Quarterly Update – July 2015

Market Backdrop

After a relatively strong start, April turned out to be a month of mixed fortunes for UK-based investors with markets becoming volatile in the last few days of the month as investors began to fret over the outlook for global growth. Weaker economic growth data, as well as central banks' continued easing of monetary policy in response to low inflation rates, resulted in the MSCI World Index posting a negative return for the month. In contrast, there were increasing signs of stabilisation in the price of both oil and iron ore which meant that the commodities sector had a stronger month.

The failure to reach an agreement on Greek reforms by the April deadline raised the expectation that a default would eventually ensue, although the markets took some comfort from more tempered language between the two sides. In the UK all eyes turned to the outcome of the general election on 7 May with the pre-election polls failing to predict a Conservative majority.

At the beginning of May the European sovereign bond market retreated over liquidity concerns and inflation expectations. This immediately spilled over into other bond markets resulting in increased volatility which in turn dampened developed market equity gains. The weakening Euro diminished the return for UK investors, although this was more than offset by relatively good returns in both the US and Japanese markets. A large crack began to appear in the six month rally of the Chinese equity market but, given the scope for the Chinese authorities to provide support the economy, market observers' eyes began to turn to Greece which, despite making a €750 million loan payment to the IMF in May, was beginning to look increasingly likely to miss its future debt repayment schedule. As previously predicted, political events rather than fundamentals are so far dominating the markets in 2015.

As the quarter came to an end, any nervousness felt by investors over the likely date of the Fed raising US interest rates was overshadowed by their reaction to the media's reporting of discussions between Greece's creditors and the Syriza-led government. The lack of any form of agreement between the parties, and Greece's inability and failure to make a further loan repayment to the IMF by 30 June, was the primary driver in the steady decline in virtually every market during June.

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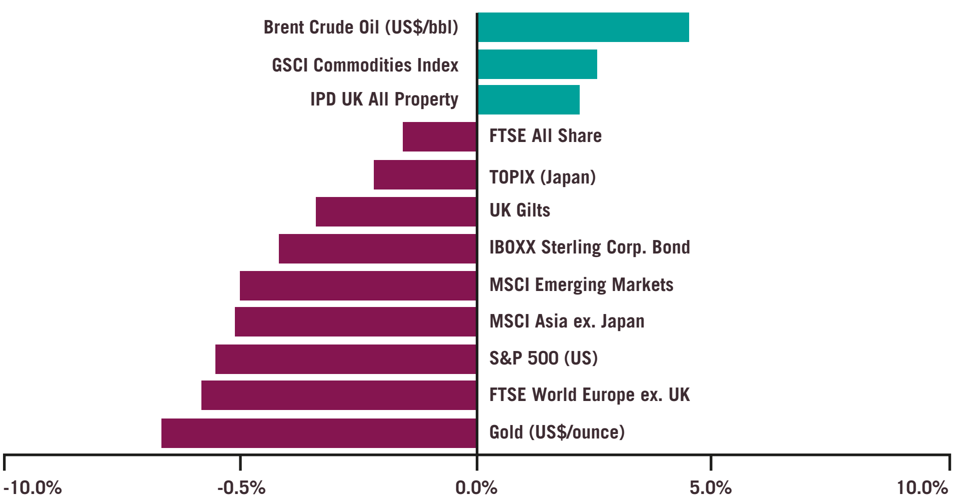
Asset Class Returns – Q2 2015



Data source: FE Analytics – rebased in Pounds Sterling

Equities

UK

The UK equity market got off to a brisk start in the quarter despite the uncertainties surrounding the outcome of the general election. This reflected economic surveys which painted a broadly positive picture, although the data was muted with too much dependency on consumer spending and a buoyant services sector in contrast to the relatively static construction and manufacturing sectors.

Despite a positive return from both the small and mid-cap sectors, overall the UK market disappointed following a significant pull-back in the price of large cap stocks during June as the Greek debt crisis rattled markets.

Business surveys suggest that economic growth has picked up in Q2 and, with unemployment continuing to fall, positive wage growth, scope for productivity gains and a benign inflation environment, all the ingredients are present for the UK to be one of the fastest growing G7 economies in 2015.

