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AJ Bell Active MPS – Q1 2019 report

Introduction

We are delighted to bring you the latest quarterly report from AJ Bell Investments which has seen our Active portfolios move through their one-year anniversary.

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

The start of 2019 has been a complete reversal of the end of 2018, with strong performance from both equities and bonds, and confidence returning after the volatility of last year. Perhaps somewhat strangely, this is amid a backdrop of slowing global growth and signs from central banks around the world that the economic environment is getting more challenging.

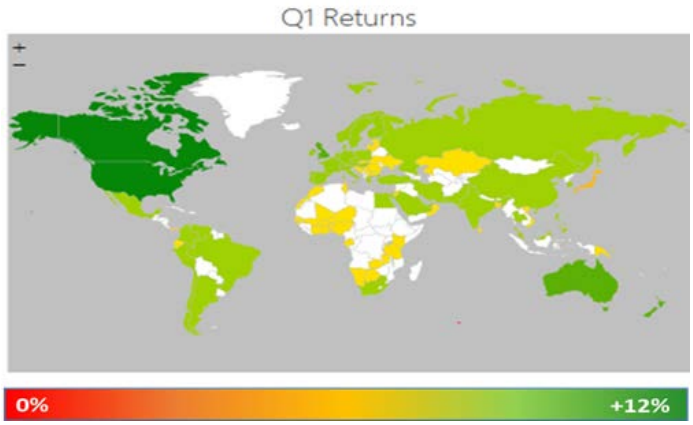
However, equity investors have taken this to mean that central banks will stop tightening monetary policy and become more accommodative, thus helping propel equities higher and indeed bonds too as the prospect of rapidly rising interest rates receded.

In the UK, Brexit seems no closer to being delivered, while Germany has struggled to grow and France continues to battle its own citizens amid discontent over President Macron's reforms. The positive story seems to be around the trade war between the US and China that has showed signs of being amicably resolved and this has certainly boosted investor confidence through the first quarter of the year.

Economic and market review

The first quarter of 2019 saw a complete rebound from the turmoil, volatility and sharp falls in markets that were seen as 2018 came to an end, with all major equity markets rallying strongly as confidence returned to investors. This time it was the US that led the way as fears over the potential for the Federal Reserve to raise interest rates too far subsided. However, UK equities lagged most major markets as uncertainties surrounding Brexit worried investors. Away from equities, fixed interest markets also had a strong quarter, particularly high-risk assets which benefited from improved investor confidence.

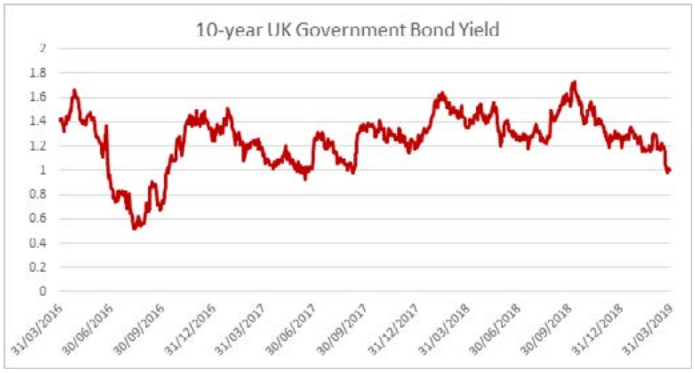
Across the regions, the US, Europe and Asia saw double digit returns in local currency terms, with the FTSE All-Share total return just below 10%. In what was a volatile quarter for sterling, it ended the quarter up against major currencies, which lowered international equity returns when converted back to sterling.



Source: Bloomberg LP, AJ Bell Investments, April 2019

In the UK, it was Brexit that unsurprisingly dominated the headlines for the entire quarter as the 29 March leaving date moved ever closer. With Theresa May failing to get her deal approved by Parliament, then losing control of the order papers and then saying she would resign if her deal was passed, it was a tumultuous three months for the Prime Minister as she had little choice but to extend the date that Britain would leave the EU. By the time you are reading this, frankly anything could have happened so apologies if this narrative appears out of date! Unsurprisingly, this uncertainty started to show in the economic data during the period with GDP falling back to an annualised rate of 1.3% while business confidence also fell back. One bright spot was that unemployment fell to its lowest level since 1975. As the end of the quarter arrived, the potential for a delay in the UK's departure from the EU saw larger UK companies surge in value, with the FTSE All Share Index returning 9.4% over the quarter.

The bond market reacted to the heightened risk with yields tightening sharply, resulting in the 10-year gilt yield falling back below 1% for the first time since mid-2017 – which helped the FTSE Actuaries UK Conventional Gilts All Stocks Index rally by 3.4%. With the risk-on environment, credit risk was rewarded, helping corporate bonds to perform well, with the iBoxx UK Sterling All Maturities Index increasing by 4.8% over the quarter, while high-yield bonds (that are more closely correlated with equities) performed even more strongly as the Bloomberg Barclays Global High Yield Bond Index increased by 6.3% over the period. Moves in sterling were significant over the quarter, with a strengthening against most major currencies during the period. This meant that returns from other markets were lower than they were in local currency terms.



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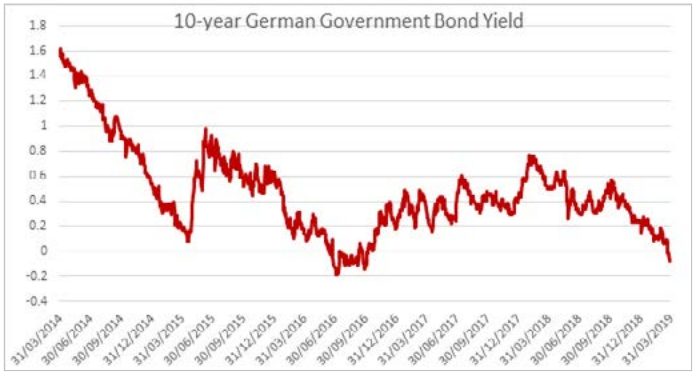

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Having been very weak in Q4 2018, the US bounced back strongly in Q1 following a truce in the trade war with China and a clear signal from the Federal Reserve that interest rates were highly unlikely to rise this year. With economic data being delayed at the start of the year due to the government shutdown over the lack of budget approval, it took until the end of March before the final GDP data was known. This came in below expectations and was sharply lower than earlier in the year, and this would have been at the forefront of Jerome Powell's mind at the Federal Reserve when the announcement came that rates were unlikely to increase again this year. Tucked away in the statement was also the news that US growth was expected to be 1% less than previously expected at 2.1% for 2019, giving a clear indication that global growth is slowing down – something that has been mentioned in these quarterly updates previously. However, business confidence remained reasonably strong while consumer confidence got better throughout the quarter. At the same time, the labour market remained tight, with low unemployment and strong wage growth. This backdrop saw equities perform strongly, with the S&P 500 Index increasing by 10.9% over the period. The changing narrative from the Federal Reserve saw interest rate expectations change markedly and as a result the US 10-year Treasury yield fell from 2.7% at the start of the year to 2.4% at the end of the quarter.

