

MANAGED PORTFOLIO SERVICE

Multi-asset investing  
made easy

QUARTERLY REPORTS 2018/2019



# Contents

Active MPS - Q2 2018

Passive MPS - Q2 2018

Active MPS - Q3 2018

Passive MPS - Q3 2018

Active MPS - Q4 2018

Passive MPS - Q4 2018

Active MPS - Q1 2019

Passive MPS - Q1 2019

Pactive MPS - Q1 2019





# Active Managed Portfolio Service – Q2 2018 report

## Introduction

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

As we reach the mid-way point in 2018, it has been the case of a tale of two halves, with the first quarter proving to be highly volatile with equity markets struggling to make headway, while in the second quarter, many major markets moved higher amid a less volatile backdrop. The overall picture has been one where Asian and emerging market equities have struggled while the UK and US have managed to deliver positive returns.

The constant in both quarters has been highly volatile currency markets which are having a large influence on the overall performance of assets, particularly for UK investors who are seeing big moves in the level of sterling this year.

What is clear is that major central banks, with the exception of Japan, are in a period of tightening which will ultimately constrain the availability of liquidity in global markets. The Federal Reserve increased rates over the period and indicated its intention to raise further well into 2019, while the ECB informed markets that it intends to stop its monthly bond buying programme at the end of the year. While the global economy continues to grow, albeit at a slower pace, these actions indicate that central banks are confident that companies have the ability to thrive without the constant need for a backstop in the economy.

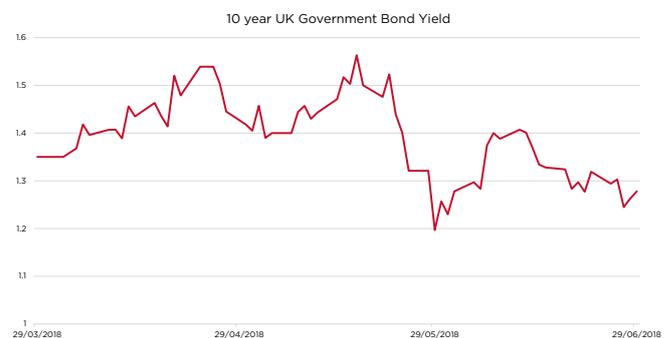
However, the onset of a trade war between the US and the rest of the world certainly has the potential to cause a few headaches as the year progresses. The risk coming from political factors is increasing across the world and we are cognisant that the intertwined nature of the global economy may mean that volatility picks up again and moves back to what would be considered more normal levels.

## Economic and market review

The second quarter of 2018 saw positive returns come from a number of equity markets, however, fixed interest markets were more challenged while Asia and the emerging markets suffered on the back of a large strengthening of the US dollar.

Having been one of the worst performers in the first quarter, the FTSE 100 Index was comfortably the strongest performing major market in the second quarter. While in Q1, the market was held back by strong sterling, in Q2, it was sterling weakness that was the major factor, helping those companies in the index that derive a significant proportion of their profits in US dollars deliver strong returns. Uncertainty over Brexit was certainly a major factor in this currency weakness, while indications from the Bank of England that the economy was perhaps not strong enough to cope with higher interest rates was seen positively by investors, in that low interest rates would be here for longer. This caution was reflected in the yield on the 10-year UK government gilt, which started the

period at 1.39%, widened out to 1.54% during April and May on expectations that rates would rise, before falling back sharply in late May and June when the Bank of England decided against the rate rise. At the end of the quarter, the yield was down to 1.33% reflecting a greater level of prudence amongst bond investors than is currently being seen by equity investors. This volatility in bond markets ultimately saw UK bond indices broadly flat over the quarter.



Source: Bloomberg LLP, AJ Bell Investments: July 2018

US equity markets continued their strong performance with a solid quarter from the S&P 500 Index helped by strong economic growth. Unemployment continued to fall and hit its lowest level since April 2000 at just 3.8% while GDP growth came in at 2% for the first quarter. This economic performance was enough for the Federal Reserve to have confidence that a rise in interest rates was warranted and as a result, the rate was increased by 0.25% in the June meeting. This was the seventh time the Fed has decided to raise interest rates since the end of ultra low rates was signalled in December 2016 and shows just how far the world's largest economy has moved on since Quantitative Easing, and the latest minutes from the Fed meeting indicated that further rises were likely over 2018 and into 2019. During the quarter, the 10-year US Treasury yield climbed back through 3% for the first time since 2012, before falling back beneath this level as the end of the quarter approached.

With the prospect of higher rates, the US dollar strengthened sharply over the period as the economic strength of the country proved attractive to investors. A move of over 6% against sterling helped significantly improve the return of US equities for UK investors once this was converted back to sterling, while the dollar also moved noticeably against the euro and the Japanese yen.



Source: Bloomberg LLP, AJ Bell Investments: July 2018

At a political level, Donald Trump was at the heart of some major developments over the period. Mid June saw the unexpected sight of Trump shaking hands with Kim Jong-un, leader of North Korea, in a summit held in Singapore. Both leaders declared themselves happy with the talks and indicated that efforts to de-nuclearise the Korean peninsula would begin shortly. While time will tell whether the desired outcome of the talks actually materialises, the world welcomed the progress made by the two countries who up until recently had traded insults across the Pacific.

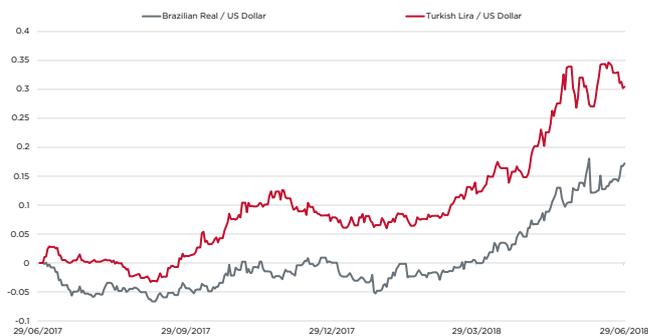
While Trump was making friends in North Korea, he was also doing his level best to upset leaders in Europe, Mexico, Canada and China with the imposition of a series of tariffs on imported goods. The US fired the opening salvo in the trade war with Europe and China, slapping a 25% tariff on steel imports and then Europe responded, introducing tariffs on nearly £2.5bn of US goods such as Harley Davidson motorbikes, whiskey and jeans, while China slapped tariffs on cars, planes and soybeans. This tit-for-tat trade war is a serious threat to the global economy and could reduce global growth as the cost of imports increases across the world. With Trump clearly pushing an 'American first' agenda, and with the knowledge that despite being the largest economy in the world, the US remains a relatively insular country that relies heavily on domestic demand, he is emboldened to take the fight to the rest of the world. Investors across the world continue to watch this developing story with concern and should it escalate further, it has the ability to create significant headwinds for the global economy.

A strong US dollar and trade wars meant that Asian and emerging markets struggled over the quarter, with both equity and bond markets falling back in these regions. In China, while economic growth was robust, the People's Bank of China saw it necessary to ease monetary conditions by cutting the reserve requirement ratio to help banks provide liquidity for smaller companies. Chinese data was particularly interesting over the period as it indicated a clear move towards building an economy reliant on domestic demand rather than simply being an exporter. This was reflected by data that showed that in the first quarter, 78% of the country's growth was driven by the domestic economy.

Over the quarter, there was clear divergence in country performance between the stronger nations and those with weaker economies. With the oil price increasing by over 13% during the period, those countries that are reliant on oil imports were hit particularly hard, and so were those countries that have issued significant government debt in US dollars, as their weakening currencies made US dollar-issued debt ever more expensive to service. Argentina was forced to call in the IMF for a \$50bn loan while Turkey and Brazil also saw their currencies weaken significantly. The result was very challenging performance of emerging market bonds over the quarter, with the JP Morgan GBI EM Index falling back sharply.



Source: Bloomberg LLP, AJ Bell Investments: July 2018



Source: Bloomberg LLP, AJ Bell Investments: July 2018

In Europe, there were signs that the economy was beginning to slow as economic indicators pointed to more challenging conditions. The real issue in Europe once again was politics, with the Five Star Movement in Italy finally forming a government after their choice of finance minister, and ardent anti-Euro campaigner was vetoed by the country's President. With a compromise reached, focus shifted to their plans for looser fiscal policies despite high levels of debt and the continuing issue of economic migrants but it is clear that with such strong rhetoric, there is likely to be further tension within the EU nations. Over the quarter, Italian equities unsurprisingly performed poorly given the instability within the country, while France was much stronger as the reform agenda being pushed by President Macron moved forward following a high profile spat with railway operator SNCF.

### Market outlook and our positioning

Overall, the second quarter was a period that saw significant divergence in the performance of major markets across the world. The main driver for all of this has been the currency markets and most importantly the strength of the US dollar, particularly for UK investors who have benefited from holding overseas assets as sterling has weakened. Looking ahead, with the US economy continuing to benefit from the Trump tax cuts, it seems plausible that the US dollar may stay strong for a while, particularly if other parts of the world begin to slow down as the impact of the strong dollar feeds through into the global economy, although, we may not see such a strong period of strengthening as we saw in this recent quarter.

The challenge ahead is to try and decipher the mixed messages that are now coming from both the equity and fixed interest markets. While equity investors seem broadly happy that corporate profits have the ability to keep growing from current levels, albeit perhaps at a slightly slower pace than we have been used to, fixed interest investors are pricing in a more unstable environment ahead. With an escalating trade war between the world's major nations, there is a clear risk that this could impact global economic growth, however, it is also clear that an all-out trade war is in nobody's best interests. Whether this rational thought is enough to stop certain world leaders is difficult to second guess!

On balance, we continue to see value in equity markets but it would be imprudent to assume that equity markets will simply move higher without some bumps in the road. As a result, our approach is to remain well diversified in each of the portfolios and not become overly reliant on any one area for returns.

Within the Active portfolios, we have two tactical positions in place, both designed to mitigate capital losses should economic conditions change. The first of these is to have our gilt exposure invested in short duration (less than five years) gilts as we expect interest rates to rise over time. This short duration exposure should limit the losses seen in gilts if this scenario occurs as we expect it to. The second position is actively deciding not to own UK commercial property on valuation grounds. In its place, we have instead invested in two absolute return strategies that offer low correlation to traditional assets

and importantly exhibit lower levels of volatility, similar to that of commercial property.

The first quarter reminded everyone that volatility can reappear quickly and while markets were a little more muted in the second quarter, it wouldn't be at all surprising if both equity and fixed interest markets saw an increase in volatility through the rest of the year.

## Active Managed Portfolio review – Q2 2018

### Introduction

On 19 February 2018, AJ Bell launched a range of actively managed portfolios (growth and income), adding further options to the AJ Bell Managed Portfolio Service to sit alongside the existing passively managed portfolios. This now brings the service up to 16 portfolios (eight active and eight passive) offering advisers a strong breadth of choice, with six growth portfolios and two income portfolios for both active and passive investors. The comments below relate to the model performance of the active portfolio range.

It brings great pleasure to report the first full quarter's performance for the AJ Bell Active Managed Portfolios, following a successful launch during the first quarter of 2018. We pride ourselves on transparency and feel it is important to provide regularly updates to advisers on the service; however, we would kindly remind readers that our underpinning investment philosophy remains long-term in nature.

### Active MPS Growth

Across the active growth range, the portfolios delivered a set of very strong absolute returns over the quarter, spurred on by a risk-on environment witnessed early on in the review period that ultimately tapered as the period came to a close. Since launch (19 February 2018) to the end of the second quarter of 2018, it is pleasing to report that all growth portfolios sit in positive territory.

