AJ Bell Active MPS – Q2 2019 review

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.

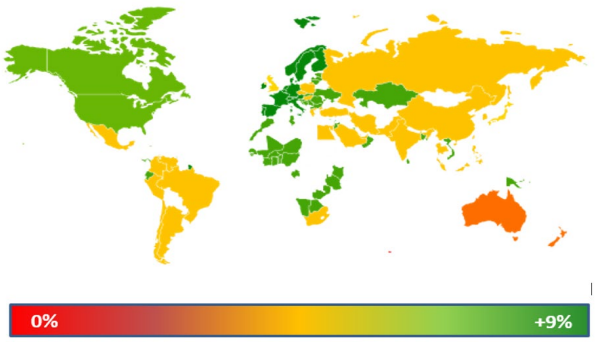
Summary

After a strong start to the year in Q1, Q2 broadly continued the theme, particularly for sterling investors who were helped by a strong tailwind from the weakening currency. Investors across the world were of the view that 'bad news was good news' as the chances of interest-rate cuts or further monetary stimulus seemed to increase as the quarter progressed.

In the UK, Brexit was once again in the spotlight with the date for leaving the EU pushed back again, this time until the end of October. However, this resulted in Theresa May resigning as Prime Minister, finally admitting defeat in getting her deal approved by parliament. Trade wars and tariffs were a feature of the quarter as the US/Chinese spat continued, while bond yields fell sharply as the bond market perceived increasing risk to the global economy.

Economic and market review

The second quarter of 2019 saw a continuation of the first with broadly positive performance from both equities and bonds, although Asian and emerging markets equities struggled to progress. The positive performance was based upon indications from central banks in the major economies that they were ready to provide further support and stimulus to economies should they judge that the world was at risk of an economic slowdown. The positive feeling behind this seemed to outweigh increasing tensions towards the US/Chinese trade war and increased tensions in the Middle East that pushed both the oil and gold prices higher.



Source: AJ Bell Investments, Bloomberg LP, July 2019

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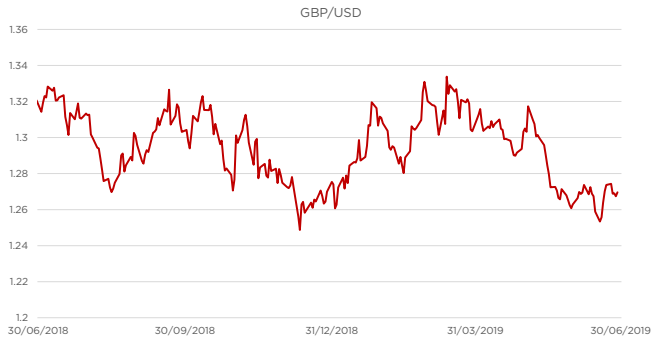
The bond market predictably reacted to the increased risk of a no-deal Brexit with the yield on the 10-year gilt falling sharply, ending the period at just 0.82%. This helped the FTSE Actuaries UK Conventional Gilts All Stocks Index increase by 1.3% over the quarter. With the risk on environment, credit risk was rewarded, helping corporate bonds to perform well, with the iBoxx UK Sterling All Maturities Index increasing by 2.3% over the quarter, while high-yield bonds also performed well with the Bloomberg Barclays Global High Yield Bond Index increasing by 2.1% over the period.



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In the US, two major issues dominated the quarter: firstly, the ongoing trade war with China; and secondly, the shift in narrative from the Federal Reserve surrounding interest rates. The trade war escalated during the quarter as negotiations broke down and in May, the US increased the tariffs on $200bn of Chinese goods from 10% to 25% and threatened to extend this to another $300bn of goods. Naturally, the Chinese didn't take this lying down and responded by increasing the tariff on $60bn of US goods. This tit-for-tat battle has yet to truly be seen in economic data, but the risk is that a pick-up in inflation and a slowdown in growth could be seen in the second half of 2019. Turning to the Federal Reserve, during the quarter it became apparent that investors sense that the Fed may have to cut interest rates at some point this year. While initially the Fed appeared adamant that it was comfortable with the economic position, as the quarter progressed the narrative shifted with an indication that rate cuts could come if data deteriorated. With inflation remaining low and the boost from the Trump tax cuts about to leave the economy, there is a sense that a slowdown is occurring that will force the Fed's hand. As a result, market behaviour has become somewhat strange, with equities and bonds rallying on weaker data in the expectation that the Fed will be more

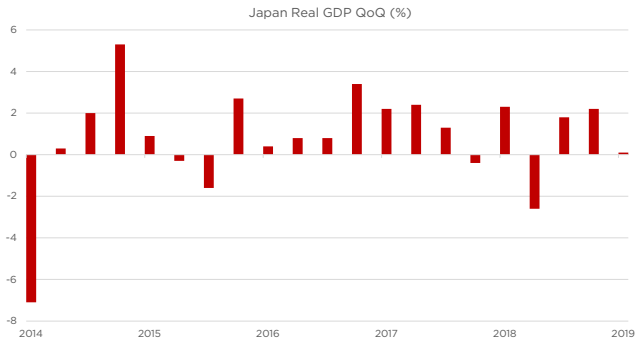
likely to act sooner rather than later. This backdrop saw equities perform strongly with the S&P 500 Index increasing by 6.6% over the period. The more accommodative language from the Federal Reserve saw interest rate expectations change markedly, and as a result the US 10-year Treasury yield fell from 2.4% at the start of the year to 2.0% at the end of the quarter, resulting in a strong rally for US bonds.

Source: Bloomberg LP, AJ Bell Investments, July 2019

With a myriad of economic and social problems in Europe, investors have been nervous of the region for some time. However, after solid performance from the equity market during the quarter, European equities have actually had their best first half of a year for 21 years, providing a healthy reminder that investing in companies is not always representative of the underlying economies. At an economic level, data has been mixed with a very poor performance of the manufacturing side of the economy as the global economy – notably China – slows down, but a stronger performance from the services element of the economy, which is less relaint on overseas consumption. The ECB has been alive to the risks and Mario Draghi has talked of the possiblity of restarting quantitative easing in some form should the economy need it. These comments saw bond yields fall sharply, with the 10-year German Bond turning negative again and actually reaching a lower level than it saw even in the eye of the Euro crisis storm back in 2014. In Italy, the government remained at loggerheads with the EU, with talk of the potential introduction of a parallel 'currency' called mini-BOTs to stimulate their economy. Over the period, the MSCI Europe ex UK Index increased by 8.3%.

In Asia, China was the dominant factor as the previously mentioned trade war was prevalent. As Trump's trade tariffs kicked in, investors began to digest how much this could impact on Chinese growth and the Chinese central bank acted quickly, providing a cut to the amount capital banks have to hold in a hope of stimulating lending. They also cut both personal and corporate tax rates in a sign that they were prepared to act decisively. Away from China, India had a general election in what is said to be the largest democratic election in the world, with nearly 1 billion voters. Prime Minister Modi was re-elected with a majority, which should enable him to continue his reform agenda. Over the period, the MSCI AC Asia ex Japan Index fell in local currency terms, but increased by 1.7% in sterling.

