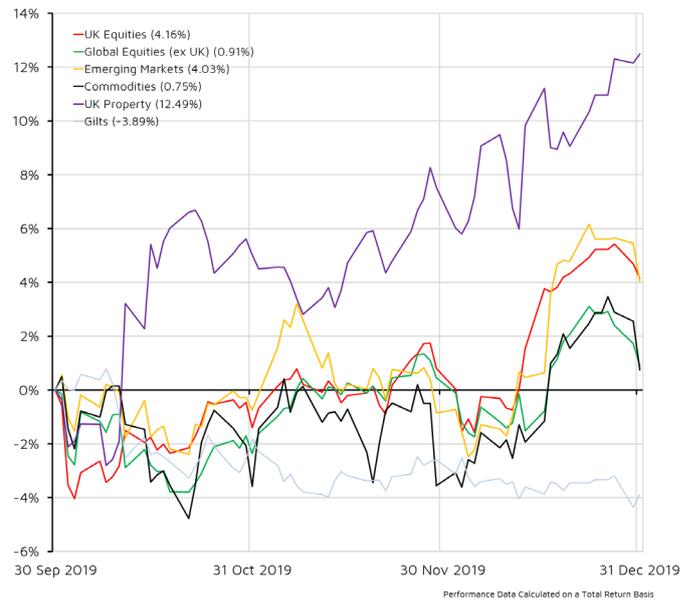


REVIEW OF THE PAST QUARTER:

Expectations of a phase one trade deal between China and the US grew over the quarter, increasing optimism around riskier assets, while cooling the enormous bond market rally witnessed over the summer. A decisive Conservative victory initially gave markets confidence that Johnson could deliver a softer Brexit. However, sterling subsequently experienced its worst week of the year as Brexit concerns resurfaced. New plans suggested that Johnson would try to forge a Canada-style free trade agreement which focuses on goods and not services. These plans also set a tight deadline for talks, with a greater risk of the UK crashing out of the EU with no deal in place.

Whether subsiding geopolitical tensions will kickstart global growth remains to be seen. In the meantime, manufacturing data remains weak. Germany narrowly avoided a technical recession in Q3 but its manufacturing activity, which is heavily reliant on Chinese demand, continues to weaken – dragging the wider eurozone down with it. Industrial production remains weak in China and in the US, manufacturing languishes in contractionary mode.

Key central banks will be keenly waiting to see if economic data improves with most holding rates steady this quarter. The Bank of Japan will also be watching retail sales closely following its long-delayed tax hike. Especially since the last hike in 2014 plunged the nation into recession.



ASSET CLASS RETURNS

| Cash | Government Bonds | Index Linked Bonds | Corporate Bonds | UK Equities | Overseas Equities | Emerging Markets | Property |
|-------|------------------|--------------------|-----------------|-------------|-------------------|------------------|----------|
| 0.16% | -3.89% | -8.47% | -0.69% | +4.16% | +0.91% | +4.03% | 12.49% |

THE ACTUARIAL VIEW:

The inversion of the yield curve, where short term bonds are yielding more than long term bonds, risks setting markets into a nasty vicious circle. Falling yields indicate that a recession is coming, which stimulates greater demand for bonds as investors look for greater certainty from their investments pushing yields down further. In recent weeks we have seen five-year bonds yielding just a fraction of what cash is paying out. Given this environment it is unsurprising that globally central banks have been cutting interest rates, something that could continue for a while yet. Meanwhile equities have remained relatively static. All this signifies a uniform slump in expectations across asset classes.

The only exception to this is property, where prices have not responded to what should be a positive change in the interest rate environment. This relative if not actual improvement makes the asset class more attractive. The other increases are into cash, lower yields make cash more attractive in the short term than higher risk bond markets.



WHAT TO LOOK FOR IN Q1:

- UK:** The UK is due to leave the EU on 31 January. The Monetary Policy Committee (MPC) announcements, minutes and quarterly inflation report are set to be released on 30 January.
- US:** There will be interest rate decisions from the Federal Open Market Committee (FOMC) on 29-30 January. Minutes will be published three weeks after each decision. GDP Growth for Q4 (Advanced estimate) on 30 January.
- Eurozone:** Quarterly GDP flash data is set to be published on 31 January. A European Central Bank Monetary policy meeting has been arranged for 23 January.
- Other Data:** OPEC meeting on 5 March. Taiwan election on 11 January. China GDP Growth for Q4 (Advanced estimate) is available on 24 January. Germany industrial production data for November is available on 9 January. Japan consumer confidence is available on 29 January.

ASSET CLASS SCENARIOS:



UK EQUITY

Most Likely: Increased certainty around Brexit and a supportive budget will likely sustain UK equities for most of Q1 with smaller companies outperforming large-caps, benefiting from sterling strength. As the deadline for ratification of Johnson's Withdrawal Bill approaches and negotiations resume, UK equities may become jittery and sterling could lose ground. The currency effect would be positive for the UK's large-cap global companies, the sentiment effect could be negative and impact relative performance versus developed market peers.

