AJBell

Active Managed Portfolio Service – Q4 2018 report

Introduction

We are delighted to bring you the latest quarterly report from AJ Bell Investments.

This report is designed to keep you up-to-date on what is happening with your AJ Bell managed investments. It covers the major macro-economic events of the past three months, looks at how these have impacted the portfolios, and highlights any changes made in the period.

Summary

Over the course of the fourth quarter, market volatility picked up markedly as investors accepted that global growth was likely to slow into 2019, resulting in significant falls in equity markets. This slowing had become evident in economies around the world with the exception of the US but with the Federal Reserve indicating it expected growth to slow, it finally dawned on US investors that they were not immune to a slowing global economy.

Closer to home, once again it was Brexit that dominated the headlines, with huge turmoil affecting the UK government on its proposed withdrawal agreement. With UK politicians unhappy with the deal and the EU saying there was no hope of renegotiation, uncertainty picked up as to what the likely outcome of Brexit would be. It wasn't just the UK that suffered though with Germany, Italy and France all suffering from political challenges that impacted upon markets.

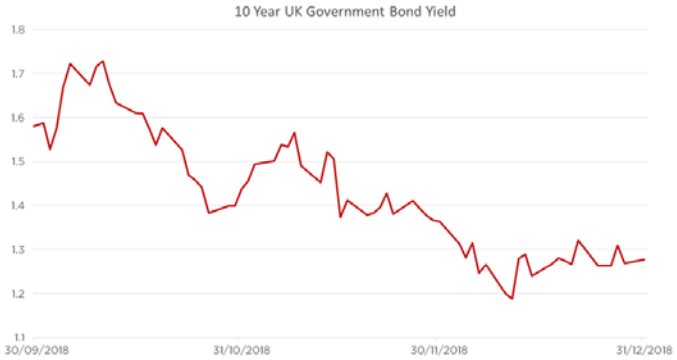
In Asia, slowing growth in China and Japan hit returns while Brazil benefited from pro-business reforms introduced by its new President. However, this was of minor consolation to global investors who suffered significant losses on equity investments, while fixed interest markets offered some protection from the worst of the volatility.

The sharp falls seen over the quarter meant that major equity markets saw their first annual falls since 2011 and brought their worst year since the financial crisis in 2008.

Economic and market review

The fourth quarter of 2018 represented a major shift in performance from that seen earlier in the year with significant falls across equity markets. While earlier in the year it was emerging markets and Asia that suffered, in the final quarter it was the turn of the developed markets with the UK, the US, Europe and Japan all registering double digit falls in their equity markets. Away from equities, fixed interest markets on the whole benefitted from this 'risk off' approach, performing better than for much of the year.

In the UK, it was impossible to escape the looming spectre of Brexit, with Theresa May's government struggling to maintain any coherence once the details of the withdrawal agreement with the EU were announced. With a number of resignations from the cabinet, a confidence vote from her own party and a clear rejection of her deal from MPs, Theresa May clung to her premiership by her fingernails. At this time, it is still unclear if and how the UK will leave the EU on 29 March 2019, with all possible outcomes still an option. Unsurprisingly, this level of uncertainty has not played out well with investors looking at the UK, and this was reflected by a weakening of sterling over the period as well as the FTSE All Share Index which fell by 10.3%. Economically, the UK appeared to be progressing reasonably well early in the quarter, with wage growth reaching its highest level since before the financial crisis, and third-quarter GDP coming in ahead of expectations helped by England's surprising progress in the World Cup! However, as the quarter progressed, momentum slowed, particularly for retail sales as the high street struggled in the run-up to Christmas and traditional Boxing Day sales events were brought forward significantly to before Christmas. The increased concerns over Brexit and economic challenges saw the 10-year government bond yield move from 1.60% down to 1.27% over the quarter, reversing the previous quarter's move, with the FTSE Actuaries UK Conventional Gilts All Stocks Index increasing by 1.9%. Corporate bonds were hit more by the uncertainty, with the iBoxx UK Sterling All Maturities Index falling back slightly over the quarter, while high yield bonds (that are more closely correlated with equities) were hit hard. The Bloomberg Barclays Global High Yield Bond Index fell by 4.2% over the period.



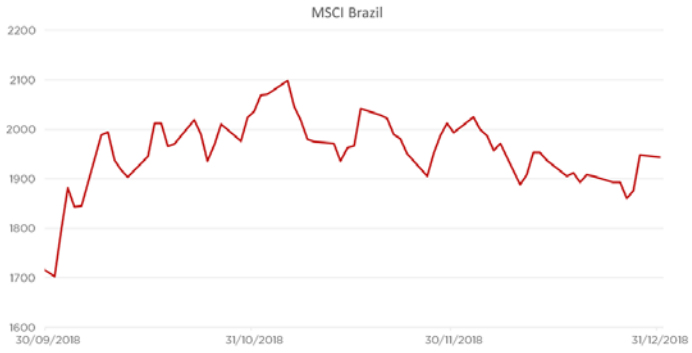
Source: Bloomberg LLP, AJ Bell Investments; January 2019