In Japan, economic data showed strong growth in the first quarter, catching experts, who had expected the economy to contract, off guard. However, as ever, the devil is in the detail and analysis of the data showed that the GDP was pulled up by a sharp fall in imports rather than any strong underlying demand. In fact, a fall in exports and private demand pointed to a continued challenging outlook, particularly given the slowdown in neighbouring China. Over the quarter, the Topix Index was the worst performing major market, but for UK investors, the weakness in sterling actually meant that the Topix Index increased by 2.7% over the period.



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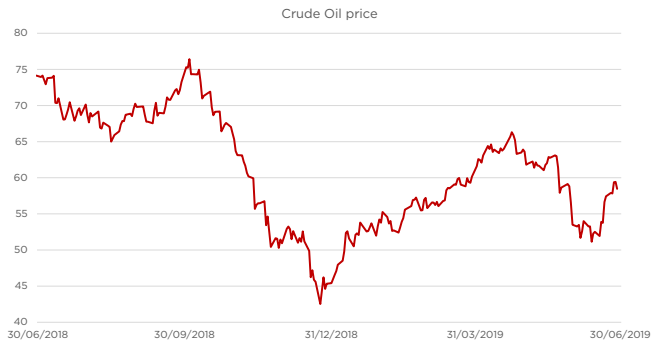
In the emerging markets, Russia was a very strong performer, as the country benefited from the rise in the oil price this year. With Gazprom and Lukoil making up a third of the Russian index, the rally in the price of 'black gold' this year has seen their share prices rally sharply, with Gazprom announcing a significant increase in its dividend. In Brazil, the stock market hit an all-time high despite the economy showing a contraction as confidence in President Bolsonaro fell and the growth rate for 2019 was slashed. During the period, MSCI announced changes to its emerging markers index which will see Saudi Arabia and Argentina added to the index while the weight of domestic Chinese equities continues to be increased. Over the period, this index was up by 3.0% while emerging markets fixed interest was the best performing asset class, with the JPMorgan GBI Emerging Market Global Composite Bond Index increasing by 8.3% over the period.



Source: Bloomberg LP, AJ Bell Investments, July 2019

Asset Allocation Contributors

	Portfolio					
Top contributors*	MPS 1	MPS 2	MPS 3	MPS 4	MPS 5	MPS 6
1	Emerging Market Bonds	UK Corporate Bonds	UK Large Cap Equities	UK Large Cap Equities	North American Equities	North American Equities
2	North American Corporate Bonds	Health Care Equities	North American Equities	North American Equities	UK Large Cap Equities	Emerging Market Equities
3	UK Corporate Bonds	North American Equities	Technology Equities	Technology Equities	Technology Equities	Technology Equities

Source: AJ Bell Investments, Bloomberg LP, July 2019

All market performance figures are in GBP

Active Managed Portfolio review – Q2 2019

Active MPS performance

With a positive performance across equities and bonds, portfolios have delivered solid performance during the second quarter. Overseas equity exposure was particularly beneficial – helped by the tailwind of weakening sterling – while fixed interest was also positive as yields tightened on the expectation of lower interest rates.

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, the core exposure from the Investec UK Alpha fund (Portfolio 3-6) outperformed the FTSE All-Share Index, while the more defensively positioned Troy Trojan Income fund (Portfolio 1-6) marginally lagged behind a rising market. The Man GLG Undervalued Assets fund (Portfolio 1-6) was also behind, as its tilt towards valued stocks was out of favour over the quarter after a strong start to the year. The Tellworth UK Smaller Companies fund (Portfolio 5-6) was very strong, with good outperformance of the broader market.

In the US, the JP Morgan US Equity Income fund (Portfolio 1-2) was a very good performer, as its focus on quality companies that generate cash was positive. The Dodge & Cox US Stock fund (Portfolio 3-6) was behind the index over the period, as its value style underperformed, while the US-focused Polar Cap Global Technology fund (Portfolio 3-6) also lagged behind the broader market as technology stocks struggled during June. The Xtrackers MSCI USA Healthcare ETF was positive, but behind the broad market, as the sector was hit by fears that the US government would change its approach to healthcare in April. These fears were unfounded and the sector recovered well.

In Europe, exposure comes from the Crux European Special Situations fund (Portfolio 2-6) and it performed well as equities had a strong quarter. With a focus on medium and smaller companies, this was a reversal of the first quarter when this approach lagged behind the market.

In Asia, our core exposure to the Invesco Asian fund (Portfolio 2-6) was ahead of its broad-based Asian benchmark, while the Schroder Asian Alpha Plus fund (Portfolio 4-6) was also marginally ahead of the index. The Stewart Asia Pacific Leaders fund (Portfolio 5-6) was a very strong relative performer as its focus on high quality companies was rewarded. The Fidelity Asian Values IT (Portfolio 6) was also a solid performer over the quarter.

In emerging markets, the Fidelity Emerging Markets fund (Portfolio 4-6) was significantly ahead of the benchmark for the second quarter in a row, as exposure to Russian oil stocks was helpful, while the JP Morgan Emerging Markets Income fund (Portfolio 2-6) was also a strong performer, as its focus on quality, cash-generative companies was rewarded. The recently-added Lazard Emerging Markets fund (Portfolio 6) was a positive as its deep value approach outperformed the index.

In Japan, the Man GLG Japan CoreAlpha fund finished the quarter behind the Topix Index, as the market focused on growth and quality companies rather than the value approach taken by this fund. In the last quarter, the Evenlode Global Income fund was added (Portfolio 1-5) and was the best performer across all holdings in absolute terms, as its clear focus on high-quality companies was rewarded.

Fixed-interest markets performed strongly as central banks hinted at potential interest-rate cuts. The Lyxor UK Gilt 0-5yr ETF marginally increased but significantly lagged behind the broad-based gilt benchmark. Within UK corporate bonds, both the Fidelity MoneyBuilder Income fund (Portfolio 1-3) and TwentyFour Corporate Bond fund (Portfolio 1-4) funds delivered solid absolute returns. The big winner over the quarter was the iShares USD Corporate Bond ETF, as this part of the market rallied strongly.

Within the high-yield market, performance of the Baillie Gifford High Yield Bond fund (Portfolio 1-5) was good, comfortably outperforming the index, while the Royal London Short Duration Global High Yield Bond fund (Portfolio 1-4) delivered positive returns over the quarter. Outside of UK fixed interest, the M&G Emerging Markets Bond fund (Portfolio 1-5) was very strong in absolute terms.

The final area of the portfolio is the commercial property allocation, which continues to be zero-weighted due to expectations of weak performance and liquidity risks that have picked up over the period. In its place, the Janus Henderson UK Absolute Return fund (Portfolio 1-5) was slightly in negative territory over the quarter.

Portfolio changes

With the annual long-term asset allocation changes being made in the previous quarter, no additional changes were made during the second quarter. However, the share class for the Lazard Emerging Markets fund was switched to a cheaper share class during the quarter.