Source: Bloomberg LP, AJ Bell Investments, April 2019

The weakness seen in Europe in the latter stages of 2018 continued into 2019 as a slowing China impacted upon the major export economies of the region. This was especially evident in Germany, which recorded no growth at all in the final quarter, while PMI data showed that manufacturing was contracting in the first months of the year. The slowdown was sufficient to see the Chief Economist of the European Central Bank say that it had been broader and more persistent and indicated that further support from the ECB may be required. Late in March, German manufacturing data collapsed, causing much alarm for European investors. The result was that the yield on the German 10-year Bund turned negative once again for the first time since the summer of 2016, showing just how worried investors are that a European slowdown may well be very difficult to exit. Over the period, the MSCI Europe ex UK Index grew by 8.0%.

Focus in emerging markets was very much on China, particularly given the ongoing trade discussions with the US. Signs that the talks were progressing well helped investor sentiment and there was hope as the quarter ended that a positive resolution would be found. At the same time, the Chinese government continued to provide stimulus to help manage the slowing economy, with a cut to the reserve ratio requirement for Chinese banks. In Brazil, volatility picked up sharply towards the end of the quarter as controversial pension reform struggled to pass in parliament, with the failure causing the equity market and currency to fall sharply. In Turkey, attention again turned to the fragility of the currency, as it did last summer, with the Turkish Lira falling sharply against major currencies as confidence drained away from President Erdogan and the recession began to take hold. Over the course of the quarter, the MSCI Emerging Markets Index rallied 7.4%. Looking at fixed interest in the region, the JPMorgan GBI Emerging Market Global Composite Bond Index increased by 0.70% over the period.

The Japanese economy bounced back in the fourth quarter of 2018 to register solid GDP growth after the sharp slowdown earlier in the year. However, it wasn't all good news, as manufacturing data weakened over the quarter while consumer confidence steadily declined as the close trade links to a slowing China hampered progress. Over the quarter, the Topix Index increased by 4.6% as broader global investor confidence pulled equities higher.

Summary of contributors and detractors by asset class:

Asset Asset Allocation Contributors and Dectractors

	Risk Profile					
Top Contributors*	**1**	**2**	**3**	**4**	**5**	**6**
1	UK Corporate Bonds	North American Equities	UK Large Cap Equities	UK Large Cap Equities	UK Large Cap Equities	UK Large Cap Equities
2	North American Equities	UK Corporate Bonds	North American Equities	North American Equities	North American Equities	Emerging Market Equities
3	UK Large Cap Equities	UK Large Cap Equities	Technology Equities	Technology Equities	Technology Equities	North American Equities

	Risk Profile					
Top Detractors*	**1**	**2**	**3**	**4**	**5**	**6**
1	International Bonds	International Bonds	International Bonds	International Bonds	Health Care Equities	Health Care Equities
2	Health Care Equities	Health Care Equities	Health Care Equities	Health Care Equities		
3						

*excludes alternative investments, due to different implementation routes across portfolio

Source: Bloomberg LP, AJ Bell Investments, April 2019

All market performance figures are in GBP

Active Managed Portfolio review – Q1 2019

Active MPS performance

2019 has started very much on the front foot, with positive returns being seen across the portfolio both from equities and from fixed interest. With equities performing strongly, it was no surprise to see big contributions coming from this exposure across the portfolios, while risk was also rewarded in fixed interest with strong performance across the fixed interest spectrum.

With strong absolute returns almost across the board, it was a good quarter for the portfolios, particularly in the higher-risk end of the spectrum where equity exposure is high.

In the UK, core equity exposure performed strongly with the Troy Trojan Income and the Man GLG Undervalued Assets funds (Portfolios 1-6) both outperforming the FTSE All Share Index, while the Investec UK Alpha fund (Portfolios 3-6) also outperformed. During the quarter, the Merian UK Smaller Companies fund (Portfolio 6) was replaced with the Tellworth UK Smaller Companies fund which was also added to Portfolio 5.

In the US, the Dodge & Cox US Stock fund (Portfolios 3-6) was behind the index over the period as its value style underperformed, while the US-focused Polar Cap Global Technology fund (Portfolios 3-6) bounced back strongly, delivering the best performance of any holding. During the period, the JP Morgan US Equity Income fund was added to Portfolios 1-2.

In Europe, exposure was reduced as part of the annual asset allocation update. Over the quarter, the Crux European Special Situations fund finished marginally behind the index as large cap equities outperformed the mid cap area.

In Asia, our core exposure to the Invesco Asian fund (Portfolios 2-6) was marginally behind its broad- based Asian benchmark, while the Schroder Asian Alpha Plus fund (added to Portfolios 4-6) was marginally ahead of the index. During the period, the Stewart Asia Pacific Leaders fund was added to Portfolios 5-6, while the Fidelity Asian Values IT was also added to Portfolio 6.

In emerging markets, the Fidelity Emerging Markets fund was significantly ahead of the benchmark. During the quarter this fund was removed from Portfolios 2-3, replaced by the JP Morgan Emerging Markets Income fund, but was retained in Portfolios 4-6. Also during the quarter, the Lazard Emerging Markets fund was added to Portfolio 6 to further diversify the portfolio, while the Jupiter Global Emerging Markets fund was sold from Portfolios 5-6.

In Japan, the Man GLG Japan Alpha fund finished the quarter behind the Topix Index having outperformed it for a large part of the period as investors' focus shifted to the growth style during March.

Fixed interest markets were in a bullish mood as the threat of rising interest rates receded. This meant that the Lyxor UK Gilt 0-5yr ETF marginally increased but significantly lagged the broad-based gilt benchmark. Within UK corporate bonds, it was a similar story as the Fidelity Moneybuilder Income (Portfolios 1-3) and TwentyFour Corporate Bond (Portfolios 1-4) funds were slightly shorter duration than the benchmark. The result was solid positive returns but marginally behind the benchmark.

Within the high yield market, performance was strong given their higher correlation to equity markets. The Baillie Gifford High Yield Bond fund (Portfolios 1-5) was marginally behind the benchmark while during the quarter, the Royal London Short Duration Global High Yield Bond fund was added to Portfolios 1-4 as allocation increased to high yield bonds as part of the asset allocation update.

Outside of UK fixed interest, the M&G Emerging Markets Bond fund (Portfolios 1-5) delivered strong absolute returns as sentiment in emerging markets improved. As part of the asset allocation update, exposure to global bonds was reduced, resulting in the M&G Global Macro Bond fund being removed from Portfolio 1-4.

The final area of the portfolio is the commercial property allocation, which continues to be zero weighted due to the Brexit and liquidity risk. In its place the Janus Henderson UK Absolute Return fund (Portfolio 1-6) performed well in absolute terms with similar low volatility characteristics. The allocation to this area was reduced as part of the review process and as a result, the M&G Absolute Return Bond fund was removed from the portfolios.

During the annual strategic asset allocation review, some new areas were introduced into the portfolios. This included US short dated Treasuries, US corporate bonds, consumer staples equities and healthcare equities. All of these positions were added to improve the overall mix of risk and return.

Portfolio changes

AJ Bell performed its annual strategic asset allocation review during the quarter, updating its long-term strategic positioning to reflect market moves over the preceding year and an evolving investment universe, making it possible to invest in different asset classes to further increase the diversification within portfolios. We provided information on these changes in our February update.

The main changes made over the quarter are summarised below. A more detailed document explaining the reasons behind the changes is available on our website.

Main asset allocation changes:

- Cash was reduced in the lower-risk portfolios where it is held.
- Fixed interest exposure was increased in the lower-risk portfolios and reduced higher up the risk spectrum.
- Equity exposure was increased across all portfolios.
- Alternatives exposure was reduced across all portfolios.