The US has been the standout performer over 2018 but in the fourth quarter this came to a juddering halt, with the S&P 500 Index falling by over 11%. For much of the quarter economic data from the US was strong, with third-quarter GDP growth coming in ahead of expectations at 3.5%, while unemployment fell back to close to a 50-year low. At the same time consumer confidence and spending were also robust, so it would be easy to ask why there were big falls in equity values. The main drivers for this are two fold; firstly, the concerns over global trade wars remained at the forefront of investors' minds over the quarter. While various comments from President Trump and President Xi of China at the G20 summit appeared to have de-escalated matters, investors remained unconvinced and took fright at how this trade war may disrupt global GDP growth in 2019. The second factor was comments from the Federal Reserve which indicated that it may have started to recognise a slower pace of US growth. While the Fed saw fit to increase the US interest rate in December, the fourth hike this year, it was the comments that accompanied the announcement that caused the concerns, with indications that the economy would need fewer rate rises next year than previously expected. The changing expectations of interest rates saw major volatility in the US 10-year Treasury yield. which climbed to above 3.2% early in the quarter but fell back sharply to 2.7% at the end of the period.

Source: Bloomberg LLP, AJ Bell Investments; January 2019

European economies showed signs of weakness over the period, with even the powerhouse that is Germany struggling. It saw its third-quarter GDP contract for the first time since early 2015, with impacts from new emissions standards for its car industry hitting output. In addition, Chancellor Angela Merkel suffered a significant weakening of her authority in regional elections and announced she would not seek re-election in 2021. Having been in power since 2005, this represents significant uncertainty in the next couple of years for Germany at a crucial time for the EU. Away from Germany, Italy also struggled with slow growth and a political stand-off between the government and the EU, which rejected its initial budget. This impasse created significant volatility in Italian bond and equity markets, particularly for financial companies. In France, President Macron faced huge social unrest as protests - initially at rising fuel prices, but latterly at his overall economic policy - turned into numerous riots in Paris. The 'yellow vests' fought repeated battles with the police and demanded an end to tax cuts for the rich, along with a host of other reforms. Macron caved in on a number of areas but unrest has continued and economic output and confidence in France has taken a major shift downwards. Over the periods, the MSCI Europe ex UK Index fell back 11%.

The emerging markets have seen significant volatility over the course of the year and this continued during the fourth quarter. For much of the year, emerging markets were hurt by a strengthening US dollar and the potential consequences of a trade war between the US and China and this continued to play a major role as the end of the year approached. However, during December, with the US Federal Reserve softening its stance on interest rate rises and the 10-year US Treasury yield falling, emerging markets actually had some respite. While in absolute terms, emerging markets still fell back sharply with the MSCI Emerging Markets Index dropping by 5.3%, they significantly outperformed other global markets. Some of this improved performance came from Brazil where new President Bolsonaro has helped improve both consumer and business confidence with his reform policies. In China, third-quarter GDP came in at 6.5% year-on-year, slightly below expectations but clearly still very strong. The People's Bank of China has recognised the risks from the trade war and implemented some monetary stimulus along with a cut in the reserve requirement for banks in an attempt to boost lending. In India, political risk increased in December when the head of the central bank unexpectedly quit following rumours of interference from central government. Looking at fixed interest in the region, the JPMorgan GBI Emerging Market Global Composite Bond Index increased by 4.9% over the period.



Source: Bloomberg LLP, AJ Bell Investments; January 2019

A series of natural disasters over the summer caused the economy in Japan to decline over the third quarter by 0.3%, although with the government spending significant sums on rebuilding, this was expected to rebound in the fourth quarter. Economic data over the period was mixed, as while manufacturing output continued to grow and new orders also increased, business confidence fell for the seventh month in a row as businesses looked ahead to next year's planned increase in consumption tax and what this will do to an already fragile economy. Over the quarter, the Nikkei 225 Index fell over 12.9%, the first time in eight years that the index has been negative.

Source: Bloomberg LLP, AJ Bell Investments; January 2019

All market performance figures are in GBP.

Market outlook & our positioning

In the last quarterly review, we highlighted that some major risks existed below the surface in the global economy that were perhaps being ignored by equity investors. Over the fourth quarter it would certainly appear that some of these risks have risen rapidly to the surface.

Economic data has changed significantly over the past three months, with investors now accepting that it is highly likely that global economic growth will slow during 2019. This has been recognised by the Federal Reserve in the US which has now indicated a more gradual increase to interest rates is expected next year. Investors have realised, with hindsight, that equity markets had got ahead of themselves over the summer and that a more realistic view should be taken, particularly as this global cycle is already longer than most investors have seen before.

Many of the risks that existed in the summer have not gone away, particularly the trade war that continues to be a headwind to global growth, especially when President Trump gets anywhere near his Twitter app! In addition, risks have escalated in Europe, with political issues spreading to Germany and France while the great unknown in 2019 remains Brexit.