Performance summary (all models)

Fund	3 months	6 months	1 year	Inception*
Active MPS 1	2.93%	6.25%	4.59%	5.93%
Active MPS 2	3.55%	8.37%	4.83%	6.12%
Active MPS 3	3.82%	10.28%	4.68%	6.84%
Active MPS 4	3.94%	11.33%	4.26%	6.92%
Active MPS 5	4.31%	12.86%	3.78%	6.52%
Active MPS 6	4.45%	13.64%	3.14%	5.68%

**Active MPS launched on 19 February 2018.*
Source: Bloomberg LP, AJ Bell Investments, July 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/QR/A-MPS/20190715

AJ Bell Active Income MPS – Q2 2019 review

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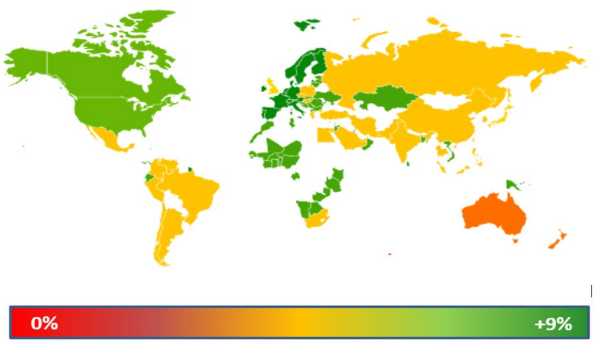

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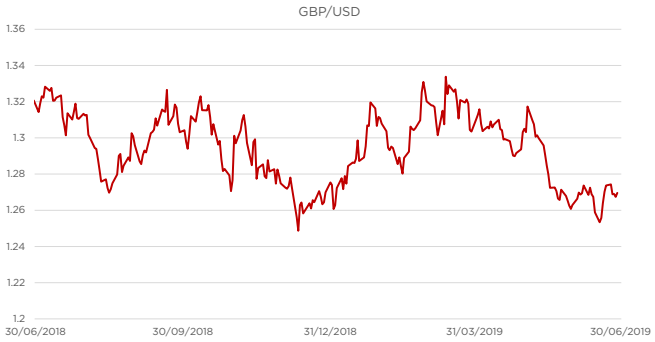

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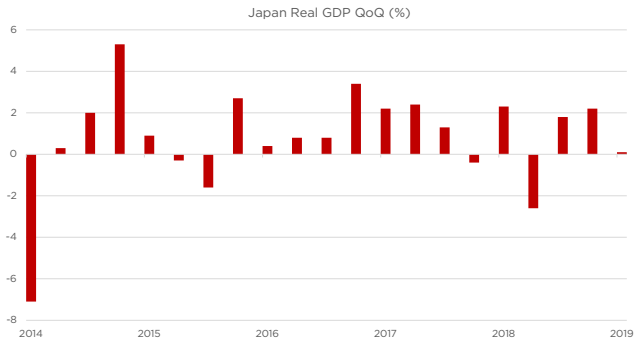

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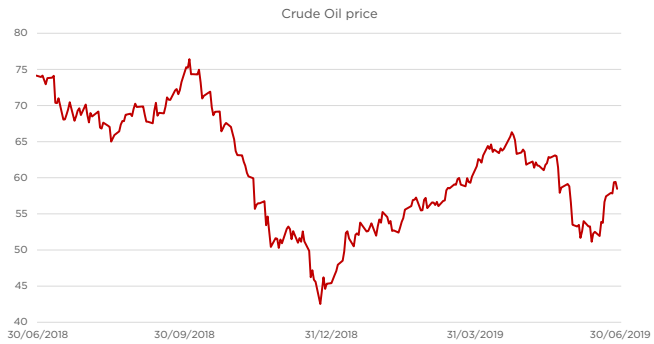

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Active Managed Portfolio review – Q2 2019

Active Income MPS performance

With positive performance across equities and bonds, portfolios have delivered positive performance during the second quarter. Overseas equity exposure was particularly beneficial – helped by the tailwind of weakening sterling – while fixed interest was also positive as yields tightened on the expectation of lower interest rates.

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, equities performed well despite uncertainty surrounding Brexit. The Montanaro UK Income fund, which focuses on smaller companies, was removed from Income 1, but retained in Income 2 during the annual asset allocation review, and overall performed strongly during the quarter. The more defensively-positioned Troy Trojan Income fund marginally lagged behind a rising market, while the Man GLG UK Income fund was also behind, as its tilt towards valued stocks was out of favour over the quarter after a strong start to the year.

Within global equities, the Artemis Global Income fund was removed from Income 1 as part of the annual asset review and its weight reduced in Income 2 and performed well in absolute terms over the quarter. The BNY Global Income fund – previously known as the Newton Global Income fund – (Income 2) had an excellent quarter, as its focus on high-quality companies was well rewarded. Its weight was also reduced as part of the annual review.

Looking at the regional allocations, it was a reversal of the previous quarter as high-quality income companies were very much in favour. As a result, the BlackRock Continental European Income fund, Jupiter Asian Income fund and JP Morgan Emerging Markets Income fund all performed very strongly. During the quarter, the Schroder Oriental Income IT was added to Income 2 as the weight to Asia was increased and got off to a solid start.

In the alternatives exposure, the allocation to both UK and global property was removed from Income 1, while UK property was reduced in Income 2 as part of the annual update. After a strong first quarter, global property via the L&G Global Real Estate Dividend Index fund was weak in the second quarter, while UK property was weaker still as the iShares MSCI UK Target Real Estate ETF was marginally negative. In infrastructure, the Premier Global Infrastructure fund was replaced with the Legg Mason RARE Global Infrastructure Income fund, albeit the exposure was reduced from the Income 1 portfolio.

Fixed-interest markets performed strongly as central banks hinted at potential interest rate cuts. There were significant additions to the fixed-interest element of the portfolio in Income 1 to diversify the holdings. This included adding US corporate bonds, US short-duration high-yield bonds, US Treasuries and some emerging market debt (changes listed below). All exposures were gained via passive holdings in line with the policy of using passives where there was no clear case for using active managers, and all performed well after their introduction, helped by weaker sterling. The stand out performer was the L&G Emerging Markets Government Bond Local Currency Index fund.

Within the existing holdings, the Lyxor UK Gilt 0-5yr ETF marginally increased but significantly lagged behind the broad-based gilt benchmark. Within UK corporate bonds, both the Fidelity MoneyBuilder Income fund and Royal London Corporate Bond fund delivered solid absolute returns. Within the high yield market, performance of the Baillie Gifford High Yield Bond fund was good while the M&G Emerging Markets Bond fund was very strong in absolute terms.