Main manager additions and removals:

Additions	Removals
Invesco US Treasury Bond 1-3 Year ETF	M&G Global Macro Bond
iShares USD Corporates Bond GBP Hgd ETF	Merian UK Smaller Companies
Royal London Short Duration Global High Yield	Jupiter Global Emerging Markets
Tellworth UK Smaller Companies	M&G Absolute Return Bond
JP Morgan US Equity Income	
Stewart Asia Pacific Leaders	
Fidelity Asian Values IT	
JPM Emerging Markets Income	
Lazard Emerging Markets	
Evenlode Global Income	
Xtrackers MSCI USA Healthcare ETF	

While not all of these managers are used in every portfolio, broadly the changes made over the quarter have increased the diversification in the portfolios, particularly across fixed interest and Asian and emerging market equities.

Performance summary (all models)

Fund	3 months	6 months	1 year	Inception*
Active MPS 1	3.21%	0.83%	3.44%	2.85%
Active MPS 2	4.65%	0.17%	3.85%	2.48%
Active MPS 3	6.22%	-0.54%	4.71%	2.91%
Active MPS 4	7.11%	-1.12%	5.03%	2.87%
Active MPS 5	8.21%	-1.66%	4.75%	2.13%
Active MPS 6	8.80%	-1.90%	4.00%	1.18%

Active MPS launched on 19 February 2018.

Source: Bloomberg LP, AJ Bell Investments, April 2019

AJB/MPS-A-QR/20190408

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AJ Bell Active Income MPS – Q1 2019 report

Introduction

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During the quarter, our annual review of our long-term return expectations was completed and a number of changes were implemented into the Growth portfolios which are covered later in this report. The Income portfolios will be updated in mid-April.

Economic and market review

The first quarter of 2019 saw a complete rebound from the turmoil, volatility and sharp falls in markets that were seen as 2018 came to an end, with all major equity markets rallying strongly as confidence returned to investors. This time it was the US that led the way as fears over the potential for the Federal Reserve to raise interest rates too far subsided. However, UK equities lagged most major markets as uncertainties surrounding Brexit worried investors. Away from equities, fixed interest markets also had a strong quarter, particularly high-risk assets which benefited from improved investor confidence.

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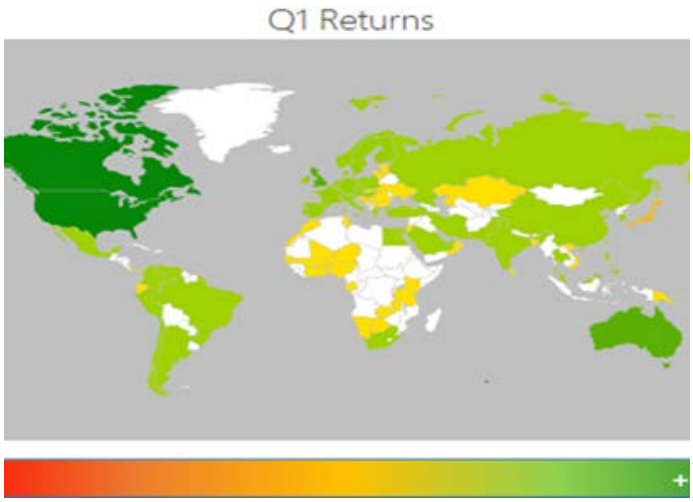

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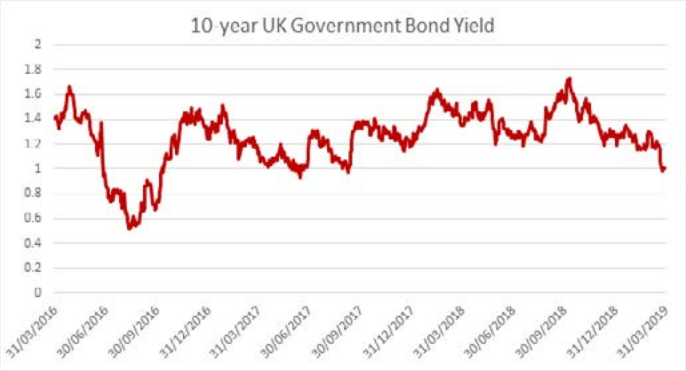

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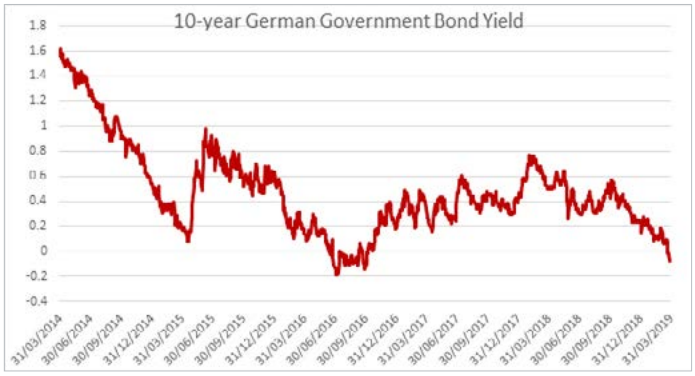
The weakness seen in Europe in the latter stages of 2018 continued into 2019 as a slowing China impacted upon the major export economies of the region. This was especially evident in Germany, which recorded no growth at all in the final quarter, while PMI data showed that manufacturing was contracting in the first months of the year. The slowdown was sufficient to see the Chief Economist of the European Central Bank say that it had been broader and more persistent and indicated that further support from the ECB may be required. Late in March, German manufacturing data collapsed, causing much alarm for European investors. The result was that the yield on the German 10-year Bund turned negative once again for the first time since the summer of 2016, showing just how worried investors are that a European slowdown may well be very difficult to exit. Over the period, the MSCI Europe ex UK Index grew by 8.0%.



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All market performance figures are in GBP

Active Managed Portfolio review – Q1 2019

Active Income MPS performance

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In the UK equities performed well despite uncertainty surrounding Brexit, with all three UK equity funds outperforming the FTSE All Share Index. The Montanaro UK Income fund, which focuses on smaller companies, was the standout performer while the Man GLG UK Income fund and the Troy Trojan Income fund also performed well.

Within global equities, the Artemis Global Income fund did well in absolute terms but lagged the benchmark as its value style continued to be out of favour. The Newton Global Income fund (Portfolio 2) fared a little better, but again lagged the broad market as investors resumed their love affair with high growth stocks.

It was a similar story when looking at the regional allocations as the income focus of the strategies lagged the broader market. This meant that the BlackRock Continental European Income fund, Jupiter Asian Income fund and JP Morgan Emerging Markets Income fund all lagged the broader market. This is as expected when the market favours high growth stocks but importantly, the income strategies still managed to deliver good absolute returns.

Looking at the specialist equity exposure, the Premier Global Infrastructure fund performed well in absolute terms, delivering nearly 10% in the quarter. Global property was the stand out performer however, with the L&G Global Real Estate Dividend Index fund growing by over 13% during the quarter. In the UK, property wasn't quite so strong but the iShares MSCI UK Target Real Estate ETF still delivered more than 8% over the quarter.