With equity markets having fallen back sharply and valuations now on more realistic levels, it is entirely possible that, should the trade wars dampen down and a path to a soft Brexit be found, equities could well be primed to rally sharply, but of course both of those issues represent a rather large 'if'! However, UK equities are certainly unloved and out of favour given the uncertainties that exist, and as a result, dividend yields have increased significantly. For some, this will make equities an attractive proposition and may well provide a useful cushion against further volatility into 2019.

In fixed interest markets, we continue with our UK gilts exposure being held entirely in short duration bonds, i.e. gilts that mature in less than five years. While this position is designed to cushion the blow from rising interest rates, it also helps protect from significant volatility in the bond market. As a result, we remain very comfortable with this position given the risks that we believe will persist into 2019.

Active Managed Portfolio review – Q4 2018

Active MPS Growth

The fourth quarter was a very challenging one for investors and there was no hiding place, with all portfolios unfortunately registering a negative return over the period.

At an overall level, the allocation to equities was a negative contributor over the period, while some elements of the fixed interest market were positive contributors. With the exception of Asia and the emerging markets, major global equity markets fell by double digit levels as fears over slowing global growth caused investors to sell down equities after a very strong first three quarters of the year. The US, which had been leading the rally this year, fell back sharply over the period and with a large element of the US exposure coming from the Fidelity US Index fund, the portfolios were not immune to these falls. The Dodge & Cox US Stock fund (Portfolio 3-6) was marginally behind the index over the period while the US-focused Polar Cap Global Technology fund (Portfolio 3-6) was hit hard as technology stocks fell sharply after a very strong run of performance.

In the UK, attention was focused on the Brexit negotiations which caused significant volatility in the FTSE All Share Index. The Troy Trojan Income fund (Portfolio 1-6) is typically more defensive than the other UK equity funds and this proved to be the case again during the fourth quarter, as it fell significantly less than peers and the index but unfortunately still fell nonetheless. Both the Investec UK Alpha fund (Portfolio 3-6) and the Man GLG Undervalued Assets fund (Portfolio 2-6) were behind the index while the Merian UK Smaller Companies fund (Portfolio 6) fell sharply as smaller companies were hit hard due to their greater exposure to the UK consumer compared to the more internationally diversified larger companies. In Europe politics was, as ever, a major contributor to negative performance and the Crux European Special Situations fund (Portfolio 2-6) underperformed as growth companies were sold down over the period.

In Asia, our core exposure to the Invesco Asian fund (Portfolio 2-6) was marginally behind its broad-based Asian benchmark after outperforming in the third quarter, while the Schroder Asian Alpha Plus fund (Portfolio 6) was marginally ahead of the index. In emerging markets, the Fidelity Emerging Markets fund (Portfolio 2-6) was a little behind the index over the period while the Jupiter Global Emerging Markets fund (Portfolio 5-6) outperformed after a very tough third quarter.

In Japan, the market was the worst-performing of the major global indices. The Man GLG Japan Undervalued Assets fund focuses on larger companies that are significantly out of favour and this approach managed to marginally outperform the index over the period.

With fixed interest, after a very tough third quarter, performance was positive in some areas as investors looked for an element of safety given the volatility seen in equity markets. The strongest performance came from the M&G Global Macro Bond fund (Portfolio 1-4) which benefited from an allocation to the US dollar which strengthened against sterling over the period, delivering a solid positive return over the period. Also performing well was the M&G Emerging Markets Bond fund (Portfolio 1-5) as investors saw that the yields it offered had once again become attractive.

Closer to home, UK corporate bonds were not as resilient as their overseas counterparts as Brexit uncertainties hit all asset classes. Both the Fidelity MoneyBuilder Income fund (Portfolio 1-3) and the TwentyFour Corporate Bond fund (Portfolio 1-4) fell back a little over the period. In high yield bonds, the market was weak as their correlation with equity markets is higher than other parts of the fixed interest market. The Baillie Gifford High Yield Bond fund (Portfolio 1-5) performed well relative to peers but unfortunately still fell back overall.

Looking at the tactical asset allocation positions, the portfolios remain underweight duration on a long- term basis. This was not as helpful during the quarter as in previous quarters but the Lyxor FTSE UK Gilt 0-5yr ETF (Portfolio 1-4) still delivered a positive return over the period. The second position is to keep away from physical commercial property, owing to challenges that may occur as the economy slows and as uncertainty escalates around Brexit. Over the quarter, the weakness in the UK economy was evidenced in UK commercial property prices with slightly negative performance. Unfortunately, the alternative positions in the M&G Absolute Return Bond fund (Portfolio 1-5) and the Janus Henderson UK Absolute Return fund (Portfolio 1-6) that are held in replacement of property exposure were also negative over the period.

Overall, while the portfolios have behaved within our expectations from a risk/reward perspective during the recent quarter, it is always disappointing to deliver negative performance. The environment was clearly very challenging, however, we retain conviction in the underlying managers and continue to take a long-term view in our approach.