At an overall level, an allocation to equities was a particularly strong contributor while fixed interest exposures yielded mixed results. Early on in the second quarter, equities benefited from both a continuation of strong economic data and a ramping up of M&A deals. The dedicated technology exposure, gained through a holding in the Polar Capital Global Technology fund (Portfolio 3-6) was a benefit as the sector continued to deliver, especial during the course of May 2018 with around 10% gains witnessed in that month alone. At the regional level, the strongest-performing areas included US and UK equities, which account for a large proportion of the equity component across all growth portfolios. US dollar strength accounted for some of the gain from US equities when reported in sterling terms. Equity markets however were not positive across the board, with emerging markets delivering negative absolute returns as US dollar strength impacted those economies directly and the portfolios' exposure here detracted from quarterly returns. Brazilian equities suffered on the back of further political uncertainty, falling by around 25% in sterling terms (Brazilian real weakness exacerbates the fall) over the quarter.

Within the fixed interest allocation, a number of the managers such as the Fidelity MoneyBuilder Income and TwentyFour Corporate Bond funds were broadly flat against their respective benchmarks. In the global bond sector, the M&G Global Macro Bond fund (Portfolio 1-4) performed very well, helped by its exposure to the US dollar while the M&G Emerging Markets Bond fund (Portfolio 1-5) managed to navigate some very challenging markets.

When looking at the equity allocation, the Investec UK Alpha fund (Portfolio 3-6) delivered a strong relative return against the FTSE All Share Index with stock selection proving to be beneficial particularly in the consumer and financials sectors.

In Asia, our core manager of Invesco Perpetual Asian (Portfolio 2-6) delivered a good positive return and also outperformed both its benchmark and the peer group, helped by exposure to the technology sector. On the negative side, both the Fidelity Emerging Markets fund (Portfolio 2-6) and the Man GLG Japan CoreAlpha fund underperformed their respective benchmarks. Man GLG Japan CoreAlpha suffered a headwind owing to its inherent biases towards value as an investment style, which has continued to struggle versus growth over the period. We remain confident in the long-term prospects of both of these strategies given our experience with each of the management teams.

From a Tactical Asset Allocation perspective, the lower-risk portfolios are underweight duration through exposure to the Lyxor FTSE Actuaries UK Gilts 0-5yr ETF (Portfolio 1-4) which invests in shorter-dated UK government bonds, and this proved to be ever so slightly beneficial over the quarter. The environment flickered between risk-on and risk-off and whilst the longer-duration gilts market delivered broadly flat returns, it was a very volatile period. Elsewhere, versus the long-term Strategic Asset Allocation, UK commercial property was not implemented due to concerns over the current valuation levels and potential economic headwinds. In its place, an allocation to two absolute return strategies, namely the M&G Absolute Return Bond fund (Portfolio 1-5) and the Janus Henderson UK Absolute Return fund. The ambition is to provide strong diversification away from traditional equities and bonds and give an element of capital preservation should equity markets see volatility increase further. Janus Henderson delivered a solid positive return over the period while M&G Absolute Return Bond was marginally negative. Both of these strategies underperformed UK commercial property over the short term.

Overall, the portfolios have behaved within our expectations from a risk/reward perspective during the recent quarter.

### Portfolio changes

As each of these growth portfolios follows a long-term investment approach, there have not been any changes to the underlying holdings or exposures, aside from market drift. We do however remain focused on ensuring that each of these portfolios is exposed to the most appropriate investments and therefore, should the need arise to undertake changes to the underlying holdings, we will not hesitate to alter the current portfolios' positioning.

### Active MPS Income

The absolute performance of the portfolios was strongly positive over the second quarter. This is mainly due to the portfolios' exposure to equities, which rebounded strongly from a period of weakness witnessed at the end of the first quarter. Since launch (19 February 2018) to the end of the second quarter of 2018, it is pleasing to report that both income portfolios sit in positive territory.

From a high level, an allocation to equities was a particularly strong contributor while fixed interest exposures yielded mixed results. Early on in the second quarter, equities benefited from both a continuation of strong economic data and a ramping up of M&A deals. Within equities, UK equities were a standout performer and account for a large portion of the equity component of the portfolios. Equity markets however were not positive across the board, with emerging markets delivering negative absolute returns as US dollar strength impacted those economies directly and the portfolios' exposure here detracted from quarter returns.

On a relative basis, the portfolios' contributors came from the Artemis Global Income and JPM Emerging Markets Income funds. The JPM Emerging Markets Income fund managed to protect against a weak market backdrop but was unable to cling on to a positive return. In a similar vein, the Jupiter Asian Income fund also performed well both in relative and absolute basis as

its focus on highly cash generative companies was rewarded amid investor uncertainty. On the flip side, the UK equity funds were positive but rose to a lesser extent than the FTSE All Share index, which was predominately driven by large caps where most active managers are structurally underweight.

Away from standard equity exposure, the dedicated infrastructure fund Premier Global Infrastructure Income delivered broadly a flat return, underperforming the benchmark in the main due to its exposure to emerging markets. Property exposure through both the iShares UK Property ETF and L&G Global Real Estate Dividend Index fund produced very strong performance over the period.

Overall, the portfolios have behaved within our expectations from a risk/reward perspective during the recent quarter.

**Portfolio changes**

As each of these income portfolios follows a long-term investment approach, there have not been any changes to the underlying holdings or exposures aside from market drift. We do however remain focused on ensuring that each of these portfolios is exposed to the most appropriate investments and therefore, should the need arise to undertake changes to the underlying holdings, we will not hesitate to alter the current portfolios' positioning.

<b>Fund</b>	<b>3 months</b>	<b>6 months</b>	<b>1 year</b>	<b>Inception*</b>
Active MPS 1	2.65%			1.39%
Active MPS 2	3.48%			1.34%
Active MPS 3	4.85%			2.13%
Active MPS 4	5.74%			2.54%
Active MPS 5	6.18%			2.64%
Active MPS 6	5.48%			2.47%
Active MPS Income 1	5.55%			1.83%
Active MPS Income 2	6.64%			3.89%

\*Active MPS launched on 19 February 2018.

Source: Bloomberg LLP



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.

## Passive Managed Portfolio Service – Q2 2018 report

### Introduction

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

As we reach the mid-way point in 2018, it has been the case of a tale of two halves, with the first quarter proving to be highly volatile with equity markets struggling to make headway, while in the second quarter, many major markets moved higher amid a less volatile backdrop. The overall picture has been one where Asian and emerging market equities have struggled while the UK and US have managed to deliver positive returns.

The constant in both quarters has been highly volatile currency markets which are having a large influence on the overall performance of assets, particularly for UK investors who are seeing big moves in the level of sterling this year.

What is clear is that major central banks, with the exception of Japan, are in a period of tightening which will ultimately constrain the availability of liquidity in global markets. The Federal Reserve increased rates over the period and indicated its intention to raise further well into 2019, while the ECB informed markets that it intends to stop its monthly bond buying programme at the end of the year. While the global economy continues to grow, albeit at a slower pace, these actions indicate that central banks are confident that companies have the ability to thrive without the constant need for a backstop in the economy.

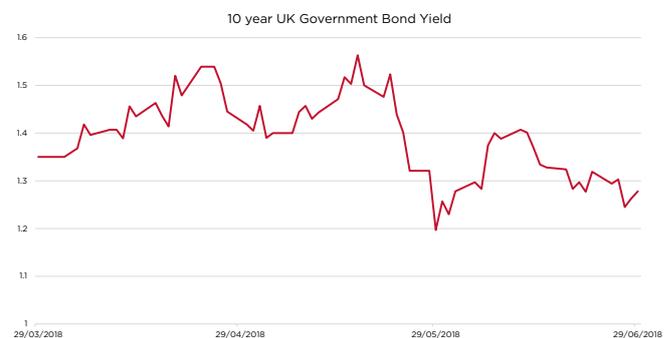
However, the onset of a trade war between the US and the rest of the world certainly has the potential to cause a few headaches as the year progresses. The risk coming from political factors is increasing across the world and we are cognisant that the intertwined nature of the global economy may mean that volatility picks up again and moves back to what would be considered more normal levels.

### Economic and market review

The second quarter of 2018 saw positive returns come from a number of equity markets, however, fixed interest markets were more challenged while Asia and the emerging markets suffered on the back of a large strengthening of the US dollar.

Having been one of the worst performers in the first quarter, the FTSE 100 Index was comfortably the strongest performing major market in the second quarter. While in Q1, the market was held back by strong sterling, in Q2, it was sterling weakness that was the major factor, helping those companies in the index that derive a significant proportion of their profits in US dollars deliver strong returns. Uncertainty over Brexit was certainly a major factor in this currency weakness, while indications from the Bank of England that the economy was perhaps not strong enough to cope with higher interest rates was seen positively by investors, in that low interest rates would be here for longer. This caution was reflected in the yield on the 10-year UK government gilt, which started the

period at 1.39%, widened out to 1.54% during April and May on expectations that rates would rise, before falling back sharply in late May and June when the Bank of England decided against the rate rise. At the end of the quarter, the yield was down to 1.33% reflecting a greater level of prudence amongst bond investors than is currently being seen by equity investors. This volatility in bond markets ultimately saw UK bond indices broadly flat over the quarter.



Source: Bloomberg LLP, AJ Bell Investments: July 2018

US equity markets continued their strong performance with a solid quarter from the S&P 500 Index helped by strong economic growth. Unemployment continued to fall and hit its lowest level since April 2000 at just 3.8% while GDP growth came in at 2% for the first quarter. This economic performance was enough for the Federal Reserve to have confidence that a rise in interest rates was warranted and as a result, the rate was increased by 0.25% in the June meeting. This was the seventh time the Fed has decided to raise interest rates since the end of ultra low rates was signalled in December 2016 and shows just how far the world's largest economy has moved on since Quantitative Easing, and the latest minutes from the Fed meeting indicated that further rises were likely over 2018 and into 2019. During the quarter, the 10-year US Treasury yield climbed back through 3% for the first time since 2012, before falling back beneath this level as the end of the quarter approached.

With the prospect of higher rates, the US dollar strengthened sharply over the period as the economic strength of the country proved attractive to investors. A move of over 6% against sterling helped significantly improve the return of US equities for UK investors once this was converted back to sterling, while the dollar also moved noticeably against the euro and the Japanese yen.



Source: Bloomberg LLP, AJ Bell Investments: July 2018

At a political level, Donald Trump was at the heart of some major developments over the period. Mid June saw the unexpected sight of Trump shaking hands with Kim Jong-un, leader of North Korea, in a summit held in Singapore. Both leaders declared themselves happy with the talks and indicated that efforts to de-nuclearise the Korean peninsula would begin shortly. While time will tell whether the desired outcome of the talks actually materialises, the world welcomed the progress made by the two countries who up until recently had traded insults across the Pacific.

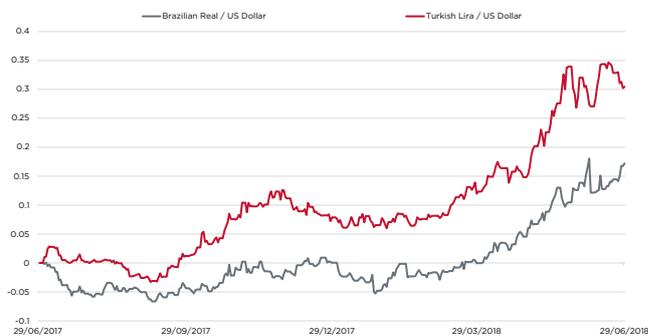
While Trump was making friends in North Korea, he was also doing his level best to upset leaders in Europe, Mexico, Canada and China with the imposition of a series of tariffs on imported goods. The US fired the opening salvo in the trade war with Europe and China, slapping a 25% tariff on steel imports and then Europe responded, introducing tariffs on nearly £2.5bn of US goods such as Harley Davidson motorbikes, whiskey and jeans, while China slapped tariffs on cars, planes and soybeans. This tit-for-tat trade war is a serious threat to the global economy and could reduce global growth as the cost of imports increases across the world. With Trump clearly pushing an 'American first' agenda, and with the knowledge that despite being the largest economy in the world, the US remains a relatively insular country that relies heavily on domestic demand, he is emboldened to take the fight to the rest of the world. Investors across the world continue to watch this developing story with concern and should it escalate further, it has the ability to create significant headwinds for the global economy.