US

Poor economic data for Q1 raised doubts over the strength of the US economy and this caused the equity market to retreat in April, pushing further out the possible date for any increase in interest rates. These concerns were short-lived, however, as Q2 data indicated a clear resurgence in momentum, with vehicle sales hitting a nine-year high and employment numbers increasing, reflected in the US equity market generating a positive return in May.

The strength of the US dollar continues to impact upon the manufacturing sector but, as this accounts for a relatively small share of the US economy, the growth in wages and an increase in retail sales pointed to a strengthening economy.

Despite this the US equity market was not immune to the possible fallout from the Greek debt crisis and so June saw a marked retreat which meant that all of 2015's return was eroded for sterling investors.

Outlook for Equity Regions

Region	View
UK	Neutral
Europe	Neutral
US	Neutral
Japan	Positive
Asia Pacific	Neutral
Emerging Markets	Neutral

Eurozone

The period was marked by a general improvement in the economic picture with a raft of data beating forecasts and indicating expansion. Inflation also moved out of negative territory after four months of declines so tempering the deflationary concerns of many market participants.

The improvement was not broad-based, however, with growth momentum showing signs of slowing in Germany in contrast to the rising trend in Spain, France and Italy as the European Central Bank's (ECB) Quantitative Easing programme improved money supply.

It is disappointing that the relatively brighter economic outlook was not matched by the return of the region's equity markets, but this primarily reflected the dark shadow cast by the challenging ongoing negotiations between Greece and its creditors, and the potential implications for European Monetary Union of a 'Grexit'. After a virtually flat April and May the period ended with the region's equity markets falling heavily, but still leaving a positive return for UK investors year to date.

Japan

The period began with economic data at last showing signs of improvement with strengthening earnings, a competitive currency, improving domestic demand, changes to corporate governance and ongoing global growth all supportive of the equity market. Despite this April's market was flat, although this quickly turned around in May with Japan posting the best return of the developed market equities.

The downward trajectory in the Yen is aiding exporters and boosting much needed tax receipts from Japanese companies trading overseas. With falling unemployment and early signs of some wage growth domestic consumption is expected to improve, but disinflationary pressures continue to act as a headwind suggesting that the government cannot afford to withdraw its support nor hold back from implementing structural change.

Although the general unsettling of equity markets in June spread to Japan resulting in a negative return for UK investors for the period, year to date Japan is the top-performing developed equity market.

Asia Pacific

April witnessed a strong return from the region although this masked considerable divergence in the performance of individual countries' equity markets, as slow growth and falling inflation indicated the need for further monetary easing.

Resource-exporting economies continued to hurt reflecting the global supply/demand imbalance and the strength of the US dollar.

The relative weakness in growth in the region's economies together with subdued consumer demand caused the markets to begin to retreat in May, and the uncertainties of the Greek debacle together with the spill-over from the recent correction in the Chinese equity market contributed to a negative quarter. Despite this setback, year to date UK investors are still in positive territory.

Emerging Markets

The sector's equity markets had a strong April on the back of a very strong Chinese market, together with those of Brazil and Colombia as oil and commodity prices rebounded. India had a poor start to the period with concerns over corporate earnings together with doubts over whether the government would be able to push through some much needed structural reforms.

Half of the gains achieved in the period's first month were wiped out in May as markets retreated, with Latin American countries showing the largest falls, closely followed by Emerging Europe, Middle East and Africa.

Downward revisions to economic forecasts, the price of oil affecting energy-exporting countries, the strength of the US dollar and the rise in developed market government bond yields all contributed to dulling investors' appetite for risk, resulting in a negative return for the period. This was accentuated by the rout in the Chinese equity markets that began in mid-June.

Outlook for Asset Classes

Asset Class	View
Equities	Positive
Fixed Interest	Negative
Property	Positive
Commodities	Negative
Absolute Return	Positive
Cash	Negative

Fixed Interest

European government bond markets began the period well as uncertainty over Greece and the effect of the ECB's QE programme offset the impact of improving economic data. The strength in the government bond markets fed through into the corporate bond markets, but this performance was short-lived as there was a sell-off in bonds as markets appeared to shift towards a 'risk-on' position, as well as engage in profit-taking.

This continued into May although some stability was brought to the market through comments made by the ECB's President, Mario Draghi, who reaffirmed their commitment to the full QE programme. The UK bond market was also supported by the Conservative party's unexpected majority in the general election as well as a benign inflationary outlook.