Portfolio changes

We did not make any changes to the portfolios over the quarter. We do however remain focused on ensuring that each of these portfolios is exposed to the most appropriate investments and therefore, should the need arise to undertake changes to the underlying holdings, we will not hesitate to alter the current portfolios' positioning.

The long-term strategic asset allocation is reviewed on an annual basis with implementation made in February. This process is currently close to completion and we will communicate any changes to the overall asset allocation once the changes have been made.

Active MPS Income

Amid a very challenging and volatile environment, both Income portfolios unfortunately fell back sharply as there was little place to hide during the quarter.

At a headline level, equities performed very poorly over the period which was negative for overall portfolio returns, and while the income style of investing outperformed the broader market it was not enough to offset the scale of negative performance from the broader equity market.

In the UK, equities were very challenged as the focus on Brexit negotiations, which seemed to be stalling, caused investors to look away from UK companies. As a result, the FTSE All Share Index performed poorly, creating a difficult environment for investors, however, the defensively positioned Troy Trojan

Income fund did manage to outperform as its focus on cash generative companies provided some respite from the negativity surrounding UK companies. In addition, the Man GLG UK Income fund also managed to outperform the market, helped by some good stock picking from manager Henry Dixon. The Montanaro UK Income fund had a more difficult period as its focus on small and medium sized companies that are often more exposed to the UK economy struggled as investors preferred larger companies.

Having been the strongest performer in the third quarter, the Artemis Global Income fund had a poor fourth quarter as its focus on value companies was very much out of favour. The Newton Global Income fund (Portfolio 2) fared much better, significantly outperforming the index as its exposure to high quality, cash generative companies was rewarded. However, despite this strong relative performance, the fund still fell in absolute terms.

Looking at regional equity exposure, the BlackRock Continental European Income fund performed well against the index as its approach helped protect against the worst of the falls in European markets. It was a similar picture in both Asia and the emerging markets where the Jupiter Asian Income fund and the JPMorgan Emerging Markets Income fund both outperformed the indices but still fell back in absolute terms.

Away from the equity exposure, the allocation to infrastructure equities was positive as the asset class significantly outperformed global equities, reversing the position seen in the previous quarter. The Premier Global Infrastructure fund performed well and ultimately ended the period fractionally in positive territory as the defensive nature of infrastructure investments came through. The allocation to property equities was also a detractor over the quarter, with the iShares MSCI UK Target Real Estate ETF falling back as investors perceived increased risk from Brexit could hurt the UK economy. International property equities fared a little better but the L&G Global Real Estate Dividend Index still ended the quarter in negative territory.

In the fixed interest holdings (Income 1 only), the highlight was the exposure M&G Emerging Markets Bond fund which performed well as investors saw attraction in the high yields on offer in emerging markets.

Closer to home, UK corporate bonds were not as resilient as their overseas counterparts as Brexit uncertainties hit all asset classes. Both the Royal London Corporate Bond fund and the TwentyFour Corporate Bond fund fell back a little over the period. In high yield bonds, the market was weak as their correlation with equity markets is higher than other parts of the fixed interest market. The Baillie Gifford High Yield Bond fund performed well relative to peers but unfortunately still fell back overall.

Once again, while the overall absolute level of performance of the portfolios over the quarter has been frustrating, it has been pleasing to see that given the equity market sell off, the income characteristics of the investments have proved to be defensive.

Portfolio changes

Having made changes to the portfolios in the previous quarter, there were no additional changes made during the final quarter of the year.

The long-term strategic asset allocation is reviewed on an annual basis, with implementation made in February. This process is currently close to completion and we will communicate any changes to the overall asset allocation once the changes have been made.

Fund	3 months	6 months	1 year	Inception*
Active MPS 1	-2.30%	-1.59%		-0.35%
Active MPS 2	-4.28%	-3.27%		-2.03%
Active MPS 3	-6.38%	-5.08%		-3.08%
Active MPS 4	-7.69%	-6.34%		-3.91%
Active MPS 5	-9.13%	-8.04%		-5.55%
Active MPS 6	-9.85%	-9.24%		-6.91%
Active MPS Income 1	-4.37%	-4.29%		-2.48%
Active MPS Income 2	-7.50%	-7.25%		-3.32%

*Active MPS launched on 19 February 2018.
Source: Bloomberg, AJ Bell Investments; January 2019.

This report provides general information about the AJ Bell Managed Portfolio Service. It should not be read or construed as investment advice. It is your responsibility to assess your client's circumstances and make a personal recommendation that is suitable for their needs.

The value of investments can go down as well as up and your client may not get back their original investment.

Past performance is not a guide to future performance and some investments need to be held for the long term.

AJB/MPS-A-QR/20190114

AJBell

Passive Managed Portfolio Service – Q4 2018 report

Introduction

We are delighted to bring you the latest quarterly report from AJ Bell Investments.