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 April 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:

- Fixed-interest exposure was increased in the Income 1 portfolio
- Equity exposure was decreased in Income 1 but increased in Income 2
- Alternatives exposure was reduced across both Income 1 and 2

Main manager additions and removals:

Additions	Removals
Vanguard USD Corporate Bond ETF	Premier Global Infrastructure
Invesco US Treasury Bond 3-7 years ETF	
SPDR Bloomberg Barclays 0-5 years US High Yield Bond ETF	
L&G Emerging Markets Government Bond Local Currency Index	
JP Morgan US Equity Income	
Schroder Oriental Income IT	
Legg Mason RARE Infrastructure Income	

Portfolio summary (all models)

Fund	3 months	6 months	1 year	Inception*
Active MPS Income 1	4.53%	11.43%	6.65%	8.74%
Active MPS Income 2	4.19%	13.17%	4.97%	9.41%

**Active MPS launched on 19 February 2018.*
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AJB/QR/A-INC/MPS/20190715

AJ Bell Passive MPS – Q2 2019 review

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Economic and market review

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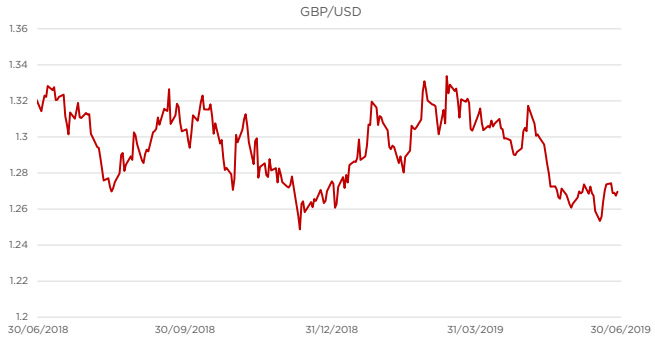
The bond market predictably reacted to the increased risk of a no-deal Brexit with the yield on the 10-year gilt falling sharply, ending the period at just 0.82%. This helped the FTSE Actuaries UK Conventional Gilts All Stocks Index increase by 1.3% over the quarter. With the risk on environment, credit risk was rewarded, helping corporate bonds to perform well, with the iBoxx UK Sterling All Maturities Index increasing by 2.3% over the quarter, while high-yield bonds also performed well with the Bloomberg Barclays Global High Yield Bond Index increasing by 2.1% over the period.



Source: Bloomberg LP, AJ Bell Investments, July 2019

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Source: Bloomberg LP, AJ Bell Investments, July 2019

With a myriad of economic and social problems in Europe, investors have been nervous of the region for some time. However, after solid performance from the equity market during the quarter, European equities have actually had their best first half of a year for 21 years, providing a healthy reminder that investing in companies is not always representative of the underlying economies. At an economic level, data has been mixed with a very poor performance of the manufacturing side of the economy as the global economy – notably China – slows down, but a stronger performance from the services element of the economy, which is less relaint on overseas consumption. The ECB has been alive to the risks and Mario Draghi has talked of the possiblity of restarting quantitative easing in some form should the economy need it. These comments saw bond yields fall sharply, with the 10-year German Bond turning negative again and actually reaching a lower level than it saw even in the eye of the Euro crisis storm back in 2014. In Italy, the government remained at loggerheads with the EU, with talk of the potential introduction of a parallel 'currency' called mini-BOTs to stimulate their economy. Over the period, the MSCI Europe ex UK Index increased by 8.3%.

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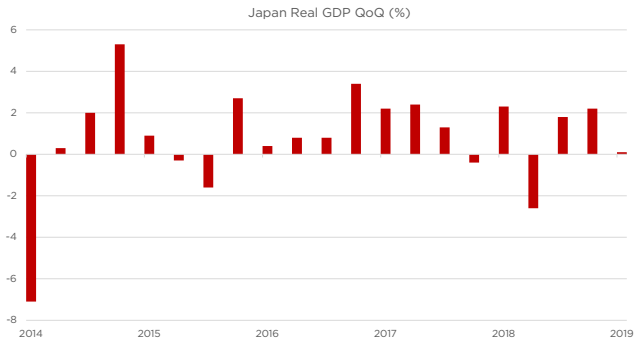

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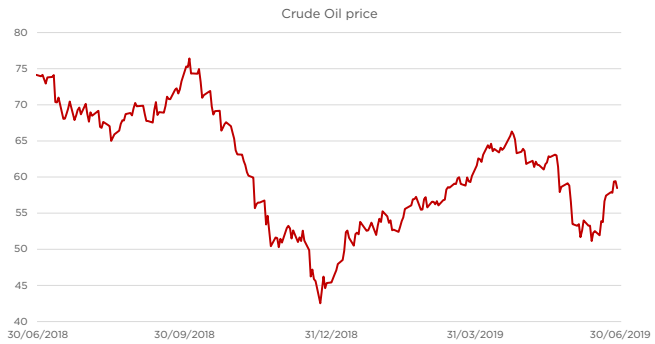
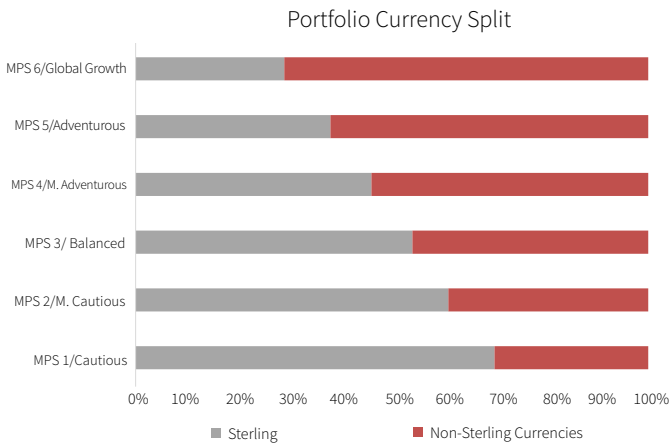


Source: Bloomberg LP, AJ Bell Investments, July 2019

Asset allocation positioning

As already highlighted, sterling fell against all major currencies over the last quarter. As sterling falls, the value of international assets increases when converted back into sterling, providing a boost to UK-based investors. Currency fluctuations provide extra volatility to the return of a portfolio, therefore our lower risk portfolios tend to be more focused towards sterling-based assets (or those hedged back to sterling), whereas our higher risk portfolios tend to have predominantly international holdings, allowing investments into higher risk equity markets such as Asia and Latin America. Therefore sterling falling up to 5% against major currencies provided a boost to returns, especially in the three highest risk portfolios, which hold a majority of non-sterling assets.



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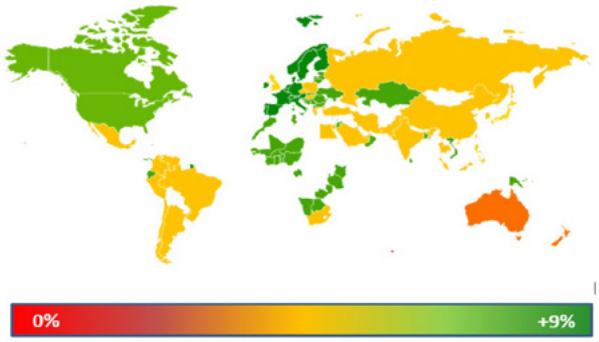
Although returns in UK stocks in general were muted, UK Large Cap equities tend to be international in nature: it is estimated that over 70% of profits from FTSE 100 companies are generated overseas and, therefore, these also benefit from a falling pound. This means that UK large cap equities actually outperformed some international regions in the quarter. A combination of these currency moves and equity market moves meant all equity regions delivered positive returns to portfolios in Q2.