Fixed interest markets were in a bullish mood as the threat of rising interest rates receded. This meant that the Lyxor UK Gilt 0-5yr ETF marginally increased but significantly lagged the broad-based gilt benchmark. Within UK corporate bonds, the Royal London Corporate Bond fund (Portfolio 1) and TwentyFour Corporate Bond (Portfolio 1) funds were slightly shorter duration than the benchmark. The result was solid positive returns but marginally behind the benchmark. Within the high yield market, performance was strong given their higher correlation to equity markets and the Baillie Gifford High Yield Bond fund (Portfolio 1). Outside of UK fixed interest, the M&G Emerging Markets Bond fund (Portfolio 1) delivered strong absolute returns as sentiment in emerging markets improved.

Portfolio changes

No changes were made to the portfolios over the quarter, however, the annual update to the strategic asset allocation will be shortly implemented. We will report on the specific changes when this is completed, and summarise them in the next quarterly report.

Performance summary (all models)

Fund	3 months	6 months	1 year	Inception*
Active MPS Income 1	6.56%	1.89%	4.88%	3.98%
Active MPS Income 2	8.67%	0.52%	6.53%	5.06%

Active MPS launched on 19 February 2018.

Source: Bloomberg LP, AJ Bell Investments, April 2019

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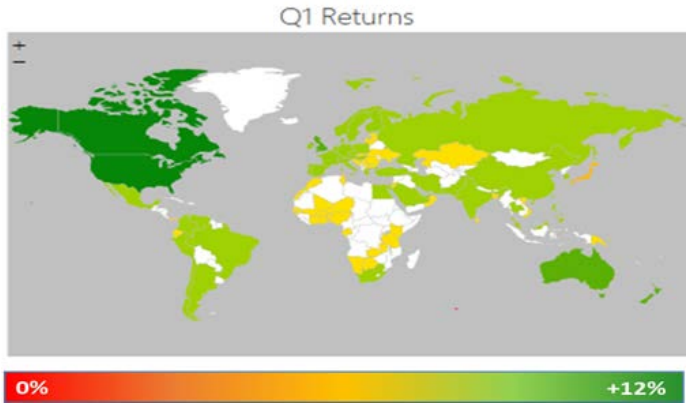

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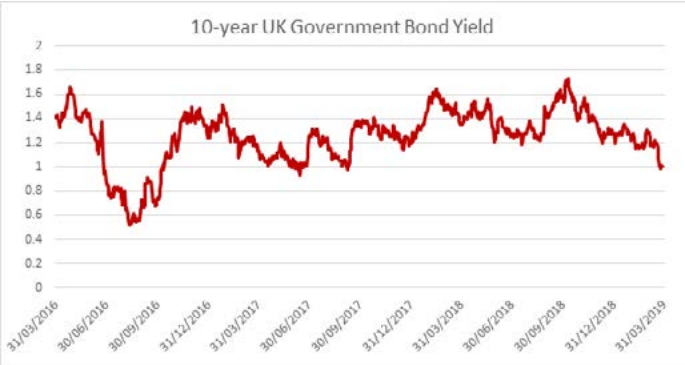

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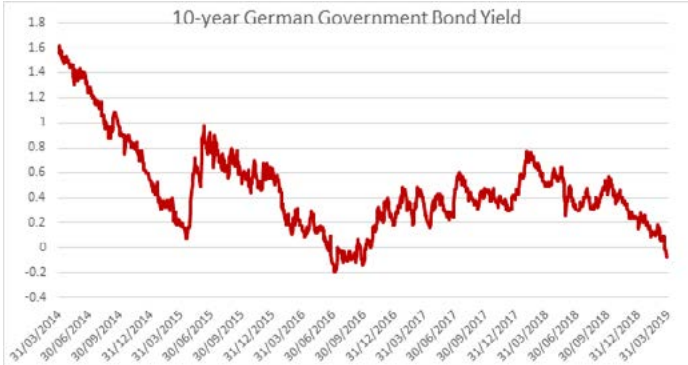

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Source: Bloomberg LP, AJ Bell Investments, April 2019

The weakness seen in Europe in the latter stages of 2018 continued into 2019 as a slowing China impacted upon the major export economies of the region. This was especially evident in Germany, which recorded no growth at all in the final quarter, while PMI data showed that manufacturing was contracting in the first months of the year. The slowdown was sufficient to see the Chief Economist of the European Central Bank say that it had been broader and more persistent and indicated that further support from the ECB may be required. Late in March, German manufacturing data collapsed, causing much alarm for European investors. The result was that the yield on the German 10-year Bund turned negative once again for the first time since the summer of 2016, showing just how worried investors are that a European slowdown may well be very difficult to exit. Over the period, the MSCI Europe ex UK Index grew by 8.0%.

Focus in emerging markets was very much on China, particularly given the ongoing trade discussions with the US. Signs that the talks were progressing well helped investor sentiment and there was hope as the quarter ended that a positive resolution would be found. At the same time, the Chinese government continued to provide stimulus to help manage the slowing economy, with a cut to the reserve ratio requirement for Chinese banks. In Brazil, volatility picked up sharply towards the end of the quarter as controversial pension reform struggled to pass in parliament, with the failure causing the equity market and currency to fall sharply. In Turkey, attention again turned to the fragility of the currency, as it did last summer, with the Turkish Lira falling sharply against major currencies as confidence drained away from President Erdogan and the recession began to take hold. Over the course of the quarter, the MSCI Emerging Markets Index rallied 7.4%. Looking at fixed interest in the region, the JPMorgan GBI Emerging Market Global Composite Bond Index increased by 0.70% over the period.

The Japanese economy bounced back in the fourth quarter of 2018 to register solid GDP growth after the sharp slowdown earlier in the year. However, it wasn't all good news, as manufacturing data weakened over the quarter while consumer confidence steadily declined as the close trade links to a slowing China hampered progress. Over the quarter, the Topix Index increased by 4.6% as broader global investor confidence pulled equities higher.

Summary of contributors and detractors by asset class:

Asset Asset Allocation Contributors and Dectractors

	Risk Profile					
Top Contributors*	**1**	**2**	**3**	**4**	**5**	**6**
1	UK Corporate Bonds	North American Equities	UK Large Cap Equities	UK Large Cap Equities	UK Large Cap Equities	UK Large Cap Equities
2	North American Equities	UK Corporate Bonds	North American Equities	North American Equities	North American Equities	Emerging Market Equities
3	UK Large Cap Equities	UK Large Cap Equities	Technology Equities	Technology Equities	Technology Equities	North American Equities

	Risk Profile					
Top Detractors*	**1**	**2**	**3**	**4**	**5**	**6**
1	International Bonds	International Bonds	International Bonds	International Bonds	Health Care Equities	Health Care Equities
2	Health Care Equities	Health Care Equities	Health Care Equities	Health Care Equities		
3						

*excludes alternative investments, due to different implementation routes across portfolios

All market performance figures are in GBP

Passive Managed Portfolio review – Q1 2019

Passive MPS performance

All portfolios delivered positive returns over the quarter, helped by strong returns from both equities and bonds. As expected in a risk-on market, the higher-risk portfolios were up the strongest, with net total returns ranging from 4.0% to 8.7%.