A strong US dollar and trade wars meant that Asian and emerging markets struggled over the quarter, with both equity and bond markets falling back in these regions. In China, while economic growth was robust, the People's Bank of China saw it necessary to ease monetary conditions by cutting the reserve requirement ratio to help banks provide liquidity for smaller companies. Chinese data was particularly interesting over the period as it indicated a clear move towards building an economy reliant on domestic demand rather than simply being an exporter. This was reflected by data that showed that in the first quarter, 78% of the country's growth was driven by the domestic economy.

Over the quarter, there was clear divergence in country performance between the stronger nations and those with weaker economies. With the oil price increasing by over 13% during the period, those countries that are reliant on oil imports were hit particularly hard, and so were those countries that have issued significant government debt in US dollars, as their weakening currencies made US dollar-issued debt ever more expensive to service. Argentina was forced to call in the IMF for a \$50bn loan while Turkey and Brazil also saw their currencies weaken significantly. The result was very challenging performance of emerging market bonds over the quarter, with the JP Morgan GBI EM Index falling back sharply.



Source: Bloomberg LLP, AJ Bell Investments: July 2018



Source: Bloomberg LLP, AJ Bell Investments: July 2018

In Europe, there were signs that the economy was beginning to slow as economic indicators pointed to more challenging conditions. The real issue in Europe once again was politics, with the Five Star Movement in Italy finally forming a government after their choice of finance minister, and ardent anti-Euro campaigner was vetoed by the country's President. With a compromise reached, focus shifted to their plans for looser fiscal policies despite high levels of debt and the continuing issue of economic migrants but it is clear that with such strong rhetoric, there is likely to be further tension within the EU nations. Over the quarter, Italian equities unsurprisingly performed poorly given the instability within the country, while France was much stronger as the reform agenda being pushed by President Macron moved forward following a high profile spat with railway operator SNCF.

### Market outlook and our positioning

Overall, the second quarter was a period that saw significant divergence in the performance of major markets across the world. The main driver for all of this has been the currency markets and most importantly the strength of the US dollar, particularly for UK investors who have benefited from holding overseas assets as sterling has weakened. Looking ahead, with the US economy continuing to benefit from the Trump tax cuts, it seems plausible that the US dollar may stay strong for a while, particularly if other parts of the world begin to slow down as the impact of the strong dollar feeds through into the global economy, although, we may not see such a strong period of strengthening as we saw in this recent quarter.

The challenge ahead is to try and decipher the mixed messages that are now coming from both the equity and fixed interest markets. While equity investors seem broadly happy that corporate profits have the ability to keep growing from current levels, albeit perhaps at a slightly slower pace than we have been used to, fixed interest investors are pricing in a more unstable environment ahead. With an escalating trade war between the world's major nations, there is a clear risk that this could impact global economic growth, however, it is also clear that an all-out trade war is in nobody's best interests. Whether this rational thought is enough to stop certain world leaders is difficult to second guess!

On balance, we continue to see value in equity markets but it would be imprudent to assume that equity markets will simply move higher without some bumps in the road. As a result, our approach is to remain well diversified in each of the portfolios and not become overly reliant on any one area for returns.

Within the Passive portfolios, we have one tactical position in place, designed to mitigate capital losses should economic conditions change. Our gilt exposure is invested in short duration (less than five years) gilts as we expect interest rates to rise over time. This short duration exposure should limit the losses seen in gilts if this scenario occurs as we expect it to.

The first quarter reminded everyone that volatility can reappear quickly and while markets were a little more muted in the second quarter, it wouldn't be at all surprising if both equity and fixed interest markets saw an increase in volatility through the rest of the year.

## Passive Managed Portfolio review – Q2 2018

### Introduction

On 19 February 2018, further options were added to the AJ Bell Managed Portfolio Service to sit alongside the existing passively managed portfolios. This now brings the service up to 16 portfolios (eight active and eight passive) offering advisers a strong breadth of choice, with six growth portfolios and two income portfolios for both active and passive investors. The comments below relate to the model performance of the passive portfolio range.

It is now over four months since we launched our passive income options and added a sixth higher risk growth portfolio. This complements our five existing growth portfolios, which are fast approaching their second anniversary. We are pleased to see a strong performance track record building, consistent with our projections; an important factor in any outcome-orientated portfolio solution.

### Passive MPS Growth

Against a backdrop of strong equity performance in developed markets, weaker performance in emerging regions and benign returns for fixed income investments, we are pleased to see good absolute returns over the quarter, especially as volatility returns to the market. Back in February when we launched the new portfolios we also moved the asset allocation process in house, enabling us to add in additional asset classes, improving the diversification of the portfolios. We added higher risk asset classes such as Global Technology alongside lower risk assets such as short duration gilts and Emerging Market Debt. We also made the conscious decision to remove some of the currency risk in the portfolios in favour of taking more equity risk.

It's almost impossible to get all decisions right all the time, however on balance the changes have helped performance. The removal of currency risk hindered returns as the US dollar performed strongly, however a reallocation of risk to Global Technology – one of the best-performing markets over the quarter – more than offset this. Despite the weak performance of Emerging Market Debt when measured in dollar terms, this asset class did benefit from the positive performance of the dollar, increasing returns for a sterling investor.

On a longer-term view we are concerned about the current low yields on UK government securities. As such all our gilt positioning is in a short-dated (less than five years to maturity) gilt ETF. Over the quarter the decision to be in shorter bonds had a small positive effect, as the expectations of rate rises diminished on weaker economic data, and the CPI Index, the Bank of England's preferred inflation measure, stabilised at 2.4%. After years of easy monetary policy we believe the risk to inflation is on the upside, and therefore feel it is prudent to own short maturity bonds, which would suffer smaller capital losses in the event of an inflation spike, whilst still offering some protection against geopolitical and recessionary risks.

The entire range has exposure to UK property through investment in a UK REIT ETF. This performed strongly, outperforming physical property indices over the quarter as the discount to net asset value of the majority of the holdings in the ETF narrowed. Performance for the quarter ranged from 2.65% for our lowest-risk MPS 1 portfolio to 6.18% for our second-highest risk MPS 5 portfolio. Our highest risk portfolio delivered a slightly lower return of 5.48%, as Emerging Market and Asian equities underperformed developed markets such as the US and UK.

### Portfolio changes

As each of the growth portfolios follows a long-term investment approach, there have not been any changes to the underlying holdings or exposures, aside from market drift. We do however remain focused on ensuring that each of these portfolios is

exposed to the most appropriate investments and therefore, should the need arise to undertake changes to the underlying holdings, we will not hesitate to alter the current portfolios' positioning. We expect to make some changes on the 18 July rebalance date, with the dual focus of reducing third party OCFs and introducing new ETFs that meet the objectives of our asset allocation in a better fashion.

### Passive MPS Income

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

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

Over the quarter Income 1 delivered a total return of 5.55% and Income 2 delivered 6.64%, both ahead of their long-term objectives, as income generating sectors such as Oil and Gas performed particularly well. Our High Yield Bond exposure is denominated in dollars, and performance was boosted in Income 1 due to this currency position.

### Portfolio changes

As each of these income portfolios follows a long-term investment approach, there have not been any changes to the underlying holdings or exposures, aside from market drift. We do however remain focused on ensuring that each of these portfolios is exposed to the most appropriate investments and therefore, should the need arise to undertake changes to the underlying holdings, we will not hesitate to alter the current portfolios' positioning. We expect to make some changes on the 18 July rebalance date, with the dual focus of reducing third party OCFs and introducing new ETFs that meet the objectives of our asset allocation in a better fashion.

Fund	3 months	6 months	1 year	Inception*
Passive MPS 1	2.65%	0.14%	2.96%	4.0%
Passive MPS 2	3.48%	0.10%	3.72%	7.3%
Passive MPS 3	4.85%	1.00%	4.98%	10.8%
Passive MPS 4	5.74%	1.78%	6.19%	13.7%
Passive MPS 5	6.18%	1.48%	6.53%	15.3%
Passive MPS 6	5.48%			3.17%
Passive MPS Income 1	5.55%			5.11%
Passive MPS Income 2	6.64%			5.21%

\*MPS1-5 launched on 18 August 2016, MPS 6 and Income portfolios launched on 19 February 2018.

Source: Bloomberg LLP



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.



# Active Managed Portfolio Service – Q3 2018 report

## Introduction

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

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

## Summary

Over the course of the third quarter, many of the economic tensions that were highlighted in the last quarterly report continued to dominate the markets, with a clear disconnect between the US economy and much of the rest of the world. With the strong US dollar hampering Asia and the emerging markets, equity market returns differed significantly as the focus on fast-growing technology companies drove share prices higher in the US.

Away from the US, challenges around Brexit and European politics continued to be a factor that investors couldn't ignore and this created some instability in markets, while interest rate rises in both the US and the UK created a more difficult environment for fixed interest investments.

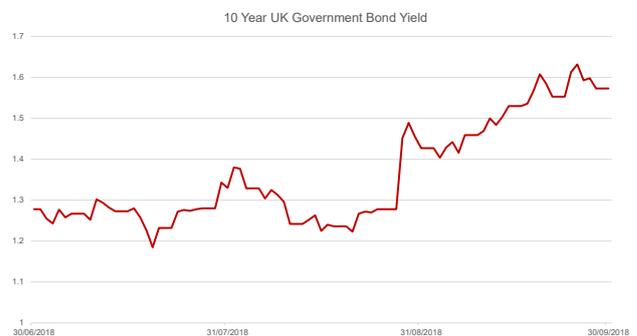
With the trade war escalating between the US and China, the risk of tensions spilling over into a more serious headwind for global growth remain and so investors have clearly been more circumspect in where they have been allocating to over the quarter. There seems little sign of this going away, particularly in the short term, and therefore our expectations are that volatility will increase back towards more normal levels in the coming months.

## Economic and market review

The third quarter of 2018 saw positive performance from equities at an overall level; however, this headline figure masked major regional differences as the fortunes of different economies dictated equity returns. Away from equities, fixed interest markets had a challenging quarter as tighter monetary policy, or at least the threat of it, saw yields in fixed interest rise and capital values fall back.

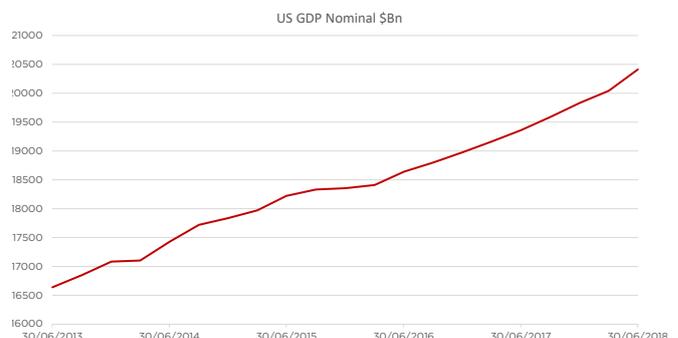
In the UK, unsurprisingly, the markets have been dictated by the direction of trade talks with the EU. While Theresa May hoped her Chequers plan would help steer the UK to a deal with the EU, it became clear as the quarter progressed that this was highly unlikely, with the EU publicly denouncing the proposal at a summit in Salzburg. However, EU officials did make some hints that a deal could be done and this led to sterling regaining some ground against the US dollar, ending the quarter down 1%. With so much revenue in the UK stock market derived from overseas, this currency move held back the market and it ultimately ended the quarter in negative territory. The Bank of England delivered a well flagged interest rate rise in August as economic growth was in line with expectations at 1.5%, helped by consumer spending as England exceeded expectations in the World Cup, while unemployment continued to fall, hitting its lowest level since 1975. These economic conditions saw the 10-year government

bond yield move from 1.33% up to 1.60% over the quarter and consequently, the FTSE Actuaries UK Conventional Gilts All Stocks Index fell back 1.7%. Corporate bonds offered a little more protection from these rising rates but the iBoxx UK Sterling All Maturities Index still fell back slightly over the quarter, however high yield bonds were stronger performers, with the Bloomberg Barclays Global High Yield Bond Index growing by 1.9% over the period.