Q2 equity market returns



Source: AJ Bell Investments, Bloomberg LP, July 2019

Alongside equity regions, we also split our equity allocations across sectors, with each portfolio having allocations to at least two sectors from technology, health care and consumer staples. Health care and consumer staples delivered performance broadly in line with global markets, whereas technology performed particularly well, given the risk on environment. It was one of the top contributors in the portfolios in which it is held, with global technology stocks up nearly 9% for the quarter.

As both equity markets rallied and government bond yields fell globally, the sweet spot for bonds over the quarter was in corporate and emerging market bonds, benefitting from falling treasury yields and tightening credit spreads.

All bond classes also delivered positive performances over the quarter and, as such, there were no detrators to portfolios in absolute terms.

Asset Allocation Contributors

	Portfolio					
Top contributors*	MPS 1	MPS 2	MPS 3	MPS 4	MPS 5	MPS 6
1	Emerging Market Bonds	UK Corporate Bonds	UK Large Cap Equities	UK Large Cap Equities	North American Equities	North American Equities
2	North American Corporate Bonds	Health Care Equities	North American Equities	North American Equities	UK Large Cap Equities	Emerging Market Equities
3	UK Corporate Bonds	North American Equities	Technology Equities	Technology Equities	Technology Equities	Technology Equities

Source: AJ Bell Investments, Bloomberg LP, July 2019

Passive Managed Portfolio review – Q2 2019

Passive MPS performance

Within the passive portfolios, the majority of performance is driven by asset allocation. However, the benchmark the team has chosen to track can lead to performance differentials, especially in bigger regions, such as emerging markets and Asia. The country–by-country classification – being either a frontier, emerging or developed nation – is still at the discretion of the index provider and, as such, the performance of indices in these regions can diverge when certain countries perform particularly well (or badly).

When selecting an ETF to use in the portfolios, we consider both the benchmark tracked and the cost to implement the strategy. Within Asia, due to the high investment costs associated with investing in products that cover both developed and emerging countries in the region, we have taken the decision to use the Vanguard FTSE Asia Pacific Ex-Japan ETF. This tracks the developed Asian Pacific nations. Unlike MSCI, FTSE classify South Korea as a developed nation, as such, and so the index is concentrated towards Australia and South Korea. Following the rise in commodity prices, the Australian stock market has performed well; as such, this product has outperformed the all-country Asia Pacific index by around 3%. This has helped performance, especially in the higher risk portfolios, where the allocation to Asia is higher.

In the MPS 6 portfolio we hold an Automation and Robotics ETF as part of our technology allocation. Although this position delivered a return of over 5% in Q2, it lagged behind technology in general. This is due to its tilt towards Asia and away from the US – US markets significantly outperformed Asia in Q2.

The final area to highlight over the quarter is the performance of our UK property holdings. We produced an article in May explaining how we implement property passively in the portfolios. This involves a combination of REITs and short-dated index-linked bonds, through an iShares ETF. The idea is that the blend provides performance much closer to physical property, by dampening the volatility caused by the inherent leverage in REITs and also avoiding the liquidity concerns surrounding active property funds. Over the quarter, an ETF tracking just UK REITS was down 2.2%. On the other hand, the ETF we use was up 0.8%, outperforming by 3%, protecting on the downside.

All other areas of the portfolios performed in line with expectations, with returns ranging from 3% for the lowest risk portfolio, to over 4.5% for the two highest risk portfolios (5 & 6).

Portfolio changes

After making significant changes to the portfolio in the first three months of the year, the second quarter was a period of calm, with no changes implemented. We continue to monitor the market place to ensure our implementation represents the most cost-effective route, whilst remaining cognisant of any costs incurred if we did switch positions. With the emergence of new ETF providers – such as L&G, Amundi and Lyxor – providing fierce price competition, we would expect OCFs to continue to fall.

Performance summary (all models)

Fund	3 months	6 months	1 year	Inception*
Passive MPS 1	2.84%	6.92%	4.41%	8.50%
Passive MPS 2	3.51%	9.18%	5.17%	12.92%
Passive MPS 3	4.04%	11.28%	5.48%	17.43%
Passive MPS 4	4.27%	12.17%	5.21%	20.75%
Passive MPS 5	4.51%	13.34%	4.97%	21.91%
Passive MPS 6	4.51%	13.57%	4.82%	8.15%

**All the portfolios 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, July 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/QR/P-MPS/20190715

AJ Bell Passive Income MPS – Q2 2019 review

Introduction

We are delighted to bring you the quarterly report from AJ Bell Investments covering the Passive Income MPS over Q2.

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

After a strong start to the year in Q1, Q2 broadly continued the theme, particularly for sterling investors who were helped by a strong tailwind from the weakening currency. Investors across the world were of the view that 'bad news was good news' as the chances of interest-rate cuts or further monetary stimulus seemed to increase as the quarter progressed.

In the UK, Brexit was once again in the spotlight with the date for leaving the EU pushed back again, this time until the end of October. However, this resulted in Theresa May resigning as Prime Minister, finally admitting defeat in getting her deal approved by parliament. Trade wars and tariffs were a feature of the quarter as the US/Chinese spat continued, while bond yields fell sharply as the bond market perceived increasing risk to the global economy.

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The second quarter of 2019 saw a continuation of the first with broadly positive performance from both equities and bonds, although Asian and emerging markets equities struggled to progress. The positive performance was based upon indications from central banks in the major economies that they were ready to provide further support and stimulus to economies should they judge that the world was at risk of an economic slowdown. The positive feeling behind this seemed to outweigh increasing tensions towards the US/Chinese trade war and increased tensions in the Middle East that pushed both the oil and gold prices higher.

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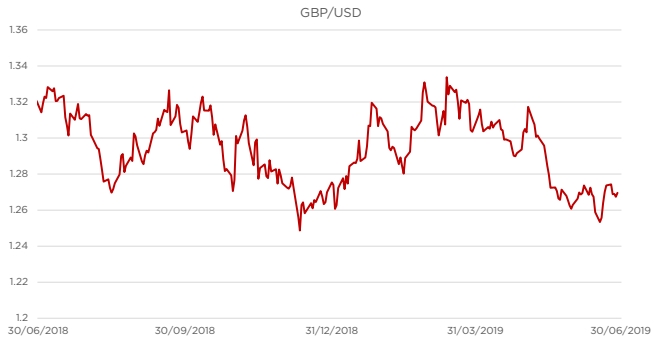

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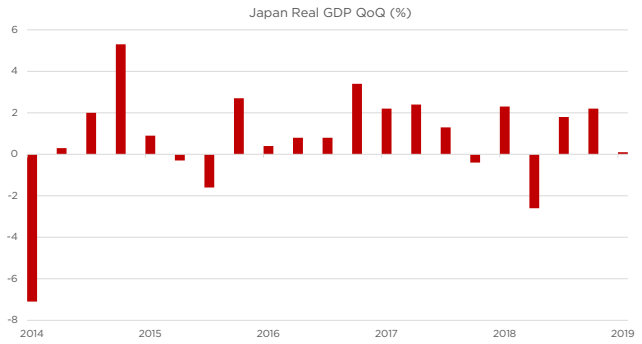