The Passive MPS uses predominantly tracker products to implement the asset allocation, and therefore the lion's share of performance is explained by our asset allocation positioning. However, in certain regions and sectors, the benchmarks tracked can have large performance differences. For example, the FTSE benchmark series classifies South Korea as a developed country, whereas MSCI still classifies it as an emerging nation. This means the inclusion of South Korea in developed Asia and emerging market products varies depending on the passive product used, and its selected index. Other vagaries like this exist, especially within the fixed income space, where index inclusion rules consider issues such as liquidity, minimum size and the definition of government and non-government debt, which then can lead to fundamental performance differences. For example, when considering Emerging Market Debt indices, FTSE has a different definition of government debt compared to Barclays. As a result, the FTSE index has 3% exposure to China, whereas the Barclays index has a much larger weighting at 17%. When selecting ETFs we try and choose benchmarks that we feel best represent the asset classes, which means deciding if we think emerging market debt is best represented by FTSE or Barclays.

An ETF can trade at a small premium or discount to the underlying NAV of the fund, due to investor demand, and the underlying cost of creating or redeeming units in the fund. This can also lead to short-term differences between the ETF performance and the index performance, however over the longer term (one year or more) this becomes less relevant.

Another point to consider as a passive investor when looking at performance over short periods is the differing valuation points of ETFs and indices. For example, a London-traded ETF stops pricing when the stock exchange closes at 4.35pm, however the underlying index may continue to price if, for example, it is tracking US equities. This again can lead to performance differences between different passive products, especially when markets and currencies are swinging around due to issues such as Brexit.

In the UK we split our exposure into large-cap stocks, by tracking the FTSE 100, with a smaller exposure to mid-cap stocks (tracking the FTSE 250). Over the quarter both products delivered similar returns, delivering a blended total return similar to the FTSE all-share index.

When adjusting for differing index points and premiums and discounts, our international equity ETFs all performed in line with their designated benchmark. In the Asian ex-Japan region we track a developed market index rather than one that includes both developed and emerging economies. We use the Vanguard FTSE Asia Pacific Ex-Japan ETF which, as discussed, classifies South Korea as a developed nation. The Vanguard product underperformed other Asian ETFs over the quarter as South Korea struggled versus other emerging market nations, such as China, which rallied significantly over the quarter.

For our sector-based equity investments, we use US indices as proxies for global exposure. This is because US-tracking products are widely available, represent better value in terms of OCF and trading costs, and represent highly correlated performance with the global indices over the longer term. For consumer staples and technology the US ETFs delivered similar performance to the global benchmarks over the quarter, whereas the healthcare product lagged slightly, as Amazon announced plans to form a healthcare division, providing a threat to incumbents. In our highest-risk portfolio we hold a thematic automation and robotics product within our technology allocation. This slightly outperformed the global technology benchmark, up 17.2%.

Within our gilt positions, we have made the tactical decision to go short duration. Over the quarter gilt yields fell, leading to underperformance versus an all maturity index. We are comfortable with this position, given the near historic lows of gilt yields, and therefore the asymmetry of expected future returns. Our other fixed income ETFs performed in line with expectations.

The portfolios have an exposure to property. In general, investment in physical property is in the realms of active investors. However, we are able to achieve physical-property-like exposure by investing in an ETF blending together short-dated index-linked bonds and listed REITs. The use of index-linked bonds helps dampen the volatility, although in the short term the ETF does exhibit higher performance variation. Over the quarter the ETF was up 6.2%, compared to 2.5% for a physical property fund, such as L&G. This is perhaps the one area of the portfolio where selection has led to a significant performance uplift.

Portfolio changes

AJ Bell performed its annual asset allocation review during the quarter, updating its long-term strategic positioning to reflect market moves over the preceding year, and an evolving investment universe, making it possible to invest in different asset classes to further increase the diversification within portfolios. We provided an update of these changes in our February update.

The main changes made over the quarter are summarised below, and a more detailed document detailing the reasons behind the changes is available on our website.

Main asset allocation changes:

- Cash was reduced in the lower-risk portfolios where it is held.
- Fixed interest exposure was increased in the lower-risk portfolios and reduced higher up the risk spectrum.
- Equity exposure was increased across all portfolios.
- Property exposure was reduced across all portfolios.

Further changes were made due to new products coming to the market, allowing AJ Bell to either implement the portfolio at a cheaper total cost to the investor, or to track a benchmark more aligned with our asset allocation decision.

As a 'passive' investor, it is often thought that the best thing to do is nothing, pick some low-cost index tracker funds, and look again at retirement. Long-term low-cost investment is central to the AJ Bell Passive MPS philosophy, however it is important to note that the investment universe is constantly evolving, and therefore to ensure the investments remain best in breed, it is important to continually review the route to implementation in the portfolios. That being the case, alongside being active on our asset allocation in the Passive MPS, we are also 'active' in our selection of trackers and ETFs, to take advantage of changes such as price cuts.

A number of investment managers have recently entered the ETF market, which has led to significant pressure on the OCF of ETFs. Unlike an open-ended fund, where the investment manager can remain competitive through multiple share classes and rebates, the single share class structure of an ETF means an ETF manager has to lower the OCF for all investors to remain competitive against new entrants.

It is, however, important to remember that headline OCF is not the only factor to consider when choosing which ETF to invest in. Other considerations should include dealing costs, tax implications, ETF size, replication style, index tracked and ETF manager infrastructure amongst other factors.

AJ Bell does not necessarily switch immediately into cheaper products, however once appropriate due diligence has been undertaken to assess the other important factors, a product switch is implemented, which will normally be timed to dovetail with the rebalance process.

AJ Bell is engaged in dialogue with all the major ETF providers to understand their future plans, and this ensures we are not constantly switching between products. However, the emerging ETF entrants disrupting on cost have led to price cuts from the large incumbents. The following table shows the OCF of UK Equity ETFs from various providers at the end of 2013 and the end of Q1 2019.

	iShares	Vanguard	SPDR	Xtrackers	HSBC	Lyxor	L&G	Average
End of 2013	0.15%	0.10%	0.30%	0.09%	0.35%			0.20%
End of Q1 2019	0.07%	0.09%	0.20%	0.09%	0.07%	0.04%	0.05%	0.09%
Price Cut	-53%	-10%	-33%	0%	-80%			-56%

Source: AJ Bell Investments, April 2019

On average, the OCF of existing products has fallen by 35%. If new entrants are included, the average cost of investing passively in UK equities has fallen, on average, by 56%.

We took the opportunity over the quarter to switch into different products, leading to an OCF saving:

Vanguard FTSE Europe Ex-UK ETF (OCF 0.12%) into Xtrackers S&P Europe ex-UK ETF (OCF 0.09%)

Vanguard FTSE 100 ETF (OCF 0.09%) into Lyxor Morningstar UK ETF (OCF 0.04%)

Xtrackers NIKKEI 225 ETF (OCF 0.09%) into Lyxor MSCI Japan ETF (OCF 0.12%)

Lower OCF products exist in other asset classes, including UK equities, however we currently still believe the higher-priced products are the most appropriate when taking into consideration index tracked, liquidity and dealing costs, alongside other factors.

Performance summary (all models)

Portfolio	3 months	6 months	1 year	Inception*
Passive MPS 1	3.97%	1.09%	4.22%	5.64%
Passive MPS 2	5.48%	0.62%	5.14%	9.05%
Passive MPS 3	6.96%	-0.05%	6.30%	12.30%
Passive MPS 4	7.58%	-0.75%	6.70%	14.76%
Passive MPS 5	8.45%	-1.44%	6.65%	15.79%
Passive MPS 6	8.67	-1.49%	5.79%	3.48%

All the funds launched on 18 August 2016, with the exception of MPS 6, which has a launch date of 19 February 2018. All performance is net of fees.