Source: Bloomberg LLP, AJ Bell Investments: October 2018

As has been the case so often, the US market was the strongest-performing region, as economic growth continued to power ahead with the S&P 500 Index growing by 7.6% over the quarter. The latest GDP data showed a 4.2% expansion in the economy while unemployment remained close to an 18-year low as business and consumer confidence, helped by higher earnings, continued to show the economy was in rude health. With this strong economic position, it was no surprise that the Federal Reserve saw fit to increase interest rates as the quarter came to an end and told the market it expected another rise before the year was out. The challenge for Chairman Jerome Powell will now be to control the rate of growth and inflation without the economy getting too hot and interest rates needing to be raised faster than the market expects. In the US government bond market, the yield on the 10-year Treasury climbed back above the 3% level to hit its highest point since mid 2011.



Source: Bloomberg LLP, AJ Bell Investments: October 2018

With Donald Trump sticking resolutely to his 'America first' policy, trade tensions between the US and China escalated sharply over the quarter. With the previously announced trade tariffs coming into force during August, Trump went even further and threatened to apply additional tariffs on a further \$200bn of Chinese goods, while also berating the Chinese economic model at a meeting of the United Nations. Initial data out of China showed that the tariffs were already having an effect, with exports to the US falling 2.5% in July.

The trade policy did not only have an impact on China as the strong US dollar weighed heavily on Asia and the emerging markets during the quarter. With a large number of countries having issued government bonds in US dollars, the sharp move in the exchange rate has hit a number of economies hard, including Turkey, India, South Africa and Argentina. Turkey has been hit particularly hard as the US punished the nation for imprisoning a US citizen through punitive tariffs on Turkish steel and aluminium and this has seen the Turkish lira lose over 40% against the US dollar this year. These challenges were reflected in the performance of emerging market debt, with the J.P. Morgan GBI Emerging Market Global Composite Bond Index falling back 1.4% over the period.



Source: Bloomberg LLP, AJ Bell Investments: October 2018

The strong US dollar theme was a continuation of that seen in previous quarters and this made it difficult for Asian and emerging markets to perform. With the Indian rupee losing 5.6% against the dollar and the Chinese renminbi down 3.6% against the dollar, it is clear that some fragility exists in these economies. This has translated itself into equity performance with China and Hong Kong hitting bear market levels with sharp pull backs this year. As a result, the MSCI Emerging Market Index was flat over the quarter while the MSCI AC Asia ex Japan Index was down 1% over the quarter.

Remaining in Asia, Japan had a remarkably strong quarter, powering the Nikkei 225 Index close to levels last seen 27 years ago. This was helped by Prime Minister Abe surviving a no confidence vote and a leadership challenge during the quarter with his opponents looking to capitalise on a number of scandals that have recently dogged his administration. Economic data was improved over the quarter with GDP growth coming in the strongest since early 2017 and noticeably ahead of expectations, helped by strong private demand. A tight labour market saw wage growth hit its highest level for over 20 years and the Bank of Japan will now be hopeful that this translates into higher inflation. With a massive Quantitative Easing programme and zero interest rates, the Bank of Japan changed tack on its policy, with a view to having more flexibility on its yield curve management. This led to a steepening of the yield curve as investors begin to seek greater yield for longer-dated maturities and this shift also saw the government bond yield of other major economies move higher.



Source: Bloomberg LLP, AJ Bell Investments: October 2018

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

In Europe, economic data improved from a challenging time during the last quarter when data pointed to a slowing economy. Thankfully, GDP growth was revised upwards to 2.2% while inflation also hit the 2% mark as a number of economic indicators, particularly in Germany, showed that confidence was once again picking up. The European Central Bank made no changes to policy over the quarter but did confirm to the market its intention to withdraw Quantitative Easing at the end of the year. The terrible bridge collapse in Genoa in August focused attention on Italy as the government there continues to challenge the EU on its budget plans. This issue is likely to come to a head in early October which will likely make for some volatility in Italian equity and debt markets in the short term.

### Market outlook and our positioning

The third quarter was one of significant growth in equity markets when taken on an aggregate level. However, beneath the surface, this headline growth masks a significant divergence in performance that has been led by the US on the back of President Trump's economic stimulus but has simultaneously hit other regions that have suffered due to the strong US dollar. The key question is how long can this continue for and what is already priced in? While the insular nature of the US economy means that it is possible for it to continue to grow while the rests of the world slows, there will come a time when a tipping point is reached.

As ever, it seems fixed interest markets are a little ahead of equity markets and are foreseeing a more challenging outlook but while earnings growth continues in the US and the world's largest economy keeps expanding, it seems possible that equity markets may move higher still. Ultimately, the question may be at what cost to the rest of the world? Emerging markets and Asian economies have certainly been hit hard over the summer and the significant valuation gap that already existed between the US and these markets has only got wider.

In fixed interest markets, we continue with our UK gilts exposure being held entirely in short duration bonds i.e. gilts that mature in less than five years. This position is designed to cushion the blow from rising interest rates and this played out over the third quarter with our short duration gilts outperforming standard gilts as interest rate expectations increased.

Overall, we continue to see opportunities in equity markets but as we highlighted in our last report, we expect to see some increased volatility. This played out in emerging markets and Asia during the summer and could well continue as we enter the latter stages of 2018. As a result, we remain diversified and ready to act should we feel that economic conditions are such that action is required to protect the portfolios further.

## Active Managed Portfolio review – Q3 2018

### Active MPS Growth

Amid a much more challenging environment, it is pleasing to report that all of the portfolios managed to deliver a positive return, albeit much more modest than the previous quarter. From their launch in February, all six portfolios have also delivered positive performance.

At a headline level, the allocation to equities was a positive contributor over the period, while fixed interest exposure held back absolute returns. Global equities were up in aggregate terms as economic growth continued to expand, although this was heavily skewed towards the US which motored ahead, fuelled by President Trump's tax cuts and buoyant business and consumer confidence. In the US it was a strongly focused growth market with technology stocks doing particularly well again. With a large proportion of the US exposure coming from a holding in the passively managed Fidelity US Index, the portfolios managed to capture a significant element of this growth. Alongside this passive holding, there is dedicated technology exposure from the Polar Cap Global Technology fund (Portfolio 3-6) and this was particularly beneficial given the market's focus on technology stocks, delivering over 9% during the quarter.

Away from the US, exposure to Japanese equities was helpful in absolute terms. Man GLG Japan Core Alpha performed strongly, growing by over 6% as its value bias was rewarded and this resulted in outperformance of the Topix Index. In Asia, our core exposure to the Invesco Asian fund (Portfolio 2-6) was marginally ahead of its broad-based Asian benchmark. During the period, it was announced that Stuart Parks, who was the previous manager and was acting as an adviser to the fund, was retiring, however, this news hasn't changed our view of the holding given manager Will Lam's long association with the fund. In emerging markets, it was a very challenging environment and our core exposure to the Fidelity Emerging Markets fund (Portfolio 2-6) underperformed sharply as did our more aggressive holding in Jupiter Global Emerging Markets (Portfolio 5-6). Both of these managers were hit by company exposure in Turkey while Chinese equities also performed poorly. While this performance is disappointing, we retain our conviction in these holdings for the long term.

Closer to home, European equities performed well in sterling terms, helped by a weaker currency. Our exposure through the Crux European Special Situations fund (Portfolio 2-6) marginally underperformed as manager Richard Pease focuses away from the mega cap stocks that performed well over this period. In the UK, equities were negative over the quarter but two of our managers performed well, delivering a positive return. Both the Troy Trojan Income fund (Portfolio 1-6) and the Merian UK Smaller Companies fund (formerly called Old Mutual) (Portfolio 6) performed well, albeit utilising very different approaches. Core holding, the Investec UK Alpha fund (Portfolio 3-6) was flat to the index while the Man GLG Undervalued Assets fund (Portfolio 2-6) was a little behind the index.

Within fixed interest, markets were much more challenged as interest rates increased in the US and the UK while expectations of future rises also increased. Both the Fidelity MoneyBuilder Income fund (Portfolio 1-3) and the TwentyFour Corporate Bond fund (Portfolio 1-4) outperformed their passive equivalents. Away from UK bonds, the M&G Global Macro Bond fund outperformed the passive equivalent while the M&G Emerging Markets Bond fund delivered a positive return and outperformed its peer group.

Looking at the tactical asset allocation positions, the lower-risk portfolios remain tilted towards shorter duration gilts on expectations of rising interest rates over time and this has been referenced earlier. The second position is to keep away from physical commercial property owing to challenges that may occur as the economy slows and as uncertainty

escalates around Brexit. Late in the quarter, we saw signs that commercial property may be moderating and therefore we retain conviction in the M&G Absolute Return Bond fund and the Janus Henderson UK Absolute Return fund that are held in replacement of property exposure.

Overall, the portfolios have behaved within our expectations from a risk/reward perspective during the recent quarter.

### Portfolio changes

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

During the period, we did make one share class switch where we managed to move to a cheaper share class for the Troy Trojan Income fund, helping to keep the portfolio costs as low as possible.

### Active MPS Income

After a very strong second quarter in absolute terms, both Income portfolios had a more muted quarter, but both still managed to deliver a positive return.

At a headline level, equities performed well over the period which was positive for overall portfolio returns, however, the income style of investing lagged the broader market which was much more focused on growth companies. Strongest performance in the portfolio came from the Artemis Global Income fund which performed well in absolute terms and was broadly in line with its peer group. While emerging markets broadly had a difficult quarter as the strength of the US Dollar weighed on many economies, it was pleasing to see that the JPMorgan Emerging Markets Income fund had a good quarter, significantly outperforming the MSCI Emerging Markets Index. It was a similar story with our Asian equity exposure where the defensive nature of the Jupiter Asian Income fund came to the fore, outperforming the MSCI AC Asia ex Japan benchmark and delivering a positive return while broader markets were negative.

Closer to home, those same defensive characteristics were actually a negative in Europe where equities performed well on the back of improving economic prospects. The BlackRock Continental European Income fund performed well in absolute terms but marginally underperformed the MSCI Europe ex UK Index.

In the UK, equities had a more challenging summer and as a result, the FTSE All Share finished the quarter in negative territory. Against this backdrop, the Troy Trojan Income fund, which focuses on higher quality companies that have positive cash flow, performed well, managing to deliver a positive return and significantly outperforming the peer group. Alongside Troy, the Man GLG UK Income fund and the Montanaro UK Income fund both managed to outperform the peer group as their exposure to smaller companies was beneficial to performance.

Looking at the alternative exposure, the allocation to infrastructure equities was negative as the Premier Global Infrastructure holdings had a tough summer. This was due to their exposure to emerging markets infrastructure companies, particularly in China that were sold off along with the rest of emerging market equities. The allocation to property equities was also a detractor over the quarter with the iShares Property ETF falling sharply over the quarter after a strong period of performance. Late in the quarter, this holding was replaced with the iShares MSCI UK Target Real Estate ETF which offers lower-risk exposure to the asset class via holding index-linked gilts alongside property equities. A more detailed note on this change can be found on our website.

In the fixed interest holdings (Income 1 only), the highlight was the exposure to the Baillie Gifford High Yield Bond fund and M&G Emerging Markets Bond fund which both managed to deliver positive returns over the quarter. The core UK corporate bond exposure via the TwentyFour Corporate Bond fund and the Royal London Corporate Bond fund was slightly negative as the market sold off, while the exposure to UK gilts was mildly negative in absolute terms, however, the focus on short duration gilts was hugely beneficial in protecting capital from the fall in the broader gilt market over the quarter.

While the overall absolute level of performance of the portfolios over the quarter has been frustrating given how strong some equity markets have been, it has been pleasing to see that where markets have sold off, the income characteristics of the investments have proved to be defensive.

**Portfolio changes**

Late in the quarter, two changes were made to the portfolios. Firstly, as previously mentioned, the iShares Property ETF was replaced with the iShares MSCI UK Target Real Estate ETF to effectively lower the exposure to geared property equities. This change had no effect on the overall cost of the portfolio.