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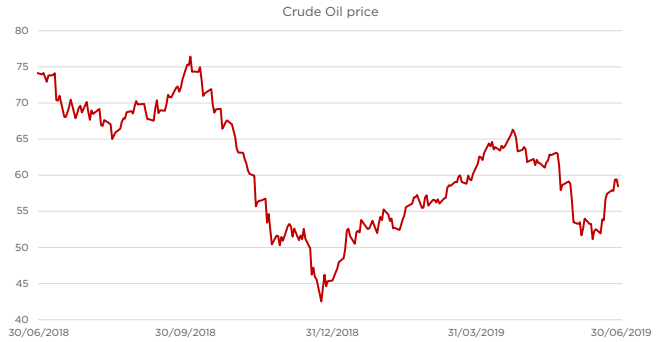
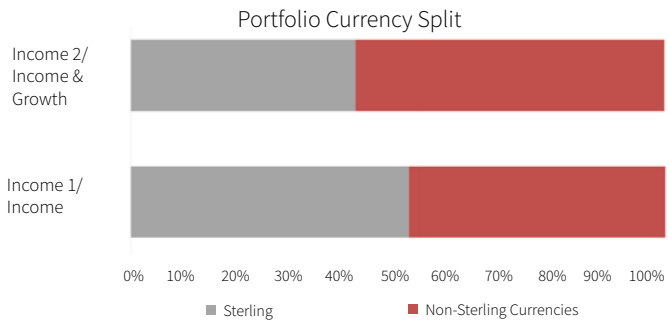


Source: Bloomberg LP, AJ Bell Investments, July 2019

Asset allocation positioning

As highlighted in the previous section, sterling fell against all major currencies. As sterling falls, the value of international assets increases when converted back into sterling, providing a boost to UK-based investors. Currency fluctuations provide extra volatility to the returns of a portfolio, therefore our lower risk income portfolio has a balance between sterling and international assets, whereas our higher risk income portfolio has a slightly greater focus on international holdings. Sterling falling up to 5% against major currencies provided a boost to returns to the income portfolios



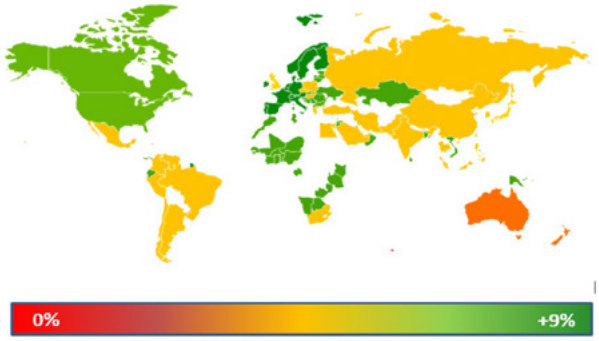
Source: AJ Bell Investments, July 2019

Although the income portfolio's equity holdings are allocated by region, income focused equities tend to be slightly tilted towards certain sectors. Mature industries tend to pay out a greater proportion of profits as dividends, and this leads to a bias towards financials, industrials and materials stocks. Given the risk-on environment, financials were the best performing sector over the quarter. Materials and industrials also outperformed the markets in general, helped by the bounce in commodities such as oil and iron ore.

Financials, materials and industrials are large sectors within the European equity markets, as such it was this region that performed the best over the quarter.

The one sector we specifically allocate to is infrastructure. This performed well (up 8%) as it tends to be focused toward utilities and industrials, with the former performing well when bond yields fall.

Q2 equity market returns



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The lower risk income portfolio aims to generate a proportion of its income target through an allocation to fixed income. Given the low level of yields in the UK, a significant part of the fixed income portion of the portfolio is in international bonds, and given the desire to maximise yield, only global high yield bonds are sterling hedged, as the hedging cost negates the yield advantage in lower risk overseas bonds. Therefore our holdings in US treasuries, US investment-grade and US high-yield bonds (all unhedged) benefitted from three factors: falling treasury yields, tightening spreads and the fall in sterling. Alongside the strong performance of emerging market bonds, fixed income was a major driver of Q2 returns in the lower risk portfolio.

The higher risk income portfolio, on the other hand, eshews fixed income, achieving diversification through listed UK and global property holdings. UK property returns crept into positive territory over the period, with returns held back by Brexit uncertainty and its effects on UK property prices. International property, however, performed well on weakening sterling and falling bond yields.

Given strong markets over the quarter, all elements of the portfolios helped deliver positive returns.

Passive Managed Portfolio review – Q2 2019

Passive Income MPS performance

The portfolios aim to generate an income yield of around 4%. To do this, the equity investments are tilted towards higher yielding equities. This means the performance of the ETFs we use may deviate away from broad equity indices, such as the FTSE 100 in the UK or the S&P 500 in the US.

For the S&P 500, the top five performing sectors for the second quarter have an estimated dividend yield of 1.6%, on the other hand the bottom five sectors have a yield of 2.7%. This has meant income focused ETFs have underperformed broader market indices over the last three months. The exception to the rule is in Asia, where income-producing equities outperformed.

In the Income 1 portfolio, the fixed income ETFs performed in line with our preferred benchmarks.

The final area to highlight over the quarter is the performance of our UK property holdings in the Income 2 portfolio. We produced an article in May explaining how we implement property passively in the portfolio. This involves a combination of REITs and short-dated index-linked bonds through an ETF. The idea is that the blend provides performance much closer to physical property, by dampening the volatility caused by the inherent leverage in REITs and also avoiding the liquidity concerns surrounding active property funds. Over the quarter, an ETF tracking just UK REITS was down 2.2%. On the other hand, the blend was up 0.8%, protecting on the downside.

Portfolio changes

We performed our annual asset allocation rebalance on 18 April. Full details of the changes and the rationale can be found here. In summary, we took the opportunity to add new asset classes into the portfolios to improve the risk/return characteristics of the portfolio, allowing us to meet the return objectives with a slightly lower level of overall risk. The overall expected yield sits just below 4%, driven by strong capital returns of the financial markets squeezing yields lower. We avoid the temptation to chase yield by moving significantly up the risk spectrum. Since launch in February 2018, the total return for Income 1 has been 11%, and 12% for Income 2. This is ahead of the total return objectives (4% and 6% annualised respectively) for the portfolios, and as such we are comfortable with the yield sitting slightly below the 4% target.