This report is designed to keep you up-to-date on what is happening with your AJ Bell managed investments. It covers the major macro-economic events of the past three months, looks at how these have impacted the portfolios, and highlights any changes made in the period.

Summary

Over the course of the fourth quarter, market volatility picked up markedly as investors accepted that global growth was likely to slow into 2019, resulting in significant falls in equity markets. This slowing had become evident in economies around the world with the exception of the US but with the Federal Reserve indicating it expected growth to slow, it finally dawned on US investors that they were not immune to a slowing global economy.

Closer to home, once again it was Brexit that dominated the headlines, with huge turmoil affecting the UK government on its proposed withdrawal agreement. With UK politicians unhappy with the deal and the EU saying there was no hope of renegotiation, uncertainty picked up as to what the likely outcome of Brexit would be. It wasn't just the UK that suffered though with Germany, Italy and France all suffering from political challenges that impacted upon markets.

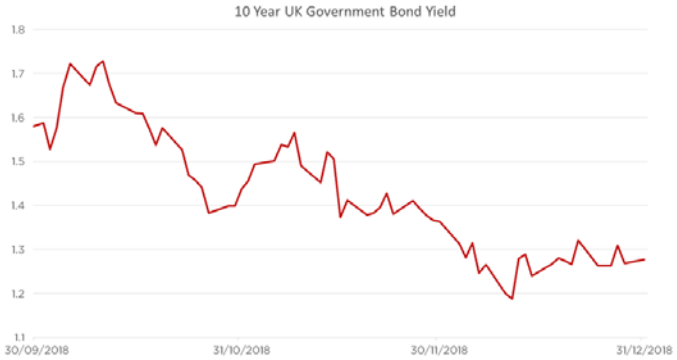
In Asia, slowing growth in China and Japan hit returns while Brazil benefited from pro-business reforms introduced by its new President. However, this was of minor consolation to global investors who suffered significant losses on equity investments, while fixed interest markets offered some protection from the worst of the volatility.

The sharp falls seen over the quarter meant that major equity markets saw their first annual falls since 2011 and brought their worst year since the financial crisis in 2008.

Economic and market review

The fourth quarter of 2018 represented a major shift in performance from that seen earlier in the year with significant falls across equity markets. While earlier in the year it was emerging markets and Asia that suffered, in the final quarter it was the turn of the developed markets with the UK, the US, Europe and Japan all registering double digit falls in their equity markets. Away from equities, fixed interest markets on the whole benefitted from this 'risk off' approach, performing better than for much of the year.

In the UK, it was impossible to escape the looming spectre of Brexit, with Theresa May's government struggling to maintain any coherence once the details of the withdrawal agreement with the EU were announced. With a number of resignations from the cabinet, a confidence vote from her own party and a clear rejection of her deal from MPs, Theresa May clung to her premiership by her fingernails. At this time, it is still unclear if and how the UK will leave the EU on 29 March 2019, with all possible outcomes still an option. Unsurprisingly, this level of uncertainty has not played out well with investors looking at the UK, and this was reflected by a weakening of sterling over the period as well as the FTSE All Share Index which fell by 10.3%. Economically, the UK appeared to be progressing reasonably well early in the quarter, with wage growth reaching its highest level since before the financial crisis, and third-quarter GDP coming in ahead of expectations helped by England's surprising progress in the World Cup! However, as the quarter progressed, momentum slowed, particularly for retail sales as the high street struggled in the run-up to Christmas and traditional Boxing Day sales events were brought forward significantly to before Christmas. The increased concerns over Brexit and economic challenges saw the 10-year government bond yield move from 1.60% down to 1.27% over the quarter, reversing the previous quarter's move, with the FTSE Actuaries UK Conventional Gilts All Stocks Index increasing by 1.9%. Corporate bonds were hit more by the uncertainty, with the iBoxx UK Sterling All Maturities Index falling back slightly over the quarter, while high yield bonds (that are more closely correlated with equities) were hit hard. The Bloomberg Barclays Global High Yield Bond Index fell by 4.2% over the period.



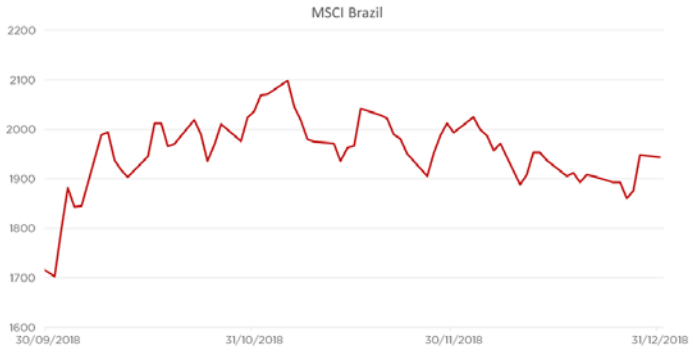
Source: Bloomberg LLP, AJ Bell Investments; January 2019