The second change occurred in the Income 2 portfolio, where an investment in the Newton Global Income fund was made. This fund has been introduced to the portfolio with a weight of 8% which has been funded from the Artemis Global Income fund and as a result, the weight here has fallen from 18% to 10%. The change improves the overall blend of the portfolio, as the two funds are very complementary. More detailed information on this change is available on our website.

Additionally, during the quarter, we were able to switch share classes on both the Troy Trojan Income fund and the Premier Global Infrastructure fund to help lower the overall costs on the portfolio.

Fund	3 months	6 months	1 year	Inception*
Active MPS 1	0.73%	2.59%		2.00%
Active MPS 2	1.07%	3.67%		2.31%
Active MPS 3	1.39%	5.28%		3.48%
Active MPS 4	1.45%	6.22%		4.03%
Active MPS 5	1.19%	6.53%		3.86%
Active MPS 6	0.67%	6.03%		3.15%
Active MPS Income 1	0.02%	2.86%		1.97%
Active MPS Income 2	0.27%	5.98%		4.52%

\*Active MPS launched on 19 February 2018.  
Source: Bloomberg LLP



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.



# Passive Managed Portfolio Service – Q3 2018 report

## Introduction

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

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

## Summary

Over the course of the third quarter, many of the economic tensions that were highlighted in the last quarterly report continued to dominate the markets, with a clear disconnect between the US economy and much of the rest of the world. With the strong US dollar hampering Asia and the emerging markets, equity market returns differed significantly as the focus on fast-growing technology companies drove share prices higher in the US.

Away from the US, challenges around Brexit and European politics continued to be a factor that investors couldn't ignore and this created some instability in markets, while interest rate rises in both the US and the UK created a more difficult environment for fixed interest investments.

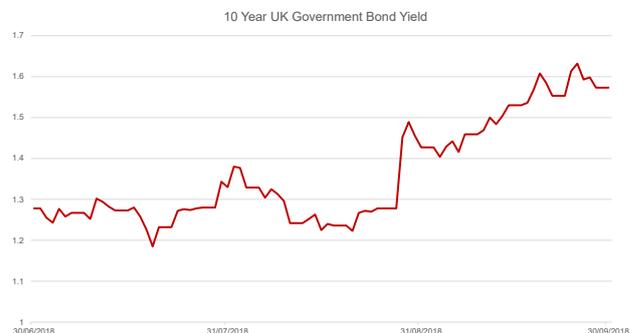
With the trade war escalating between the US and China, the risk of tensions spilling over into a more serious headwind for global growth remain. As a result, investors have clearly been more circumspect in where they have been allocating to over the quarter. There seems little sign of this going away, particularly in the short term and, therefore, our expectations are that volatility will increase back towards more normal levels, in the coming months.

## Economic and market review

The third quarter of 2018 saw positive performance from equities at an overall level; however, this headline figure masked major regional differences as the fortunes of different economies dictated equity returns. Away from equities, fixed interest markets had a challenging quarter as tighter monetary policy, or at least the threat of it, saw yields in fixed interest rise and capital values fall back.

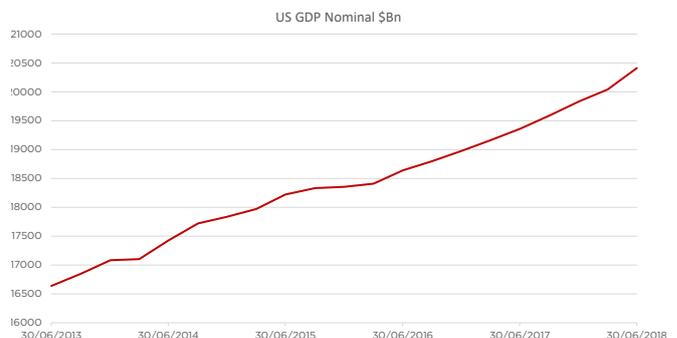
In the UK, unsurprisingly, the markets have been dictated by the direction of trade talks with the EU. While Theresa May hoped her Chequers plan would help steer the UK to a deal with the EU, it became clear as the quarter progressed that this was highly unlikely, with the EU publically denouncing the proposal at a summit in Salzburg. However, EU officials did make some hints that a deal could be done and this led to sterling regaining some ground against the US dollar, ending the quarter down 1%. With so much revenue in the UK stock derived from overseas, this currency move held back the market and it ultimately ended the quarter in negative territory. The Bank of England delivered a well flagged interest rate rise in August as economic growth was in line with expectations at 1.5%, helped by consumer spending as England exceeded expectations in the World Cup, while unemployment continued to fall, hitting its lowest level since

1975. These economic conditions saw the 10-year government bond yield move from 1.33% up to 1.60% over the quarter and consequently, the FTSE Actuaries UK Conventional Gilts All Stocks Index fell back 1.7%. Corporate bonds offered a little more protection from these rising rates but the iBoxx UK Sterling All Maturities Index still fell back slightly over the quarter, however high yield bonds were stronger performers, with the Bloomberg Barclays Global High Yield Bond Index growing by 1.9% over the period.



Source: Bloomberg LLP, AJ Bell Investments: October 2018

As has been the case so often, the US market was the strongest-performing region, as economic growth continued to power ahead with the S&P 500 Index growing by 7.6% over the quarter. The latest GDP data showed a 4.2% expansion in the economy while unemployment remained close to an 18-year low as business and consumer confidence, helped by higher earnings, continued to show the economy was in rude health. With this strong economic position, it was no surprise that the Federal Reserve saw fit to increase interest rates as the quarter came to an end and told the market it expected another rise before the year was out. The challenge for Chairman Jerome Powell will now be to control the rate of growth and inflation without the economy getting too hot and interest rates needing to be raised faster than the market expects. In the US government bond market, the yield on the 10-year Treasury climbed back above the 3% level to hit its highest point since mid 2011.



Source: Bloomberg LLP, AJ Bell Investments: October 2018

With Donald Trump sticking resolutely to his ‘America first’ policy, trade tensions between the US and China escalated sharply over the quarter. With the previously announced trade tariffs coming into force during August, Trump went even further and threatened to apply additional tariffs on a further \$200bn of Chinese goods, while also berating the Chinese economic model at a meeting of the United Nations. Initial data out of China showed that the tariffs were already having an effect, with exports to the US falling 2.5% in July.

The trade policy did not only have an impact on China as the strong US dollar weighed heavily on Asia and the emerging markets during the quarter. With a large number of countries having issued government bonds in US dollars, the sharp move in the exchange rate has hit a number of economies hard, including Turkey, India, South Africa and Argentina. Turkey has been hit particularly hard as the US punished the nation for imprisoning a US citizen through punitive tariffs on Turkish steel and aluminium and this has seen the Turkish lira lose over 40% against the US dollar this year. These challenges were reflected in the performance of emerging market debt, with the J.P. Morgan GBI Emerging Market Global Composite Bond Index falling back 1.4% over the period.



Source: Bloomberg LLP, AJ Bell Investments: October 2018

The strong US dollar theme was a continuation of that seen in previous quarters and this made it difficult for Asian and emerging markets to perform. With the Indian rupee losing 5.6% against the dollar and the Chinese renminbi down 3.6% against the dollar, it is clear that some fragility exists in these economies. This has translated itself into equity performance with China and Hong Kong hitting bear market levels with sharp pull backs this year. As a result, the MSCI Emerging Market Index was flat over the quarter while the MSCI AC Asia ex Japan Index was down 1% over the quarter.

Remaining in Asia, Japan had a remarkably strong quarter, powering the Nikkei 225 Index close to levels last seen 27 years ago. This was helped by Prime Minister Abe surviving a no confidence vote and a leadership challenge during the quarter with his opponents looking to capitalise on a number of scandals that have recently dogged his administration. Economic data was improved over the quarter with GDP growth coming in the strongest since early 2017 and noticeably ahead of expectations, helped by strong private demand. A tight labour market saw wage growth hit its highest level for over 20 years and the Bank of Japan will now be hopeful that this translates into higher inflation. With a massive Quantitative Easing programme and zero interest rates, the Bank of Japan changed tack on its policy, with a view to having more flexibility on its yield curve management. This led to a steepening of the yield curve as investors begin to seek greater yield for longer-dated maturities and this shift also saw the government bond yield of other major economies move higher.



Source: Bloomberg LLP, AJ Bell Investments: October 2018

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

In Europe, economic data improved from a challenging time during the last quarter when data pointed to a slowing economy. Thankfully, GDP growth was revised upwards to 2.2% while inflation also hit the 2% mark as a number of economic indicators, particularly in Germany, showed that confidence was once again picking up. The European Central Bank made no changes to policy over the quarter but did confirm to the market its intention to withdraw Quantitative Easing at the end of the year. The terrible bridge collapse in Genoa in August focused attention on Italy as the government there continues to challenge the EU on its budget plans. This issue is likely to come to a head in early October which will likely make for some volatility in Italian equity and debt markets in the short term.

### Market outlook and our positioning

The third quarter was one of significant growth in equity markets when taken on an aggregate level. However, beneath the surface, this headline growth masks a significant divergence in performance that has been led by the US on the back of President Trump’s economic stimulus but has simultaneously hit other regions that have suffered due to the strong US dollar. The key question is how long can this continue for and what is already priced in? The insular nature of the US economy means that it is possible for it to continue to grow, whilst the rest of the work slows, however, there will come a time when a tipping point is reached.

As ever, it seems fixed interest markets are a little ahead of equity markets and are foreseeing a more challenging outlook but while earnings growth continues in the US and the world’s largest economy keeps expanding, it seems possible that equity markets may move higher still. Ultimately, the question may be at what cost to the rest of the world? Emerging markets and Asian economies have certainly been hit hard over the summer and the significant valuation gap that already existed between the US and these markets has only got wider.

In fixed interest markets, we continue with our UK gilts exposure being held entirely in short duration bonds i.e. gilts that mature in less than five years. This position is designed to cushion the blow from rising interest rates and this played out over the third quarter with our short duration gilts outperforming standard gilts as interest rate expectations increased.

Overall, we continue to see opportunities in equity markets but as we highlighted in our last report, we expect to see some increased volatility. This played out in emerging markets and Asia during the summer and could well continue as we enter the latter stages of 2018. As a result, we remain diversified and ready to act should we feel that economic conditions are such that action is required to protect the portfolios further.

## Passive Managed Portfolio review – Q3 2018

### Introduction

On 19 February 2018, further options were added to the AJ Bell Managed Portfolio Service to sit alongside the existing passively managed portfolios. This now brings the service up to 16 portfolios (eight active and eight passive) offering advisers a strong breadth of choice, with six growth portfolios and two income portfolios for both active and passive investors. The comments below relate to the model performance of the passive portfolio range.

The five original passive portfolios passed through their second anniversary during the quarter. We produced an article (you can find it [here](#)) summarising how the portfolios have performed over the last two years. For those of you who don't have time to read the article; we have stolen the motto of a well-known fence care brand – they are doing exactly what it says on the tin!

AJ Bell Investments produces an article every month which aims to be thought-provoking and to provide an insight as to what is going on under the bonnet. In August it was passive's turn, and we took the opportunity to [explain](#) how index providers are driving the industry. It perhaps helps to show that picking passive funds within our MPS is not just picking the products with the cheapest cost. If you have any questions on either piece, or are interested to hear in more detail about some of the work the passive team undertakes, please do not hesitate to get in touch with your AJ Bell contact.

### Passive MPS Growth

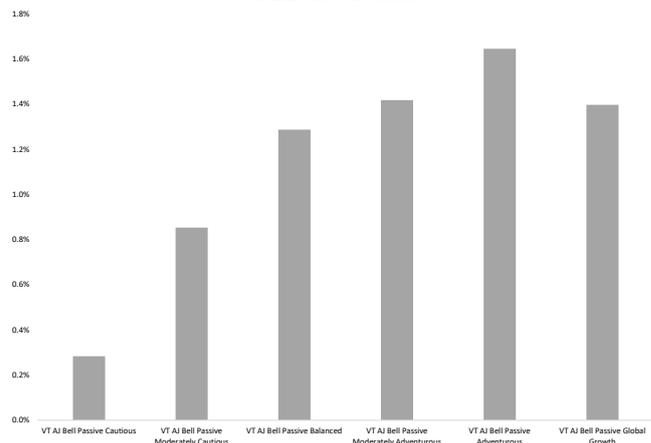
The quarter was punctuated by a few performance outliers, with everything else tightly bunched and therefore the performance of the portfolios hinged on our weightings in a few key asset classes.