Performance summary (all models)

Fund	3 months	6 months	1 year	Inception*
Passive MPS Income 1	3.37%	10.47%	6.01%	11.42%
Passive MPS Income 2	3.06%	11.24%	6.61%	12.16%

**Both portfolios launched on 19 February 2018. All performance is net of fees.*
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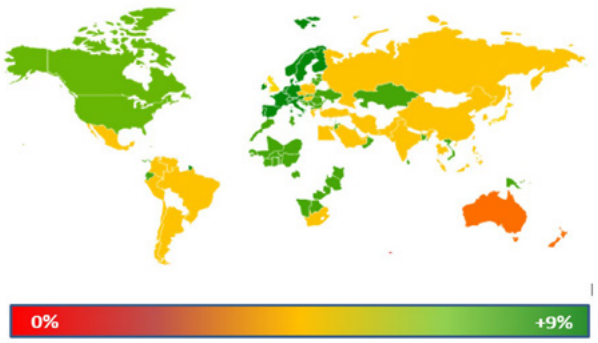
Economic and market review

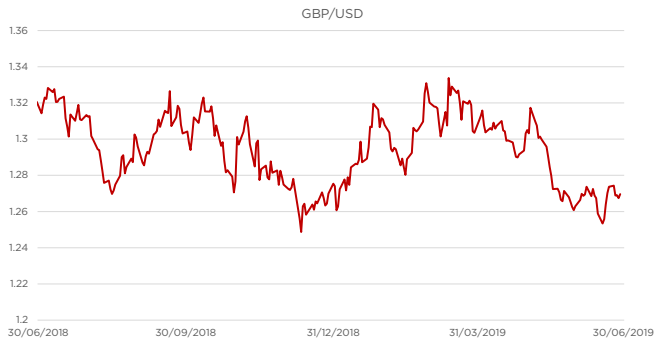
The second quarter of 2019 saw a continuation of the first with broadly positive performance from both equities and bonds, although Asian and emerging markets equities struggled to progress. The positive performance was based upon indications from central banks in the major economies that they were ready to provide further support and stimulus to economies should they judge that the world was at risk of an economic slowdown. The positive feeling behind this seemed to outweigh increasing tensions towards the US/Chinese trade war and increased tensions in the Middle East that pushed both the oil and gold prices higher.



Source: AJ Bell Investments, Bloomberg LP, July 2019

In a serious case of déjà vu, Brexit dominated the UK agenda over the past quarter as the original date for leaving the EU was extended, perhaps aptly, to 31 October, or Halloween! However, following disastrous European election results for the Conservative Party and a failure for parliament to pass the Withdrawal Agreement, Theresa May took the decision to resign, triggering a leadership contest and a market expectation that the risk of a no-deal Brexit had increased. With Boris Johnson the hot favourite, all eyes will be on the run up to the October deadline. During the period, UK economic performance was solid with continued low unemployment and GDP growth in line with expectations. The Brexit uncertainty saw sterling fall in value vs the US dollar, which helped the performance of larger stocks given their focus on overseas earnings while overall the FTSE All-Share Index was up 3.3%. With the weakening of sterling, overseas exposure in both equities and bonds was boosted in GBP terms.

The bond market predictably reacted to the increased risk of a no-deal Brexit with the yield on the 10-year gilt falling sharply, ending the period at just 0.82%. This helped the FTSE Actuaries UK Conventional Gilts All Stocks Index increase by 1.3% over the quarter. 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 2.3% over the quarter, while high-yield bonds also performed well with the Bloomberg Barclays Global High Yield Bond Index increasing by 2.1% over the period.



Source: Bloomberg LP, AJ Bell Investments, July 2019

In the US, two major issues dominated the quarter: firstly, the ongoing trade war with China; and secondly, the shift in narrative from the Federal Reserve surrounding interest rates. The trade war escalated during the quarter as negotiations broke down and in May, the US increased the tariffs on $200bn of Chinese goods from 10% to 25% and threatened to extend this to another $300bn of goods. Naturally, the Chinese didn't take this lying down and responded by increasing the tariff on $60bn of US goods. This tit-for-tat battle has yet to truly be seen in economic data, but the risk is that a pick-up in inflation and a slowdown in growth could be seen in the second half of 2019. Turning to the Federal Reserve, during the quarter it became apparent that investors sense that the Fed may have to cut interest rates at some point this year. While initially the Fed appeared adamant that it was comfortable with the economic position, as the quarter progressed the narrative shifted with an indication that rate cuts could come if data deteriorated. With inflation remaining low and the boost from the Trump tax cuts about to leave the economy, there is a sense that a slowdown is occurring that will force the Fed's hand. As a result, market behaviour has become somewhat strange, with equities and bonds

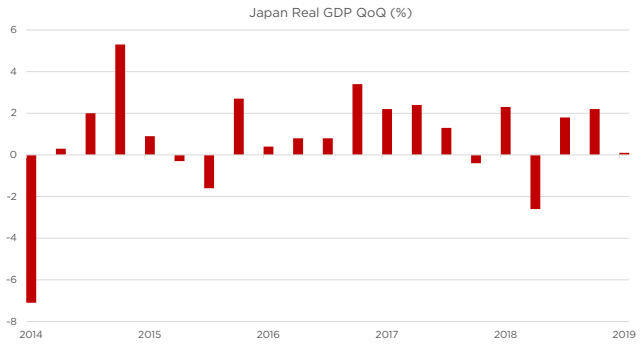
rallying on weaker data in the expectation that the Fed will be more likely to act sooner rather than later. This backdrop saw equities perform strongly with the S&P 500 Index increasing by 6.6% over the period. The more accommodative language from the Federal Reserve saw interest rate expectations change markedly, and as a result the US 10-year Treasury yield fell from 2.4% at the start of the year to 2.0% at the end of the quarter, resulting in a strong rally for US bonds.

Source: Bloomberg LP, AJ Bell Investments, July 2019

With a myriad of economic and social problems in Europe, investors have been nervous of the region for some time. However, after solid performance from the equity market during the quarter, European equities have actually had their best first half of a year for 21 years, providing a healthy reminder that investing in companies is not always representative of the underlying economies. At an economic level, data has been mixed with a very poor performance of the manufacturing side of the economy as the global economy – notably China – slows down, but a stronger performance from the services element of the economy, which is less relaint on overseas consumption. The ECB has been alive to the risks and Mario Draghi has talked of the possiblity of restarting quantitative easing in some form should the economy need it. These comments saw bond yields fall sharply, with the 10-year German Bond turning negative again and actually reaching a lower level than it saw even in the eye of the Euro crisis storm back in 2014. In Italy, the government remained at loggerheads with the EU, with talk of the potential introduction of a parallel 'currency' called mini-BOTs to stimulate their economy. Over the period, the MSCI Europe ex UK Index increased by 8.3%.

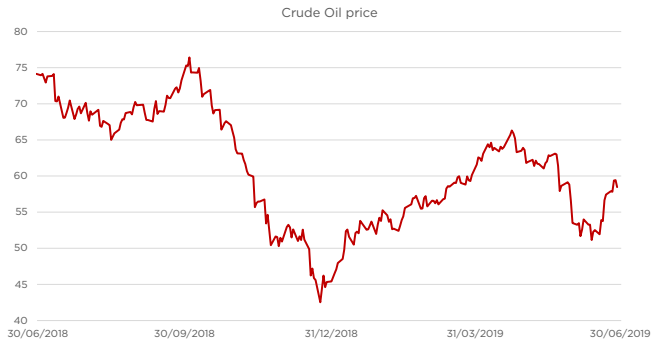
In Asia, China was the dominant factor as the previously mentioned trade war was prevalent. As Trump's trade tariffs kicked in, investors began to digest how much this could impact on Chinese growth and the Chinese central bank acted quickly, providing a cut to the amount capital banks have to hold in a hope of stimulating lending. They also cut both personal and corporate tax rates in a sign that they were prepared to act decisively. Away from China, India had a general election in what is said to be the largest democratic election in the world, with nearly 1 billion voters. Prime Minister Modi was re-elected with a majority, which should enable him to continue his reform agenda. Over the period, the MSCI AC Asia ex Japan Index fell in local currency terms, but increased by 1.7% in sterling.