The sector produced a negative return for the period and there has been a noticeable uptick in volatility reflecting heightened nervousness among investors. Three reasons are behind their concerns: the significant volume of cash invested in bonds since 2008, investors' insatiable demand for high yields, and the lack of liquidity in the bond markets in recent times. Caution is paramount and an abrupt rise in interest rates or an unexpected surge in inflation could destabilise the markets.

Alternatives: Commodities/Absolute Return/Property

Commodities had a better second quarter with the S&P GSCI Index (a composite of both hard and soft commodities) recording a small positive return, although there was a marked contrast between soft commodities (grains etc.) which performed well and hard commodities (precious and industrial metals) which performed poorly.

Soft commodities benefited from a stabilisation in the oil price and an improvement in the price of grains to reflect weather-related concerns over the size of the forthcoming harvest. Hard commodities struggled reflecting the strength of the US dollar and the current supply/demand imbalance.

The **Absolute Return** sector posted a marginal negative return for the period, but with heightened volatility witnessed in both the equity and fixed interest markets the defensive qualities of our selected funds in this sector proved beneficial.

Over the last quarter listed **Property** equities have fallen, especially in Europe ex-UK, reflecting some spill-over from the volatility in the wider markets, and this is in contrast to direct property which has continued to gain steady ground. The long-run prospective returns from this sector remain attractive relative to the yields available from other asset classes.

Portfolio Overview

Performance (%) for the period ending 30 June 2015

Portfolio	Descriptor	Quarter	1 Year	2 Years	3 Years
Parallel Multi Asset A	Defensive Growth	-2.0	2.5	5.8	10.1
Parallel Multi Asset B	Conservative Growth	-2.2	4.7	10.6	20.2
Parallel Multi Asset C	Cautious Growth	-2.2	6.3	13.3	27.3
Parallel Multi Asset D	Balanced Growth	-1.8	8.6	17.4	36.3
Parallel Multi Asset E	Adventurous Growth	-2.2	8.5	17.2	37.5
Parallel Multi Asset F	Global Opportunities	-2.8	7.9	17.1	37.0
Parallel Multi Asset B Income	Conservative Income	-2.3	3.0	7.5	12.7
Parallel Multi Asset D Income	Balanced Income	-3.8	4.5	10.6	25.9
Socially Responsible Growth		-2.6	7.1	16.6	38.3

Figures quoted net of management fee. Source: FE Analytics

Fund Selection: Contributing Funds

Legg Mason Japan – This was again the top performing fund in our portfolios over the quarter, returning 12.8% and was the top performing fund in the IA Japan sector. The hedged-currency version we hold outperformed the un-hedged version by 8.5%.

Unicorn UK Income – This fund benefitted from its bias towards small and mid-cap stocks as well as strong stock picking. The fund returned 3.1% over the period, placing it comfortably in the first quartile in the IA Equity Income Sector.

Neptune Japan Opportunities – Another of our Japan fund holdings performed well over the quarter, outperforming its benchmark by 5%. This can largely be attributed to the currency hedging strategy the fund manager has in place.

Fund Selection: Detracting Funds

Fidelity Emerging Markets – Emerging Markets performed poorly over the quarter, resulting in the fund falling around 6.9%. The fund's overweight position in India had a negative impact on fund performance.

HSBC American Index – This index fund tracks the S&P 500 index and as a result fell in line with the falls seen in the US equity market over the quarter.

First State Asia Pacific Leaders – Asia was one of the worst performing equity regions over the quarter, with this fund falling in line with the market. The fund is still comfortably ahead of the index on a twelve month view however.

Portfolio Activity

A summary of some of the main changes during the quarter:

A move from Investment Grade to Strategic Bonds – We have become concerned that investors' search for yield has created a demand for bonds that has pushed prices up to unsustainable levels. The potential for a fall in bond prices is therefore significant. In this environment, we believe strategic bonds offer better potential for returns through the greater flexibility enjoyed by their managers. On this basis we have sold some of our investment grade bond fund holdings in favour of strategic bond funds.

Increase exposure to equities – In April we took the decision to reduce our exposure to the UK equity market in the run up to the general election due to a concern that the outcome had the potential to create significant volatility. The proceeds were temporarily placed in cash fund holdings. Following the election result these monies were recommitted to equity markets where we see better potential returns when compared with cash or government bonds. The proceeds were split between the UK, European and Japanese equity markets.