The US was top of the equity market leader board, up 9% over the quarter. This was hotly followed by Japan, up over 7% in sterling terms. The remaining equity regions across the globe were closely grouped, ranging from -1% to +1%. A similar pattern emerged in the fixed income markets; high yield and emerging market debt (hard currency) performed well, both up 3% in sterling terms over the quarter. However, all other major fixed income asset classes delivered negative returns over the last three months.

The strategic asset allocation is designed in such a way as to maximise return for the level of risk taken. To achieve this the allocation has to be suitably diversified and as such has a bias to be underweight the US (which makes up over half of global equity markets) and overweight the UK, as this reduces the currency risk in the portfolio, helping to lower volatility. These biases therefore detracted over the quarter when compared to the 'market portfolio', i.e. a portfolio invested in regions based on their relative sizes. However, these detractors were offset by our use of other asset classes. Our riskiest portfolios have a significant exposure to the technology sector, up 9% over the quarter. With the exception of MPS 6 all the portfolios are overweight Japan, again versus the 'market portfolio'. For fixed income we have diversified away from the traditional asset classes held by UK-based multi asset funds (gilts and corporate bonds), with holdings in emerging market debt, global high yield bonds and global investment grade bonds. This has helped performance, in particular for our lower-risk portfolios, where weightings to defensive asset classes are higher.

All our growth portfolios delivered a positive return over the quarter, a pleasing outcome given the negative performance of many fixed income markets. In addition, the return of the portfolios improved as the amount of risk taken increased – in line with how the portfolios are designed.

Q3 2018 Passive Fund Returns



Passive MPS Growth Portfolios Q3 2018 return.

Source: Bloomberg, AJ Bell

### Portfolio changes

As telegraphed in our Q2 review, a number of changes were made to our growth portfolios at the 18 July 2018 rebalance. An explanation of all the changes, including those made to the income portfolios, can be found [here](#).

The rationales for the changes fitted into one of three categories:

- Cost reduction
- A better reflection of the asset class we are tracking
- Additional diversification benefits

We introduced a cheaper hedged S&P 500 ETF into our MPS 5 portfolio. The old and new holdings were both managed by iShares (BlackRock), as such it was simply a case of implementing a newer (cheaper) product into this portfolio.

We switched our property holdings in all our portfolios, switching from the iShares UK Property ETF to the iShares MSCI Target Real Estate ETF. The MSCI product combines REIT investments with short-dated inflation-linked gilts, producing a return profile more akin to physical property investments.

Finally, we introduced a new holding in our MPS 6 portfolio. We diversified our holding in technology, introducing a 3% weight to iShares Automation & Robotics ETF.

### Passive MPS Income

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

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

Over the quarter Income 1 delivered a total return of 0.74% and Income 2 delivered 1.98%, this is pleasing to see as it backs up a very strong Q2 return to bring the return since we launched the portfolios on 19 February this year to 5.89% and 7.29% respectively. Our exposures to global equities and bonds were the main contributors to performance in Income 1, with UK equities, bonds and property proving to be detractors. Our Income 2 portfolio has no exposure to bonds, as such it outperformed Income 1. In a similar pattern, international investments drove returns over the quarter.

### Portfolio changes

As telegraphed in our Q2 review a number of changes were made to our income portfolios at the 18 July 2018 rebalance. An explanation of all the changes, including those made to the growth portfolios, can be found [here](#).

Mirroring the rationale for the growth changes, new positions were implemented to either reduce the underlying OCF or improve benchmark tracking. In some cases the changes achieved both objectives.

We also switched our property holdings in the income portfolios, switching from the iShares UK Property ETF to the iShares MSCI Target Real Estate ETF. The MSCI product combines REIT investments with short-dated, inflation-linked gilts, producing a return profile more akin to physical property investments.

In addition we made a further change in our Income 1 portfolio, switching our high yield ETF from iShares to BMO. This allowed us to move into a hedged share class, move to an ETF that tracks global high yield more closely, and as a bonus has an OCF of 0.35%, 5bps less than the iShares ETF. This had the effect of cutting the overall synthetic OCF of Income 1 from 0.34% to 0.33%.

### Performance summary

MPS	3 months	6 months	1 year	Inception*
Passive MPS 1	0.44%	3.10%	3.25%	4.50%
Passive MPS 2	0.98%	4.49%	4.36%	8.37%
Passive MPS 3	1.44%	6.36%	5.94%	12.36%
Passive MPS 4	1.66%	7.50%	7.06%	15.63%
Passive MPS 5	1.90%	8.20%	7.51%	17.48%
Passive MPS 6	1.82%	7.39%		5.05%
Passive MPS Income 1	0.74%	6.33%		5.89%
Passive MPS Income 2	1.98%	8.75%		7.29%

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

Source: Bloomberg LLP



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.

## Active Managed Portfolio Service – Q4 2018 report

### Introduction

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

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

### Summary

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

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

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

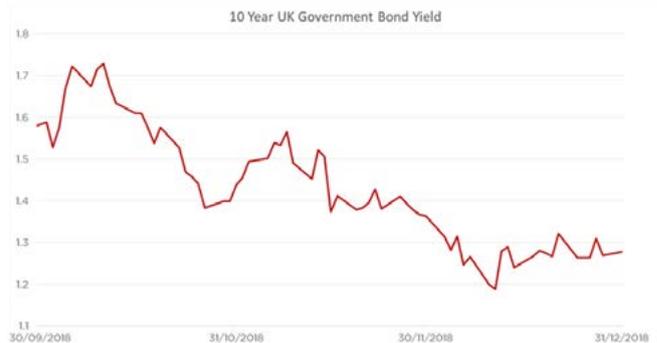
The sharp falls seen over the quarter meant that major equity markets saw their first annual falls since 2011 and brought their worst year since the financial crisis in 2008.

### Economic and market review

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

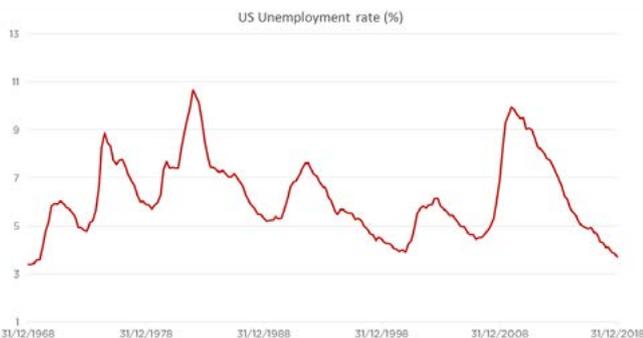
In the UK, it was impossible to escape the looming spectre of Brexit, with Theresa May's government struggling to maintain any coherence once the details of the withdrawal agreement with the EU were announced. With a number of resignations from the cabinet, a confidence vote from her own party and a clear rejection of her deal from MPs, Theresa May clung to her premiership by her fingernails. At this time, it is still unclear if and how the UK will leave the EU on 29 March 2019, with all possible outcomes still an option. Unsurprisingly, this level of

uncertainty has not played out well with investors looking at the UK, and this was reflected by a weakening of sterling over the period as well as the FTSE All Share Index which fell by 10.3%. Economically, the UK appeared to be progressing reasonably well early in the quarter, with wage growth reaching its highest level since before the financial crisis, and third-quarter GDP coming in ahead of expectations helped by England's surprising progress in the World Cup! However, as the quarter progressed, momentum slowed, particularly for retail sales as the high street struggled in the run-up to Christmas and traditional Boxing Day sales events were brought forward significantly to before Christmas. The increased concerns over Brexit and economic challenges saw the 10-year government bond yield move from 1.60% down to 1.27% over the quarter, reversing the previous quarter's move, with the FTSE Actuaries UK Conventional Gilts All Stocks Index increasing by 1.9%. Corporate bonds were hit more by the uncertainty, with the iBoxx UK Sterling All Maturities Index falling back slightly over the quarter, while high yield bonds (that are more closely correlated with equities) were hit hard. The Bloomberg Barclays Global High Yield Bond Index fell by 4.2% over the period.



Source: Bloomberg LLP, AJ Bell Investments; January 2019

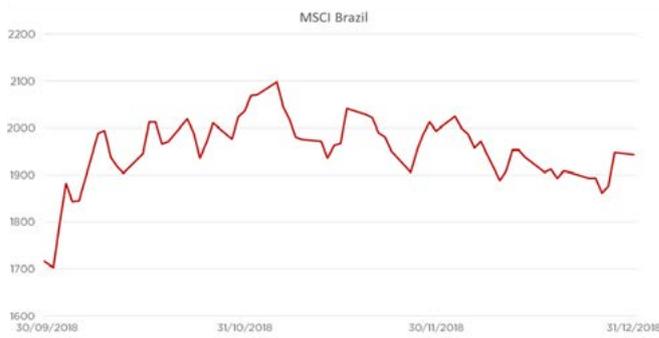
The US has been the standout performer over 2018 but in the fourth quarter this came to a juddering halt, with the S&P 500 Index falling by over 11%. For much of the quarter economic data from the US was strong, with third-quarter GDP growth coming in ahead of expectations at 3.5%, while unemployment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



Source: Bloomberg LLP, AJ Bell Investments; January 2019

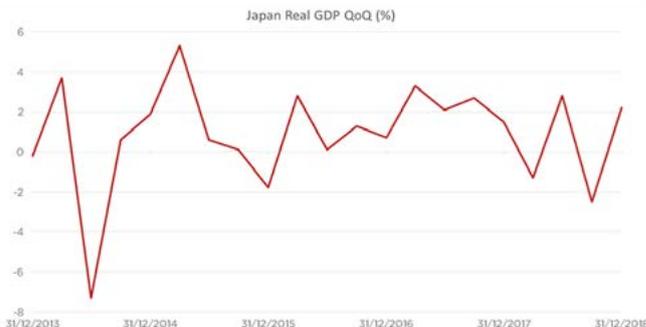
European economies showed signs of weakness over the period, with even the powerhouse that is Germany struggling. It saw its third-quarter GDP contract for the first time since early 2015, with impacts from new emissions standards for its car industry hitting output. In addition, Chancellor Angela Merkel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

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



Source: Bloomberg LLP, AJ Bell Investments; January 2019

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



Source: Bloomberg LLP, AJ Bell Investments; January 2019

All market performance figures are in GBP.

### Market outlook & our positioning

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

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

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

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

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

## Active Managed Portfolio review – Q4 2018

### Active MPS Growth

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

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

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

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

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

With fixed interest, after a very tough third quarter, performance

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

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

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

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

### Portfolio changes

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

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

### Active MPS Income

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

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

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

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

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

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

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

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

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

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

### Portfolio changes

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

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

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

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



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

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

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

## Passive Managed Portfolio Service – Q4 2018 report

### Introduction

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

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

### Summary

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

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

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

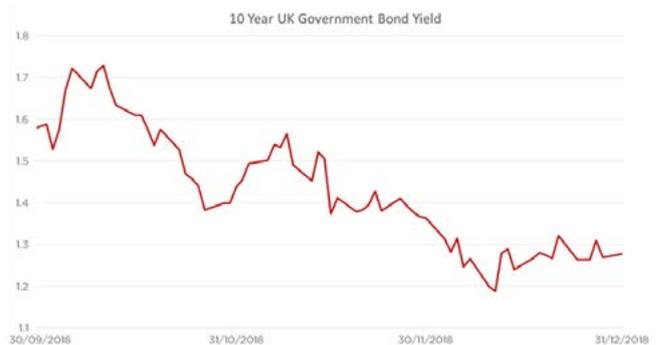
The sharp falls seen over the quarter meant that major equity markets saw their first annual falls since 2011 and brought their worst year since the financial crisis in 2008.