In Japan, economic data showed strong growth in the first quarter, catching experts, who had expected the economy to contract, off guard. However, as ever, the devil is in the detail and analysis of the data showed that the GDP was pulled up by a sharp fall in imports rather than any strong underlying demand. In fact, a fall in exports and private demand pointed to a continued challenging outlook, particularly given the slowdown in neighbouring China. Over the quarter, the Topix Index was the worst performing major market, but for UK investors, the weakness in sterling actually meant that the Topix Index increased by 2.7% over the period.



Source: Bloomberg LP, AJ Bell Investments, July 2019

In the emerging markets, Russia was a very strong performer, as the country benefited from the rise in the oil price this year. With Gazprom and Lukoil making up a third of the Russian index, the rally in the price of 'black gold' this year has seen their share prices rally sharply, with Gazprom announcing a significant increase in its dividend. In Brazil, the stock market hit an all-time high despite the economy showing a contraction as confidence in President Bolsonaro fell and the growth rate for 2019 was slashed. During the period, MSCI announced changes to its emerging markers index which will see Saudi Arabia and Argentina added to the index while the weight of domestic Chinese equities continues to be increased. Over the period, this index was up by 3.0% while emerging markets fixed interest was the best performing asset class, with the JPMorgan GBI Emerging Market Global Composite Bond Index increasing by 8.3% over the period.



Source: AJ Bell Investments, July 2019

Asset Allocation Contributors

	Portfolio					
Top contributors*	MPS 1	MPS 2	MPS 3	MPS 4	MPS 5	MPS 6
1	Emerging Market Bonds	UK Corporate Bonds	UK Large Cap Equities	UK Large Cap Equities	North American Equities	North American Equities
2	North American Corporate Bonds	Health Care Equities	North American Equities	North American Equities	UK Large Cap Equities	Emerging Market Equities
3	UK Corporate Bonds	North American Equities	Technology Equities	Technology Equities	Technology Equities	Technology Equities

Source: AJ Bell Investments, Bloomberg LP, July 2019

All market performance figures are in GBP

Pactive Managed Portfolio review – Q2 2019

Pactive MPS performance

With a positive performance across equities and bonds, portfolios have delivered a positive performance during the second quarter. Overseas equity exposure was particularly beneficial – helped by the tailwind of weakening sterling – while fixed interest was also positive as yields tightened on the expectation of lower interest rates.

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, the core exposure from the Investec UK Alpha fund (Portfolio 3-6) outperformed the FTSE All Share Index, while the more defensively positioned Troy Trojan Income fund (Portfolio 1-6) marginally lagged behind a rising market. The Man GLG Undervalued Assets fund (Portfolio 1-6) was also behind as its tilt towards valued stocks was out of favour over the quarter after a strong start to the year. The Tellworth UK Smaller Companies fund (Portfolio 5-6) was very strong, with good outperformance of the broader market.

In the US, the JP Morgan US Equity Income fund (Portfolio 1-2) was a very good performer, as its focus on quality companies that generate cash was positive. The Dodge & Cox US Stock fund (Portfolio 3-6) was behind the index over the period, as its value style underperformed, while the US-focused Polar Cap Global Technology fund (Portfolio 3-6) also lagged behind the broader market as technology stocks struggled during June. The Xtrackers MSCI USA Healthcare ETF was positive, but behind the broad market, as the sector was hit by fears that the US government would change its approach to healthcare in April. These fears were unfounded and the sector recovered well.

In Europe, exposure comes from the Crux European Special Situations fund (Portfolio 2-6) and it performed well as equities had a strong quarter. With a focus on medium and smaller companies, this was a reversal of the first quarter when this approach lagged behind the market.

In Asia, our core exposure to the Invesco Asian fund (Portfolio 2-6) was ahead of its broad-based Asian benchmark, while the Schroder Asian Alpha Plus fund (Portfolio 4-6) was also marginally ahead of the index. The Stewart Asia Pacific Leaders fund (Portfolio 5-6) was a very strong relative performer as its focus on high quality companies was rewarded.

In emerging markets, the Fidelity Emerging Markets fund (Portfolio 4-6) was significantly ahead of the benchmark for the second quarter in a row, as exposure to Russian oil stocks was helpful, while the JP Morgan Emerging Markets Income fund (Portfolio 2-6) was also a strong performer, as its focus on quality, cash-generative companies was rewarded. The recently-added Lazard Emerging Markets fund (Portfolio 6) was a positive as its deep value approach outperformed the index.

In Japan, the Man GLG Japan CoreAlpha fund finished the quarter behind the Topix Index, as the market focused on growth and quality companies rather than the value approach taken by this fund. In the last quarter, the Evenlode Global Income fund was added (Portfolio 1-5) and was the best performer across all holdings in absolute terms, as its clear focus on high-quality companies was rewarded.

Fixed-interest markets performed strongly as central banks hinted at potential interest-rate cuts. The Lyxor UK Gilt 0-5yr ETF marginally increased but significantly lagged behind the broad-based gilt benchmark. Within UK corporate bonds, both the Fidelity MoneyBuilder Income (Portfolio 1-3) and TwentyFour Corporate Bond (Portfolio 1-4) funds delivered solid absolute returns. The big winner over the quarter was the iShares USD Corporate Bond ETF, as this part of the market rallied strongly.

Within the high-yield market, performance of the Baillie Gifford High Yield Bond fund (Portfolio 1-5) was good, comfortably outperforming the index, while the Royal London Short Duration Global High Yield Bond fund (Portfolio 1-4) delivered positive returns over the quarter. Outside of UK fixed interest, the M&G Emerging Markets Bond fund (Portfolio 1-5) was very strong in absolute terms.

The final area of the portfolio is the commercial property allocation, which continues to be zero-weighted due to expectations of weak performance and liquidity risks that have picked up over the period. In its place, the Janus Henderson UK Absolute Return fund (Portfolio 1-5) was slightly in negative territory over the quarter.

Portfolio changes

Given the very recent launch of the Pactive portfolios, no changes have been made at this stage. However, the share class for the Lazard Emerging Market fund was switched to a cheaper share class during the quarter.

Performance summary (all models)

Fund	3 months	6 months	1 year	Inception*
Pactive MPS 1	2.88%	-	-	-
Pactive MPS 2	3.62%	-	-	-
Pactive MPS 3	4.19%	-	-	-
Pactive MPS 4	4.34%	-	-	-
Pactive MPS 5	4.70%	-	-	-
Pactive MPS 6	4.89%	-	-	-

Source: Bloomberg LP, AJ Bell Investments, July 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.

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