The US has been the standout performer over 2018 but in the fourth quarter this came to a juddering halt, with the S&P 500 Index falling by over 11%. For much of the quarter economic data from the US was strong, with third-quarter GDP growth coming in ahead of expectations at 3.5%, while unemployment fell back to close to a 50-year low. At the same time consumer confidence and spending were also robust, so it would be easy to ask why there were big falls in equity values. The main drivers for this are two fold; firstly, the concerns over global trade wars remained at the forefront of investors' minds over the quarter. While various comments from President Trump and President Xi of China at the G20 summit appeared to have de-escalated matters, investors remained unconvinced and took fright at how this trade war may disrupt global GDP growth in 2019. The second factor was comments from the Federal Reserve which indicated that it may have started to recognise a slower pace of US growth. While the Fed saw fit to increase the US interest rate in December, the fourth hike this year, it was the comments that accompanied the announcement that caused the concerns, with indications that the economy would need fewer rate rises next year than previously expected. The changing expectations of interest rates saw major volatility in the US 10-year Treasury yield. which climbed to above 3.2% early in the quarter but fell back sharply to 2.7% at the end of the period.

Source: Bloomberg LLP, AJ Bell Investments; January 2019

European economies showed signs of weakness over the period, with even the powerhouse that is Germany struggling. It saw its third-quarter GDP contract for the first time since early 2015, with impacts from new emissions standards for its car industry hitting output. In addition, Chancellor Angela Merkel suffered a significant weakening of her authority in regional elections and announced she would not seek re-election in 2021. Having been in power since 2005, this represents significant uncertainty in the next couple of years for Germany at a crucial time for the EU. Away from Germany, Italy also struggled with slow growth and a political stand-off between the government and the EU, which rejected its initial budget. This impasse created significant volatility in Italian bond and equity markets, particularly for financial companies. In France, President Macron faced huge social unrest as protests - initially at rising fuel prices, but latterly at his overall economic policy - turned into numerous riots in Paris. The 'yellow vests' fought repeated battles with the police and demanded an end to tax cuts for the rich, along with a host of other reforms. Macron caved in on a number of areas but unrest has continued and economic output and confidence in France has taken a major shift downwards. Over the periods, the MSCI Europe ex UK Index fell back 11%.

The emerging markets have seen significant volatility over the course of the year and this continued during the fourth quarter. For much of the year, emerging markets were hurt by a strengthening US dollar and the potential consequences of a trade war between the US and China and this continued to play a major role as the end of the year approached. However, during December, with the US Federal Reserve softening its stance on interest rate rises and the 10-year US Treasury yield falling, emerging markets actually had some respite. While in absolute terms, emerging markets still fell back sharply with the MSCI Emerging Markets Index dropping by 5.3%, they significantly outperformed other global markets. Some of this improved performance came from Brazil where new President Bolsonaro has helped improve both consumer and business confidence with his reform policies. In China, third-quarter GDP came in at 6.5% year-on-year, slightly below expectations but clearly still very strong. The People's Bank of China has recognised the risks from the trade war and implemented some monetary stimulus along with a cut in the reserve requirement for banks in an attempt to boost lending. In India, political risk increased in December when the head of the central bank unexpectedly quit following rumours of interference from central government. Looking at fixed interest in the region, the JPMorgan GBI Emerging Market Global Composite Bond Index increased by 4.9% over the period.



Source: Bloomberg LLP, AJ Bell Investments; January 2019

A series of natural disasters over the summer caused the economy in Japan to decline over the third quarter by 0.3%, although with the government spending significant sums on rebuilding, this was expected to rebound in the fourth quarter. Economic data over the period was mixed, as while manufacturing output continued to grow and new orders also increased, business confidence fell for the seventh month in a row as businesses looked ahead to next year's planned increase in consumption tax and what this will do to an already fragile economy. Over the quarter, the Nikkei 225 Index fell over 12.9%, the first time in eight years that the index has been negative.

Source: Bloomberg LLP, AJ Bell Investments; January 2019

All market performance figures are in GBP.

Market outlook & our positioning

In the last quarterly review, we highlighted that some major risks existed below the surface in the global economy that were perhaps being ignored by equity investors. Over the fourth quarter it would certainly appear that some of these risks have risen rapidly to the surface.

Economic data has changed significantly over the past three months, with investors now accepting that it is highly likely that global economic growth will slow during 2019. This has been recognised by the Federal Reserve in the US which has now indicated a more gradual increase to interest rates is expected next year. Investors have realised, with hindsight, that equity markets had got ahead of themselves over the summer and that a more realistic view should be taken, particularly as this global cycle is already longer than most investors have seen before.

Many of the risks that existed in the summer have not gone away, particularly the trade war that continues to be a headwind to global growth, especially when President Trump gets anywhere near his Twitter app! In addition, risks have escalated in Europe, with political issues spreading to Germany and France while the great unknown in 2019 remains Brexit.