### Economic and market review

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

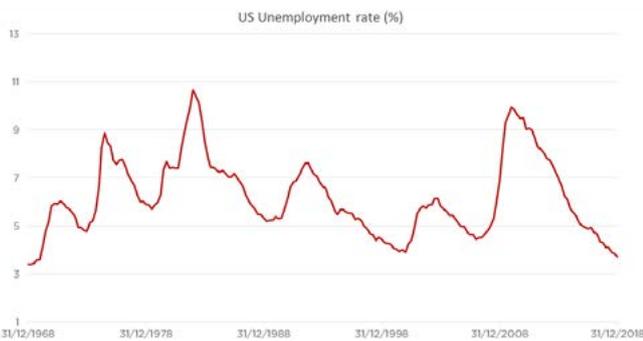
In the UK, it was impossible to escape the looming spectre of Brexit, with Theresa May's government struggling to maintain any coherence once the details of the withdrawal agreement with the EU were announced. With a number of resignations from the cabinet, a confidence vote from her own party and a clear rejection of her deal from MPs, Theresa May clung to her premiership by her fingernails. At this time, it is still unclear if and how the UK will leave the EU on 29 March 2019, with all possible outcomes still an option. Unsurprisingly, this level of

uncertainty has not played out well with investors looking at the UK, and this was reflected by a weakening of sterling over the period as well as the FTSE All Share Index which fell by 10.3%. Economically, the UK appeared to be progressing reasonably well early in the quarter, with wage growth reaching its highest level since before the financial crisis, and third-quarter GDP coming in ahead of expectations helped by England's surprising progress in the World Cup! However, as the quarter progressed, momentum slowed, particularly for retail sales as the high street struggled in the run-up to Christmas and traditional Boxing Day sales events were brought forward significantly to before Christmas. The increased concerns over Brexit and economic challenges saw the 10-year government bond yield move from 1.60% down to 1.27% over the quarter, reversing the previous quarter's move, with the FTSE Actuaries UK Conventional Gilts All Stocks Index increasing by 1.9%. Corporate bonds were hit more by the uncertainty, with the iBoxx UK Sterling All Maturities Index falling back slightly over the quarter, while high yield bonds (that are more closely correlated with equities) were hit hard. The Bloomberg Barclays Global High Yield Bond Index fell by 4.2% over the period.



Source: Bloomberg LLP, AJ Bell Investments; January 2019

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



Source: Bloomberg LLP, AJ Bell Investments; January 2019

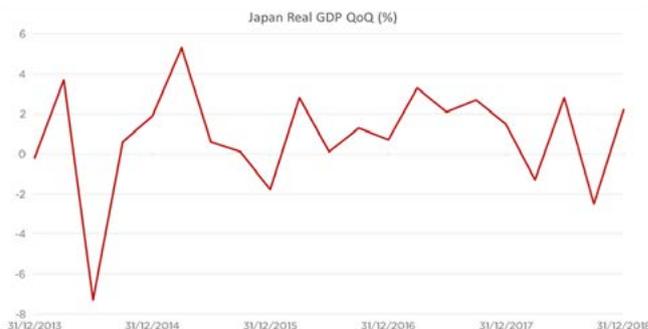
European economies showed signs of weakness over the period, with even the powerhouse that is Germany struggling. It saw its third-quarter GDP contract for the first time since early 2015, with impacts from new emissions standards for its car industry hitting output. In addition, Chancellor Angela Merkel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

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



Source: Bloomberg LLP, AJ Bell Investments; January 2019

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



Source: Bloomberg LLP, AJ Bell Investments; January 2019

All market performance figures are in GBP.

### Market outlook & our positioning

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

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

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

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

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

### Passive Managed Portfolio Review – Q4 2018

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

### Passive MPS Growth Models

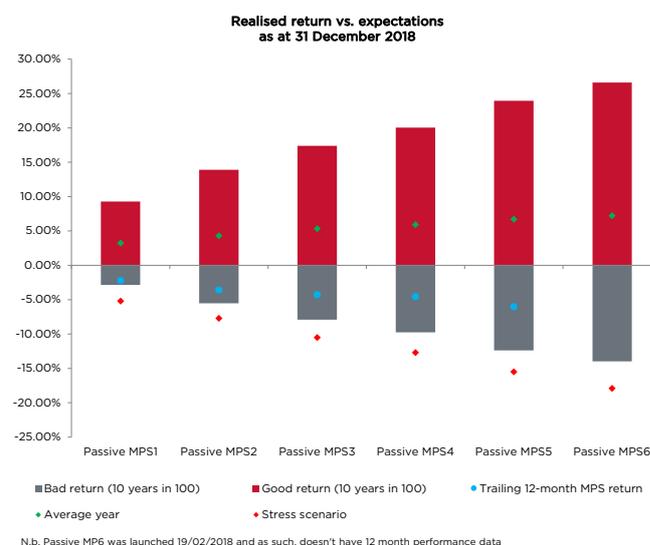
With the performance of the portfolios being a function of the assets held within them, a tough period for financial markets across the board in Q4, meant performance for the passive range was held back. With market participants forced to digest various unsettling situations in the quarter; US/China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

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

worst of the falls in US stock markets and the ensuing volatility. Lastly, one of the year's best performing sectors, Technology, saw a reversal of fortunes, falling over 15% in Q4, to leave it clinging onto a positive return for the year. Our riskier models have notable weightings toward this sector and, as such, sell offs here hindered the portfolios.

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

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



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

## Portfolio Changes

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

## Passive MPS Income Models

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

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

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

## Portfolio Changes

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

## Performance Summary (All Models)

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

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



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

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

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

## Portfolio Changes

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

## Passive MPS Income Models

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

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

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

## Portfolio Changes

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

## Performance Summary (All Models)

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

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



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

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

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

## 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.

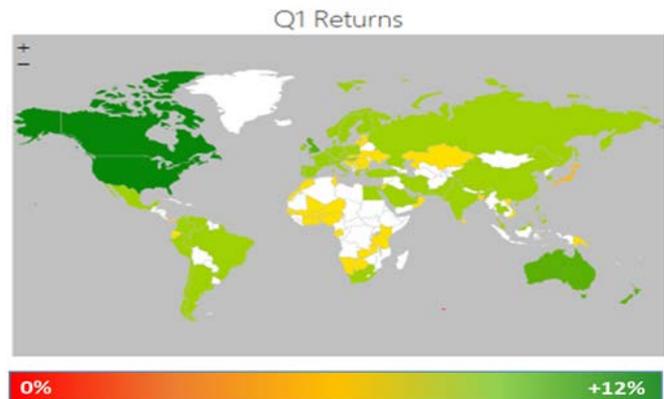
However, equity investors have taken this to mean that central banks will stop tightening monetary policy and become more accommodative, thus helping propel equities higher and indeed bonds too as the prospect of rapidly rising interest rates receded.

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.

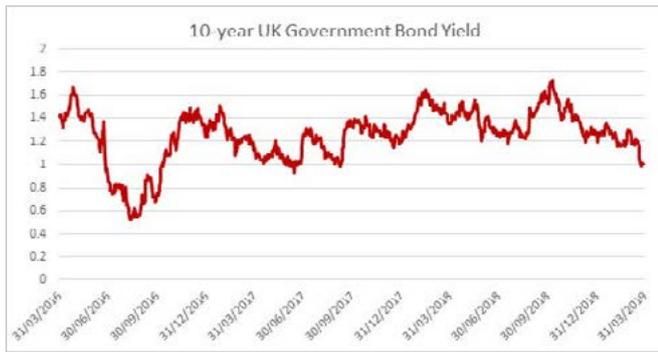
Across the regions, the US, Europe and Asia saw double digit returns in local currency terms, with the FTSE All-Share total return just below 10%. In what was a volatile quarter for sterling, it ended the quarter up against major currencies, which lowered international equity returns when converted back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



Source: Bloomberg LP, AJ Bell Investments, April 2019

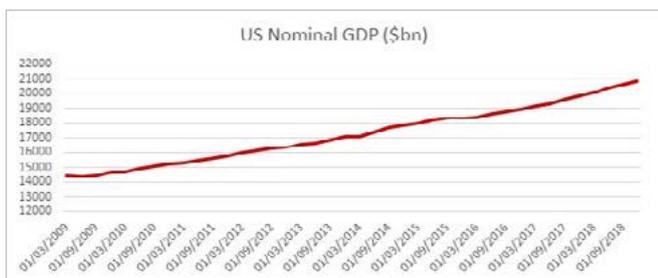
In the UK, it was Brexit that unsurprisingly dominated the headlines for the entire quarter as the 29 March leaving date moved ever closer. With Theresa May failing to get her deal approved by Parliament, then losing control of the order papers and then saying she would resign if her deal was passed, 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.



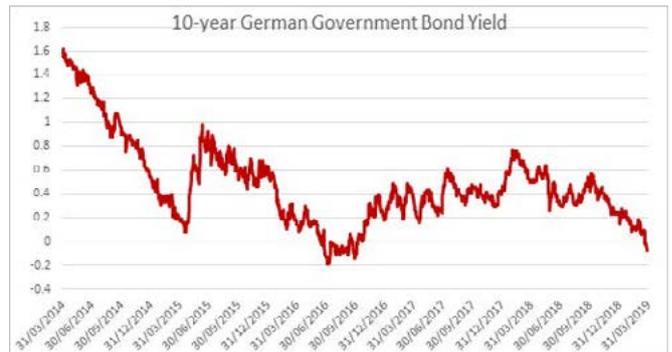
Source: Bloomberg LP, AJ Bell Investments, April 2019

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%.



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 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 Allocation Contributors and Detractors

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*

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.

## AJ Bell Active 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.

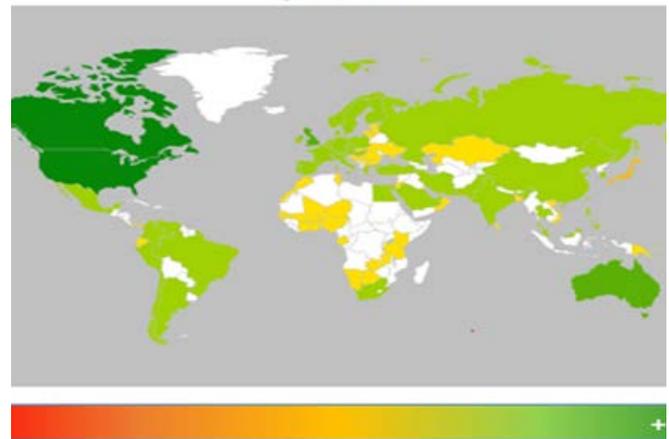
During the quarter, our annual review of our long-term return expectations was completed and a number of changes were implemented into the Growth portfolios which are covered later in this report. The Income portfolios will be updated in mid-April.

### 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.

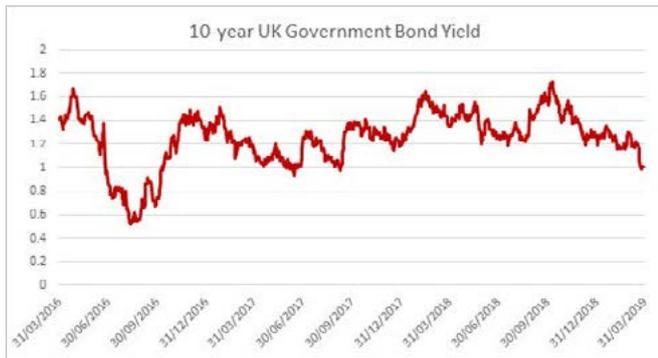
Q1 Returns



Source: Bloomberg LP, AJ Bell Investments April 2019

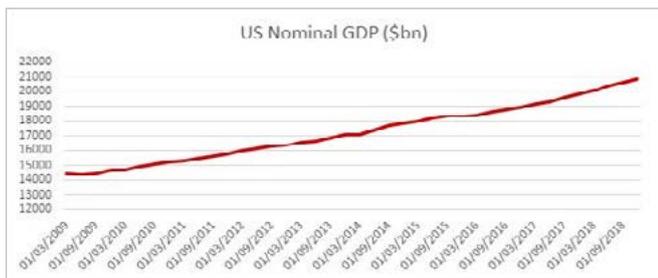
In the UK, it was Brexit that unsurprisingly dominated the headlines for the entire quarter as the 29 March leaving date moved ever closer. With Theresa May failing to get her deal approved by Parliament, then losing control of the order papers and then saying she would resign if her deal was passed, 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.