Source: Bloomberg LP, AJ Bell Investments, April 2019.

AJB/MPS-P-QR/20190408

AJ Bell Passive Income MPS – Q1 2019 report

Introduction

We are delighted to bring you the latest quarterly report from AJ Bell Investments which has seen our Income portfolios move through their one-year anniversary.

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

The start of 2019 has been a complete reversal of the end of 2018, with strong performance from both equities and bonds, and confidence returning after the volatility of last year. Perhaps somewhat strangely, this is amid a backdrop of slowing global growth and signs from central banks around the world that the economic environment is getting more challenging.

However, equity investors have taken this to mean that central banks will stop tightening monetary policy and become more accommodative, thus helping propel equities higher and indeed bonds too, as the prospect of rapidly rising interest rates receded.

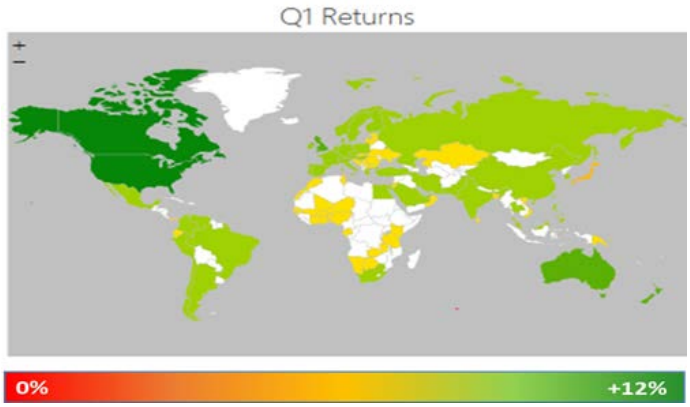
In the UK, Brexit seems no closer to being delivered, while Germany has struggled to grow and France continues to battle its own citizens amid discontent over President Macron's reforms. The positive story seems to be around the trade war between the US and China that has showed signs of being amicably resolved and this has certainly boosted investor confidence through the first quarter of the year.

During the quarter, our annual review of our long-term return expectations was completed and a number of changes were implemented into the Growth portfolios which are covered later in this report. The Income portfolios will be updated in mid-April.

Economic and market review

The first quarter of 2019 saw a complete rebound from the turmoil, volatility and sharp falls in markets that were seen as 2018 came to an end, with all major equity markets rallying strongly as confidence returned to investors. This time it was the US that led the way as fears over the potential for the Federal Reserve to raise interest rates too far subsided. However, UK equities lagged most major markets as uncertainties surrounding Brexit worried investors. Away from equities, fixed interest markets also had a strong quarter, particularly high-risk assets which benefited from improved investor confidence.

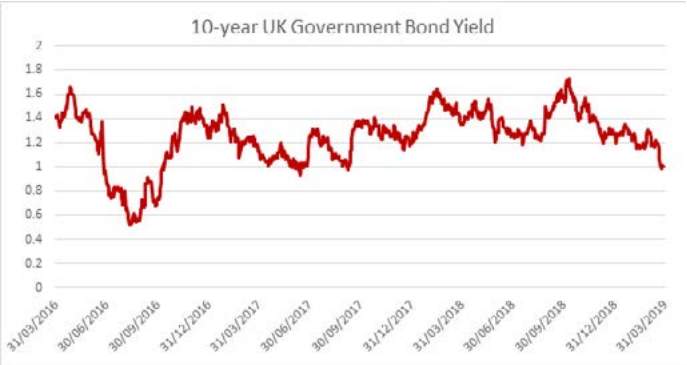
Across the regions, the US, Europe and Asia saw double digit returns in local currency terms, with the FTSE All-Share total return just below 10%. In what was a volatile quarter for sterling, it ended the quarter up against major currencies, which lowered international equity returns when converted back to sterling.



Source: Bloomberg LP, AJ Bell Investments April 2019

In the UK, it was Brexit that unsurprisingly dominated the headlines for the entire quarter as the 29 March leaving date moved ever closer. With Theresa May failing to get her deal approved by Parliament, then losing control of the order papers and then saying she would resign if her deal was passed, it was a tumultuous three months for the Prime Minister as she had little choice but to extend the date that Britain would leave the EU. By the time you are reading this, frankly anything could have happened so apologies if this narrative appears out of date! Unsurprisingly, this uncertainty started to show in the economic data during the period with GDP falling back to an annualised rate of 1.3% while business confidence also fell back. One bright spot was that unemployment fell to its lowest level since 1975. As the end of the quarter arrived, the potential for a delay in the UK's departure from the EU saw larger UK companies surge in value, with the FTSE All Share Index returning 9.4% over the quarter.

The bond market reacted to the heightened risk with yields tightening sharply, resulting in the 10-year gilt yield falling back below 1% for the first time since mid-2017 – which helped the FTSE Actuaries UK Conventional Gilts All Stocks Index rally by 3.4%. With the risk-on environment, credit risk was rewarded, helping corporate bonds to perform well, with the iBoxx UK Sterling All Maturities Index increasing by 4.8% over the quarter, while high-yield bonds (that are more closely correlated with equities) performed even more strongly, as the Bloomberg Barclays Global High Yield Bond Index increased by 6.3% over the period. Moves in sterling were significant over the quarter, with a strengthening against most major currencies during the period. This meant that returns from other markets were lower than they were in local currency terms.



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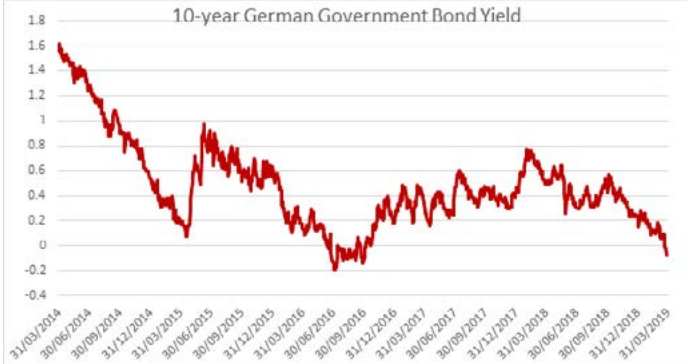
The weakness seen in Europe in the latter stages of 2018 continued into 2019 as a slowing China impacted upon the major export economies of the region. This was especially evident in Germany, which recorded no growth at all in the final quarter, while PMI data showed that manufacturing was contracting in the first months of the year. The slowdown was sufficient to see the Chief Economist of the European Central Bank say that it had been broader and more persistent and indicated that further support from the ECB may be required. Late in March, German manufacturing data collapsed, causing much alarm for European investors. The result was that the yield on the German 10-year Bund turned negative once again for the first time since the summer of 2016, showing just how worried investors are that a European slowdown may well be very difficult to exit. Over the period, the MSCI Europe ex UK Index grew by 8.0%.



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All market performance figures are in GBP

Passive Income MPS performance

AJ Bell offers four income MPS portfolios; two implemented through ETFs and tracker funds (passive), and two implemented through active funds where appropriate, alongside trackers in some asset classes (active). These are split into two risk categories. Income MPS 1 looks to deliver a sustainable yield of around 4%, whilst protecting capital over a five-year time horizon by using a mix of equities, bonds and alternatives, whereas Income 2 also looks to generate a 4% yield, alongside a modest capital growth objective, aiming to keep the value of the overall portfolio in line with inflation on a five-year horizon, using predominantly equity investments alongside some alternatives.