With equity markets having fallen back sharply and valuations now on more realistic levels, it is entirely possible that, should the trade wars dampen down and a path to a soft Brexit be found, equities could well be primed to rally sharply, but of course both of those issues represent a rather large 'if'! However, UK equities are certainly unloved and out of favour given the uncertainties that exist, and as a result, dividend yields have increased significantly. For some, this will make equities an attractive proposition and may well provide a useful cushion against further volatility into 2019.

In fixed interest markets, we continue with our UK gilts exposure being held entirely in short duration bonds, i.e. gilts that mature in less than five years. While this position is designed to cushion the blow from rising interest rates, it also helps protect from significant volatility in the bond market. As a result, we remain very comfortable with this position given the risks that we believe will persist into 2019.

Passive Managed Portfolio Review – Q4 2018

The team are committed to working to improve the cost efficiency of the MPS service and this quarter was no exception. This process can involve improvements to the delivery/execution of the service, switches to the holdings within the portfolio (where more competitive options exist in the market) or, explicit reductions in the costs of the service for investors. Whilst Q4 never saw any specific changes we can report, we take the opportunity to reiterate that AJ Bell Investcentre have committed to the removal of the Platform Dealing charges, for the users of the MPS portfolios, effective 1st January 2019. This will help the range be even more cost efficient for advisers and their clients and the work is ongoing and continuous, in order to improve the outcome for AJ Bell MPS users.

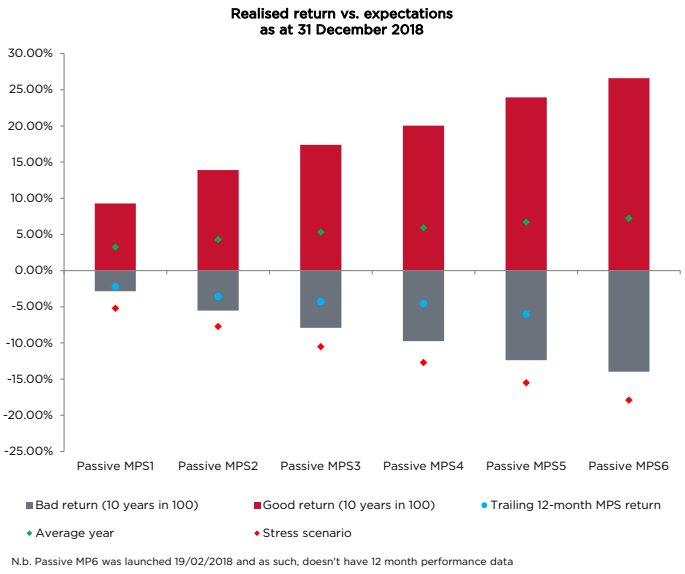
Passive MPS Growth Models

With the performance of the portfolios being a function of the assets held within them, a tough period for financial markets across the board in Q4, meant performance for the passive range was held back. With market participants forced to digest various unsettling situations in the quarter; US/China trade wars, Brexit uncertainty, French fuel protests and EU/Italy budget standoffs, relatively few asset classes escaped unscathed and this was reflected in the performance of the portfolios.

Equities in particular were punished over the period, with all of the major stock markets in the red for the quarter, although, in our portfolios, the worst of the falls were offset by a weaker sterling which cushioned the blow for UK based investors. UK mid-caps were the worst performer, as investors deserted the UK while Brexit uncertainty persisted, with the domestic focused FTSE 250 Index down over 13% on the quarter. Our portfolios are structured with a bias to the UK, versus a market portfolio based on the respective size of global markets and, as such, a poor period for the UK detracted from returns. However, within this UK overweight, the portfolios are tilted to the large cap, internationally focused FTSE 100 Index, which performed better than the FTSE 250 Index, helping to mitigate some of the fall. Hot on the heels of the FTSE 250 Index was Japan (down over 12%) and Europe (down over 10%) as optimism around global growth waned and the concerns of a trade war between the world's largest economies, the US and China escalated. All of the models, with the exception of MPS6 are overweight Japan, so from helping performance last quarter, this positioning weighed on performance in Q4. The trade war rhetoric, allied to a rate hiking cycle in the US, saw the S&P500 Index shift from being the last bastion of positive stock market returns amongst major developed indices prior to December, to posting the worst December in its history (starting 1957), falling over 9% in the month (and over 11% in the quarter), despite a rip-roaring Boxing Day rally, which saw it up over 5% in one day! With all of our models underweight the US, again versus the market portfolio, the portfolios avoided the worst of the falls in US stock markets and the ensuing volatility. Lastly, one of the year's best performing sectors, Technology, saw a reversal of fortunes, falling over 15% in Q4, to leave it clinging onto a positive return for the year. Our risker models have notable weightings toward this sector and, as such, sell offs here hindered the portfolios.

