despite a recent rate rise in the US, the asset class is still attractive. The rise suggests an economy getting stronger, meaning rents can grow, supporting performance. In the UK, the performance of real estate investment trusts (REITs) is likely to be tightly correlated to the Brexit deal being negotiated with the EU and could go either way.

Worst Case: In the UK, a no-deal Brexit would leave corporates, hence tenants of commercial property, with high uncertainty. Capital values might fall, and we do expect an increase in income return. In the US, an acceleration in the growth of the economy would not necessarily be a good thing as the Federal Reserve would raise rates quicker and money would rotate from the real estate sector to bonds.

Best Case: Clear guidance on the Brexit deal from the government would help corporates prepare for a transition period and support property performance. Continental Europe would continue to benefit from cheap financing. This could help corporate activity and support capital growth. A weaker pound would also be supportive, both for Europe and the US, where continuing healthy growth will push rents higher.