To ensure the yield objective is achieved in the Passive Income MPS, it is insufficient to pick purely 'passive' ETFs, such as a FTSE 100 tracker. Instead, the portfolios also use factor-based ETFs, which aim to generate higher yields, in a sustainable way.

Over Q1 the passive Income portfolios delivered strong positive returns in absolute terms, Income 1 up 6.9% and Income 2 up 7.9%, bringing the one year total net returns to 8.2% and 10.3% respectively, ahead of the return objectives and with a yield just below 4%.

Unlike the passive growth portfolios, where performance is delivered predominantly from asset allocation, in the passive income portfolios, performance is driven by a combination of asset allocation and selection, given the factor-based approach to implementation.

The equity market rally in Q1 was led by growth stocks, and so called bond proxies, as demonstrated by the strong performance of the technology and real estate sectors. In addition, an oil price rally led to strong performance in the energy and industrial sectors. This means an ETF tracking high dividend stocks (which tends to have a slight value tilt), slightly underperformed a broad market index. However, as this dividend tilt is undertaken in a controlled way, the four equity ETFs used in the two portfolios delivered a total return of between 6.9% and 7.9%.

Whereas Income 2 does not contain bonds, the Income 1 portfolio has an exposure. The bond allocation in Income 1 is focused towards non-government bonds. The high-yield bond performed broadly in line with the equity ETFs, up 6.7%, with good performance from UK corporate bonds, up 5.1%. The portfolio has a small allocation to gilts (5% target weighting), which is our short duration positioning, and we saw a modest total return of 0.5% in this asset class.

Within alternatives, the portfolios invest across three areas: infrastructure, global property and UK property. As the portfolios are implemented using listed securities, each asset class is implemented using ETFs containing either equities or bonds, with the aim of providing a risk/return profile in line with the desired asset class. For infrastructure, an ETF tracking equities is used, where the equities generate a high proportion of revenues from infrastructure projects. This leads to investments in companies concentrated in the utilities, industrials, energy and real estate sectors. As previously outlined, the strong rally in the oil price led to good performance in energy and industrial stocks, whilst the fall in yields led to strong performance in bond proxies such as utilities and real estate. As such, the infrastructure ETF delivered a total return of 11.5% over the quarter. Similarly, global REITs were up 11.9% and UK real estate (a blend of UK REITs and short-dated index linked bonds) was up 7.6%.

Given the strong return of all major asset classes within the portfolios, it is no surprise to see strong overall returns for both portfolios. It is, however, pertinent to highlight that some of the returns have been delivered from narrow factors, such as the oil price or a fall in bond yields. We are still comfortable with the long-term positioning of the portfolios, however, we will be performing our annual asset allocation review in Q2. Our asset allocation process uses market-based returns to determine efficient allocation of capital, as such the strong return due to these factors will be taken into account.

Portfolio changes

No changes were made to the portfolios over the quarter, however, the annual update to the long-term strategic asset allocation will shortly be implemented. We will report on the specific changes when this is completed, and summarise them in the next quarterly report.

Performance summary (all models)

Portfolio	3 months	6 months	1 year	Inception*
Passive Income MPS 1	6.86%	1.79%	8.23%	7.78%
Passive Income MPS 2	7.93%	1.43%	10.30%	8.83%

Both portfolios launched on 19 February 2018. All performance is net of fees.

Source: Bloomberg LP, AJ Bell Investments, April 2019.

AJ Bell Management Limited (company number 03948391), AJ Bell Securities Limited (company number 02723420) and AJ Bell Asset Management Limited (company number 09742568) are authorised and regulated by the Financial Conduct Authority. All companies are registered in England and Wales at 4 Exchange Quay, Salford Quays, Manchester M5 3EE. See website for full details.

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AJ Bell Pactive MPS – Q1 2019 report

Introduction

We are delighted to bring you the first quarterly report from AJ Bell Investments covering the new Pactive MPS which launched on 19th February 2019. This is a range of portfolios blending the AJ Bell Passive funds with the Active MPS to create low cost portfolios that still retain an element of actively managed investment solutions.

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

The start of 2019 has been a complete reversal of the end of 2018 with strong performance from both equities and bonds and confidence returning after the volatility of last year. Perhaps somewhat strangely, this is amid a backdrop of slowing global growth and signs from central banks around the world that the economic environment is getting more challenging.

However, equity investors have taken this to mean that central banks will stop tightening monetary policy and become more accommodative, thus helping propel equities higher and indeed bonds too as the prospect of rapidly rising interest rates receded.

In the UK, Brexit seems no closer to being delivered, while Germany has struggled to grow and France continues to battle its own citizens amid discontent over President Macron's reforms. The positive story seems to be around the trade war between the US and China that has showed signs of being amicably resolved and this has certainly boosted investor confidence through the first quarter of the year.

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In the UK, it was Brexit that unsurprisingly dominated the headlines for the entire quarter as the 29th March leaving date moved ever closer. With Theresa May failing to get her deal approved by Parliament, then losing control of the order papers and then saying she would resign if her deal was passed, it was a tumultuous 3 months for the Prime Minister as she had little choice but to extend the date that Britain would leave the EU. By the time you are reading this, frankly anything could have happened so apologies if this narrative appears out of date! Unsurprisingly, this uncertainty started to show in the economic data during the period with GDP falling back to an annualised rate of 1.3% while business confidence also fell back. One bright spot was that unemployment fell to its lowest level since 1975. As the end of the quarter arrived, the potential for a delay in the UKs departure from the EU saw larger UK companies surge in value, with the FTSE All Share Index returning 9.4% over the quarter.

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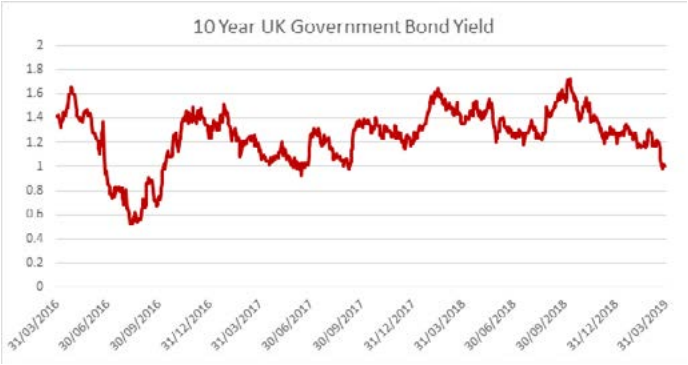
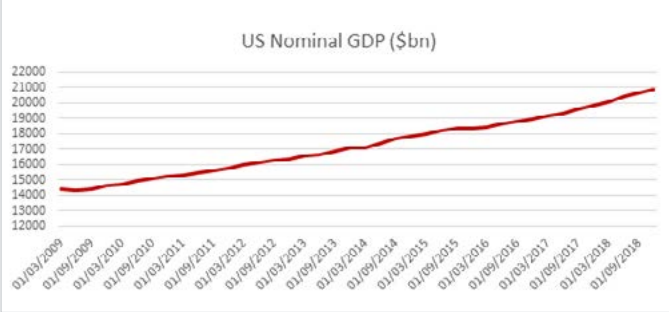