In fixed income markets, things were slightly brighter with UK short dated gilts showing positive returns around 1% in the quarter, while global government and investment grade corporate bonds were up over 3.5%. With our models deliberately more exposed to global fixed income, as opposed to the usual UK gilts and UK corporate bonds seen in most UK based multi-asset models, it was pleasing to see good performance here, which subsequently translated into the portfolios. In particular, this helped our lower risk mandates, where weightings to defensive asset classes are higher. Hard currency emerging market debt i.e. debt denominated in US dollars, while falling in local terms, also showed positive performance, when translated back to sterling, showing gains of almost 2% for UK based investors, again helping the portfolios. Despite gains in fixed income in the main, one area that didn't participate was global high yield, which fell over 4% in local terms and 2% in GBP terms, as the same concerns that hit stock markets, also fed into the riskier fixed income assets.

While the portfolios have suffered in the face of challenging markets this quarter, it should be noted that the returns for the year are in line with the range of expectations that were generated from back-testing of the Strategic Asset Allocation (see graphic below). While these expectations are based on statistical analysis and are not guaranteed, it is further worth noting that performance has remained in the range of "normal" expected outcomes and are not close to the stressed scenarios that we also test for, which should put some context to the moves we've seen recently. Although the market moves have been uncomfortable this quarter, especially given the relatively calm markets we've experienced and became accustomed to over the last few years, we are nowhere near the sort of stress we've seen in the past, 2008 for example and, that being the case, keeping some perspective that these are normal market moves is advised.



**Passive MPS - Trailing 12 month return as at 31/12/2018. The 'Average Year' and range of expected returns are forward-looking and based on a five year time horizon. Source: Bloomberg, AJ Bell*

Portfolio Changes

With no changes to report for the growth models in Q4, this quarter has been one of taking stock as well as monitoring and researching potential updates for 2019. With all of the major passive providers looking to cut costs to gain market share and notable new entrants into the space in 2018 (L&G's ETF offering, for instance) the team are in the midst of a full market review to ensure that the holdings within the models are best of breed, while the models themselves are as cost and operationally efficient as possible, in order to always offer value for money to investors. To this end, the already advised removal of the AJ Bell platform dealing charge, as of 1st January 2019, will make the model's even more cost efficient, for advisers and their clients.

Passive MPS Income Models

The objective of the Income 1 portfolio is capital preservation over a longer time horizon and a competitive yield. Currently we see this as somewhere close to 4% based on yields for different parts of the market and central bank interest rate policy across the globe. The objective for Income 2 is the same yield target; however, it also aims to grow capital at least in line with CPI inflation over the longer term.

This equates to around a 4% per annum total return target for Income 1 portfolio and around 6% total return target for the Income 2 portfolio.

Income MPS1 delivered a total return of -4.74% for the quarter, while Passive Income MPS2 delivered a return of -6.02%, negating most of the gains seen since the models were launched on 19th February 2018. While it is pleasing that the portfolios still show positive total returns since launch, 0.87% and 0.83% for Passive Income 1 and 2 respectively, it is disappointing to see the final quarter of the year reverse the fortunes of the portfolios, after very attractive returns in Q2 and Q3. With equities in particular struggling in Q4, our significant exposure to UK dividend paying stocks and global stocks in general, hurt the portfolios, with Income 2 hit particularly hard, due to not having any offsetting fixed income allocation, unlike Income 1.

Portfolio Changes

With no changes to report for the income models in Q4, this quarter has been one of taking stock as well as monitoring and researching potential updates for 2019. The passive income space is developing rapidly, with all providers expanding their ranges and offering more choices and ways to generate income for use in passive portfolios and, as such, the team are in the midst of a full market review to ensure that the holdings within the models are best of breed, while the models themselves are as cost and operationally efficient as possible, in order to always offer value for money to investors. To this end, the already advised removal of the AJ Bell platform dealing charge, as of 1st January 2019, will make the model's even more cost efficient, for advisers and their clients.

Performance Summary (All Models)

Portfolio	3 months	6 months	1 year	Inception*
Passive MPS 1	-2.77%	-2.34%	-2.21%	1.61%
Passive MPS 2	-4.61%	-3.68%	-3.58%	3.38%
Passive MPS 3	-6.56%	-5.21%	-4.26%	4.99%
Passive MPS 4	-7.74%	-6.21%	-4.54%	6.68%
Passive MPS 5	-9.11%	-7.38%	-6.02%	6.77%
Passive MPS 6	-9.35%	-7.70%		-4.77%
Passive MPS Income 1	-4.74%	-4.04%		0.87%
Passive MPS Income 2	-6.02%	-4.16%		0.83%

*Passive MPS 1 – 5 launched on 18th August 2016, Passive MPS 6 & Passive Income portfolios launched on 19th February 2018.

This report provides general information about the AJ Bell Managed Portfolio Service. It should not be read or construed as investment advice. It is your responsibility to assess your client's circumstances and make a personal recommendation that is suitable for their needs.

The value of investments can go down as well as up and your client may not get back their original investment.

Past performance is not a guide to future performance and some investments need to be held for the long term.

AJB/MPS-P-QR/20190114