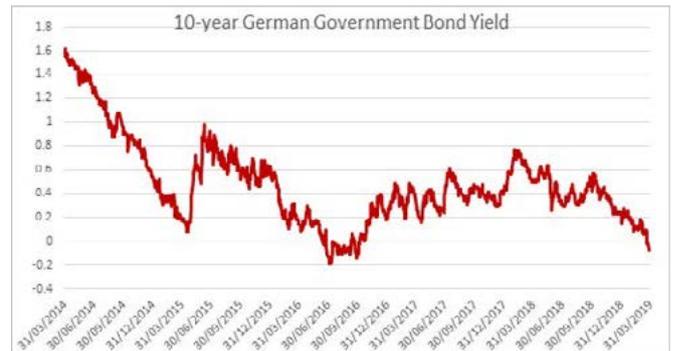
Source: Bloomberg LP, AJ Bell Investments April 2019

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%.



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 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.

All market performance figures are in GBP

## Active Managed Portfolio review – Q1 2019

### Active Income 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.

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*

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.

## AJ Bell Passive MPS – Q1 2019 report

### Introduction

We are delighted to bring you the first quarterly report from AJ Bell Investments covering the Growth MPS.

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.

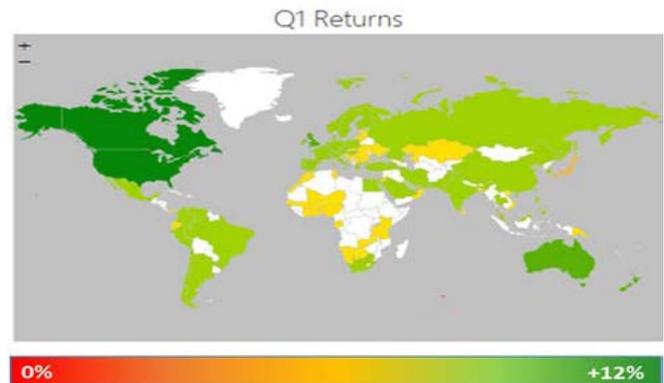
However, equity investors have taken this to mean that central banks will stop tightening monetary policy and become more accommodative, thus helping propel equities higher and indeed bonds too as the prospect of rapidly rising interest rates receded.

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.

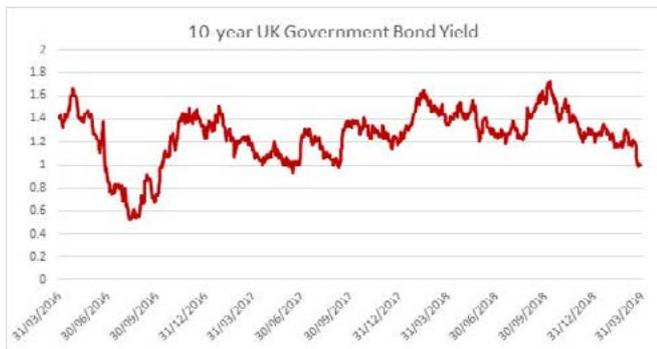
Across the regions, the US, Europe and Asia saw double digit returns in local currency terms, with the FTSE All-Share total return just below 10%. In what was a volatile quarter for sterling, it ended the quarter up against major currencies, which lowered international equity returns when converted back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



Source: Bloomberg LP, AJ Bell Investments, April 2019

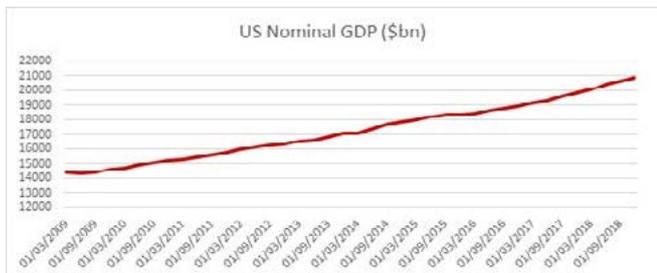
In the UK, it was Brexit that unsurprisingly dominated the headlines for the entire quarter as the 29 March leaving date moved ever closer. With Theresa May failing to get her deal approved by Parliament, then losing control of the order papers and then saying she would resign if her deal was passed, 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.



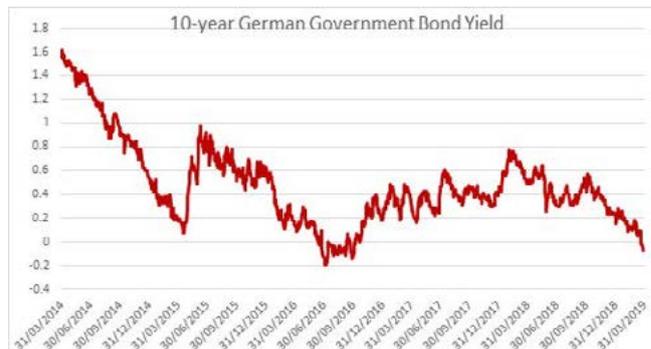
Source: Bloomberg LP, AJ Bell Investments, April 2019

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%.



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 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 Allocation Contributors and Detractors**

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.

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.

## 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.

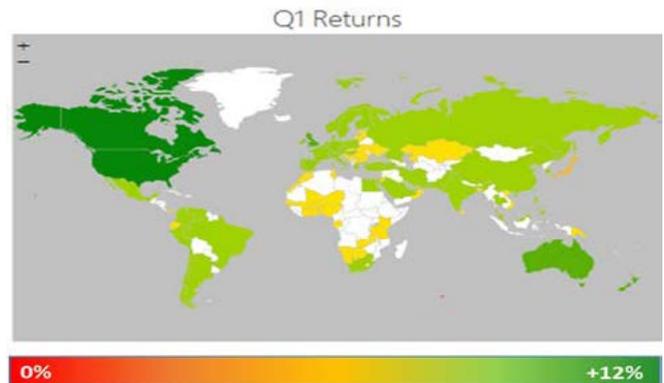
In the UK, Brexit seems no closer to being delivered, while Germany has struggled to grow and France continues to battle its own citizens amid discontent over President Macron's reforms. The positive story seems to be around the trade war between the US and China that has showed signs of being amicably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

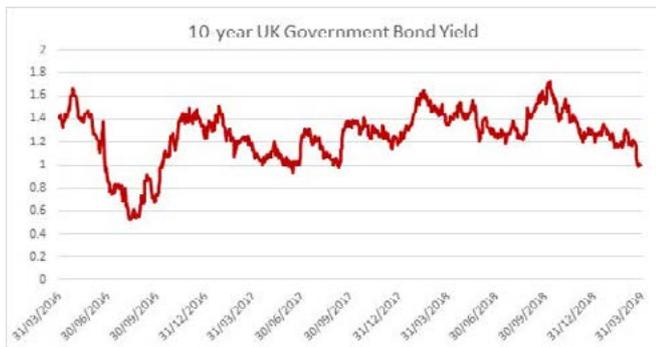
Across the regions, the US, Europe and Asia saw double digit returns in local currency terms, with the FTSE All-Share total return just below 10%. In what was a volatile quarter for sterling, it ended the quarter up against major currencies, which lowered international equity returns when converted back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



Source: Bloomberg LP, AJ Bell Investments April 2019

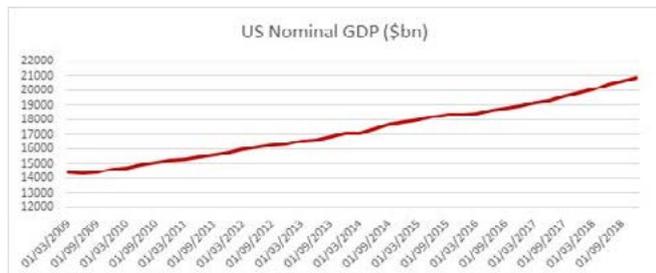
In the UK, it was Brexit that unsurprisingly dominated the headlines for the entire quarter as the 29 March leaving date moved ever closer. With Theresa May failing to get her deal approved by Parliament, then losing control of the order papers and then saying she would resign if her deal was passed, 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.



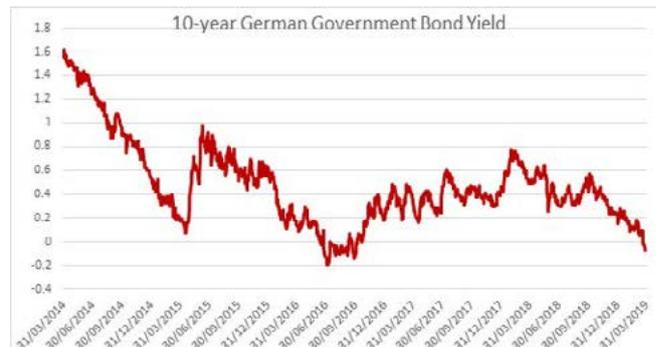
Source: Bloomberg LP, AJ Bell Investments April 2019

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%.



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 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.

All market performance figures are in GBP

## Passive Managed Portfolio review – Q1 2019

### 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.

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.

## 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.

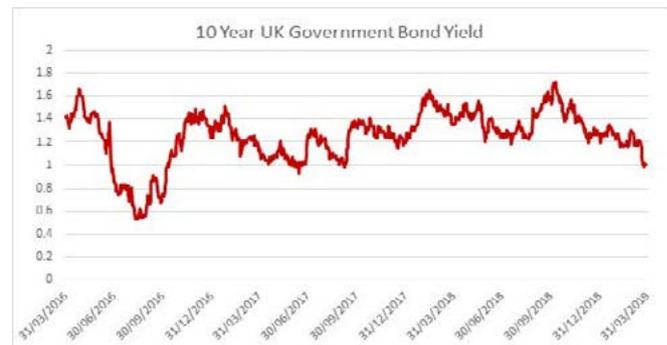
### Economic and market review

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.

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

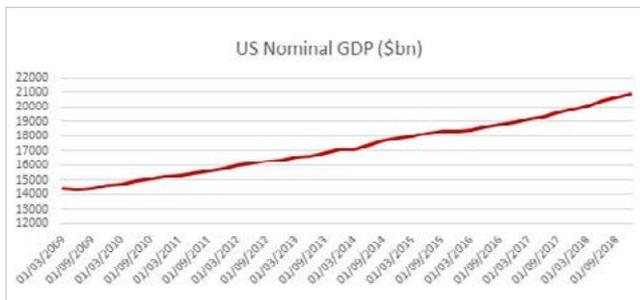
rate of 1.3% while business confidence also fell back. One bright spot was that unemployment fell to its lowest level since 1975. As the end of the quarter arrived, the potential for a delay in the UK's departure from the EU saw larger UK companies surge in value, with the FTSE All Share Index returning 9.4% over the quarter.

The bond market reacted to the heightened risk with yields tightening sharply resulting in the 10yr 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 stronger 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.



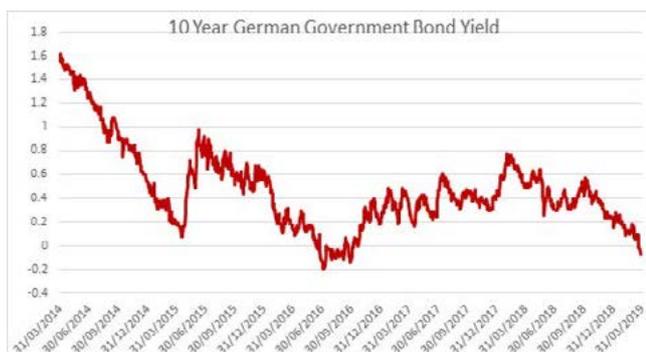
Source: Bloomberg LP, AJ Bell Investments, April 2019

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.



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.