Worst Case: Renewed uncertainty around the longer-term implications of Brexit may set in earlier than expected if hard-Brexit probabilities increase. Additionally, if the budget provides more stimulus and borrowing than markets expect this would increase inflation and interest rate expectations which would be negative for UK equities.

Best Case: Positive sentiment continues through the quarter benefiting sterling and smaller companies whilst off-setting negative currency effects. Positive trade war developments and double-headed fiscal and monetary policy expansion - greater than expected tax cuts and fiscal stimulus along with a continued pause in interest rate changes - would be a positive concoction for UK equities.



GLOBAL EQUITY

Most Likely: The ease in trade tensions should support European markets substantially driven by manufacturing. US economic data remains supportive although any weakening in consumer spending data could hurt performance. The market expects that the Federal Reserve will keep rates steady until inflation picks up. Although this won't deliver a boost to share prices, it reflects their view of the economic data.

Worst Case: As Brexit takes centre stage across Europe, European stocks could be negatively impacted. European manufacturing, particularly in Germany, remains in contraction territory. This could hurt the regions performance and weaken sentiment further. If the Fed changes tack and moves towards a less accommodative stance; or the US, or China back out of the trade truce the US would suffer.

Best Case: Should positive trade developments between the US and China continue, the US market will remain supported throughout the first quarter; particularly if we see an increase of business investment as a result. The UK election result reduced risks of a no-deal Brexit at the start of the year and this should support European equity markets.



EMERGING MARKET EQUITY

Most Likely: Emerging markets will continue to be driven by lingering US-China trade uncertainty. A lot of positive news around accommodative US monetary policy is already priced in so any disappointment on that front will expose the asset class to losses. The biggest proportion of returns in 2019 came from investors willing to pay higher prices for emerging markets stocks, but earnings will have to be strong for this to be sustainable.

Worst Case: The most notable risk to emerging markets is an increase in trade uncertainty, and the single biggest reason why many investors are not buying the asset class. Earnings disappointments or the Fed sending a strong signal contrary to market expectations of monetary easing could prove painful.

Best Case: While Fed Chairman Jerome Powell scoffed at the idea of restarting of quantitative easing, the market seems to believe otherwise. The market appears certain that more accommodative measures are to be unveiled and if the Fed meets these expectations, emerging markets could see a solid start to 2020.



CASH

Most Likely: The BoE has signalled its intention to keep interest rates on hold in the near future. The demand for cash is likely to increase as investors await more certainty on Brexit. There has been a decline in the headline consumer price index (CPI) over recent months, removing pressure from the BoE to hike rates to avoid price overheating. However, the latest core inflation reading stands at 1.7%, so returns from cash remain negative.

Worst Case: The worst-case scenario for cash savers is that inflation continues to rise with cost-push pressures at the fore. With the UK elections behind us, the attention moves towards Brexit; any signal towards a hard Brexit will likely lead to higher imported inflation, deteriorating returns on cash.

Best Case: Any progress in Brexit negotiations could well be taken by the BoE as a signal to continue tightening, especially if wage growth surprises to the upside. In such a scenario, returns to cash would improve despite staying negative. Cash could also act as a defensive holding amid Brexit and US-China trade negotiations.



FIXED INCOME

Most Likely: There are no expectations for the Fed to make any interest rate changes in Q1, but the market seems to believe that the Fed has restarted quantitative easing. This is despite Powell maintaining that expanding the balance sheet was aimed at managing the level of bank reserves rather than lowering long-term rates. Our view is that expectations for easing seem excessive which leaves us wary of Treasury valuations, exposing us more to the downside. Despite the Tory election majority, Brexit is still an overhang, so exposure to UK Gilts should help to navigate choppy waters.

Worst Case: Any unexpected sign of wage growth and inflation will continue to be negative for bond markets. A pick up in economic activity, or a strong improvement in leading indicators globally could lead to higher yields and subsequently lower bond prices.

Best Case: Given expensive valuations and high expectations for easing, the upside for most bond markets is limited. The ECB's "lower for longer" stance until inflation picks up and renewed ECB corporate bond purchases should limit volatility and be somewhat positive for European fixed income.



PROPERTY

Most Likely: Given the weak investment volumes seen in 2019, particularly in the UK and US, the short-term easing of political tensions around US-China trade and Brexit should help investment volumes pick up, supported by continuing central bank easing. Given the attractive yields on offer, particularly in the UK, property will likely remain an attractive investment compared to many fixed income products. However, this will be tempered by EU-UK trade deal talks starting, potentially slower growth rates in the global economy and China, and the retail market continuing to struggle.

Worst Case: The woes of the retail sector will have an adverse impact on the wider market causing yields to widen and investors to flee. If rhetoric around a potential no-deal Brexit pick up again and Trump goes ahead with more proposed tariffs this could affect confidence, and any nascent signs of inflation or potential rate hikes would hurt.

Best Case: If monetary policy remains easy - and the Fed cuts rates once more - whilst investor positivity and investment volumes pick up, then we could see strong returns in the sector. Furthermore, if retail figures surprise on the upside, particularly in the US which relies heavily on the consumer, then this could be a further boon to markets. outcome of Brexit negotiations will also help to boost UK real estate.