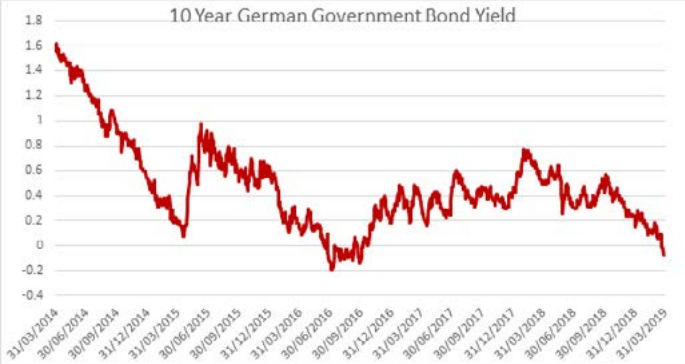
Source: Bloomberg LP, AJ Bell Investments, April 2019

Having been very weak in Q4 2018, the US bounced back strongly in Q1 as a truce in the trade war with China and a clear signal from the Federal Reserve that interest rates were highly unlikely to rise this year. With economic data being delayed at the start of the year due to the government shutdown over the lack of budget approval, it took until the end of March before the final GDP data was known. This came in below expectations and was sharply lower than earlier in the year and this would have been at the forefront of Jerome Powell's mind at the Federal Reserve when the announcement came that rates were unlikely to increase again this year. Tucked away in the statement was also the news that US growth was expected to be 1% less than previously expected at 2.1% for 2019 giving a clear indication that global growth is slowing down, something that has been mentioned in these quarterly updates previously. However, business confidence remained reasonably strong while consumer confidence got better throughout the quarter. At the same time, the labour market remained tight with low unemployment and strong wage growth. This backdrop saw equities perform strongly with the S&P 500 Index increasing by 10.9% over the period. The changing narrative from the Federal Reserve saw of interest rate expectations change markedly and as a result the US 10-year Treasury yield fell from 2.7% at the start of the year to 2.4% at the end of the quarter.



Source: Bloomberg LP, AJ Bell Investments, April 2019

The weakness seen in Europe in the latter stages of 2018 continued into 2019 as a slowing China impacted upon the major export economies of the region. This was especially evident in Germany, recording no growth at all in the final quarter while PMI data showed that manufacturing was contracting in the first months of the year. The slowdown was sufficient to see the Chief Economist of the European Central Bank say that it had been broader and more persistent and indicated that further support from the ECB may be required. Late in March, German manufacturing data collapsed causing much alarm for European investors. The result was that the yield on the German 10 year Bund turned negative once again for the first time since the summer of 2016 showing just how worried investors are that a European slowdown may well be very difficult to exit. Over the periods, the MSCI Europe ex UK Index grew by 8.0%.



Source: Bloomberg LP, AJ Bell Investments, April 2019

Focus in emerging markets was very much on China, particularly given the ongoing trade discussions with the US. Signs that the talks were progressing well helped investor sentiment and there was hope as the quarter ended that a positive resolution would be found. At the same time, the Chinese government continued to provide stimulus to help manage the slowing economy with a cut to the reserve ratio requirement for Chinese banks. In Brazil, volatility picked up sharply towards the end of the quarter as controversial pension reform struggled to pass in parliament with the failure causing the equity market and currency to fall sharply. In Turkey, attention again turned to the fragility of the currency as it did last summer with the Turkish Lira falling sharply against major currencies as confidence drained away from President Erdogan as the recession began to take hold. Over the course of the quarter, the MSCI Emerging Markets Index rallied 7.4% while looking at fixed interest in the region, the JPMorgan GBI Emerging Market Global Composite Bond Index increased by 0.70% over the period.

The Japanese economy bounced back in the 4th quarter of 2018 to register solid GDP growth after the sharp slowdown earlier in the year. However, it wasn't all good news, as manufacturing data weakened over the quarter while consumer confidence steadily declined as the close trade links to a slowing China hampered progress. Over the quarter, the Topix Index increased by 4.6% as broader global investor confidence pulled equities higher.

All market performance figures are in GBP

Pactive Managed Portfolio review – Q1 2019

Pactive MPS performance

The performance comments below refer to the first quarter of 2019 in its entirety even though the product launched mid-quarter.

2019 has started very much on the front foot, with positive returns being seen across the portfolio both from equities and from fixed interest. With equities performing strongly, it was no surprise to see big contributions coming from this exposure across the portfolios, while risk was also rewarded in fixed interest with strong performance across the fixed interest spectrum.

With strong absolute returns almost across the board, it was a strong quarter for the portfolios, particularly in the higher-risk end of the spectrum where equity exposure is high.

In the UK, core equity exposure performed strongly, with the Troy Trojan Income and the Man GLG Undervalued Assets funds both outperforming the FTSE All Share Index, while the Investec UK Alpha fund (Portfolios 3-6) also outperformed. In Europe, exposure was reduced as part of the annual asset allocation update. Over the quarter, the Crux European Special Situations fund finished marginally behind the index as large cap equities outperformed the mid cap area.

In the US, the Dodge & Cox US Stock fund (Portfolios 3-6) was behind the index over the period as its value style underperformed, while the JP Morgan US Equity Income fund was also marginally behind. The US-focused Polar Cap Global Technology fund (Portfolios 3-6) bounced back strongly, delivering the best performance of any holding.

In Asia, our core exposure to the Invesco Asian fund (Portfolios 2-6) was marginally behind its broad- based Asian benchmark, while the Schroder Asian Alpha Plus fund was marginally ahead of the index. The Stewart Asia Pacific Leaders fund (Portfolios 5-6) was a strong performer, particularly in March. In emerging markets, the Fidelity Emerging Markets fund was significantly ahead of the benchmark, while the JP Morgan Emerging Markets Income fund and the Lazard Emerging Markets fund were a little behind the index.

In Japan, the Man GLG Japan Alpha fund finished the quarter behind the Topix Index having outperformed it for a large part of the period, as investors' focus shifted to the growth style during March.

Fixed interest markets were in bullish mood as the threat of rising interest rates receded. This meant that the Lyxor UK Gilt 0-5yr ETF (Portfolios 1-2) marginally increased but significantly lagged the broad-based gilt benchmark. Within UK corporate bonds it was a similar story as the Fidelity Moneybuilder Income (Portfolios 1-3) and TwentyFour Corporate Bond (Portfolios 1-4) funds were slightly shorter duration than the benchmark. The result was solid positive returns but marginally behind the benchmark.

Within the high-yield market, performance was strong given their higher correlation to equity markets. The more cautious Baillie Gifford High Yield Bond fund (Portfolios 1-5) was marginally behind the benchmark, while the Royal London Short Duration Global High Yield Bond fund was also behind as its shorter duration held back returns. Outside of UK fixed interest, the M&G Emerging Markets Bond fund (Portfolios 1-4) delivered strong absolute returns as sentiment in emerging markets improved.

The final area of the portfolio is the commercial property allocation, which continues to be zero weighted due to the Brexit and liquidity risk. In its place the Janus Henderson UK Absolute Return fund (Portfolios 1-6) performed well in absolute terms, with similar low volatility characteristics.

Portfolio changes

Given the very recent launch of the Pactive portfolios, no changes have been made at this stage.

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