Parallel
Investment Management

Quarterly Update – July 2016

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Market Backdrop

After the buoyant end to the previous quarter some investors anticipated that April would bring a sharp pullback in the markets, but for sterling investors global equity markets stayed relatively flat, supported by better-than-expected corporate earnings, a jump in commodity prices as the US dollar weakened and some stronger data coming out of China. May was generally positive for the markets as US economic data showed signs of improvement, thereby renewing the possibility that US interest rates would shortly increase, and as oil prices continued to climb.

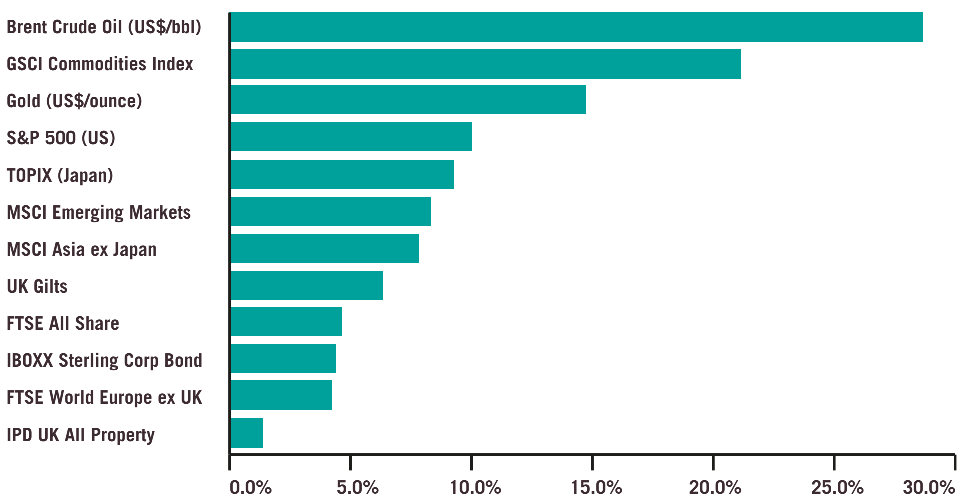
As we entered the final month of the quarter investor focus turned to the EU referendum, and with the polls indicating the result would be a close call markets were in a state of limbo, although there was a widely held belief that the economic argument had been won by the 'Remainers'. Consequently, the markets were completely wrong-footed when the result was announced causing an extreme reaction, not just in the UK and the eurozone but around the world. In classic 'risk-off' mode bond market prices, particularly core government bonds, went up with the yields on the benchmark 10-year US Treasuries, German Bunds and UK Gilts hitting historic lows. The day after the vote global stock markets had lost more than US$2 trillion of value.

Much of the selling was indiscriminate as fear for the future added to existing concerns about lower global growth. David Cameron's stated intention to step down as UK Prime Minister added to the uncertainty, and the media fuelled the fire with both conjecture and hyperbole when there were simply too many unknowns. Developed markets took the brunt of the sell-off.

The value of sterling fell by more than 10% from its pre-Brexit level to a 31-year low against the US dollar causing Mark Carney, the Governor of the Bank of England, to indicate that additional monetary easing may be required to ease the ensuing 'economic post-traumatic stress disorder'. This soothed investors and the FTSE 100 Index recouped all of its losses by the month end. Furthermore, a lower sterling benefitted returns from overseas markets with the MSCI World Index in June losing 1.1% in US$ terms but gaining 7.7% in sterling terms.

There is no doubt that we have entered a period of heightened uncertainty for financial markets and so in the next two pages we comment on the global economy, the threats that continue to linger, and our short-term outlook for asset classes and the equity regions.

Asset Class Returns – Q2 2016



Data source: FE Analytics – rebased in Pounds Sterling

In our last newsletter we reported comments made in April by Christine Lagarde, the Managing Director of the International Monetary Fund, who said, "the world risks being trapped in a new mediocre of persistent low growth, with damaging effects on the social and political fabric of many countries."

Economic growth in both developed and developing economies was already facing significant challenges ahead of the EU referendum, but the vote by British people to leave the EU has intensified the uncertainty in both economic and political terms. This uncertainty doesn't stop at the UK borders, but encompasses the EU and to a limited extent the global economy.

Although the initial political uncertainty in the UK has been dissipated by the swift appointment of a new Prime Minister and cabinet, the tough part, which has yet to be faced, is the timing of the triggering of Article 50 and the negotiation of the UK's exit from the EU. Clearly, the EU leaders will be keen to avoid other members heading for the door and so the negotiations are expected to be both tough and protracted, causing the uncertainty to persist, although hopefully allowing investors an opportunity to adopt a more considered approach than was the case on 24 June. Despite the heightened uncertainty the equity markets of developed countries have been surprisingly strong since the referendum result was announced, with both the UK and eurozone markets returning over 8% to 27 July for the sterling investor, whilst other regions have produced double digit returns albeit aided by the weakness of sterling.

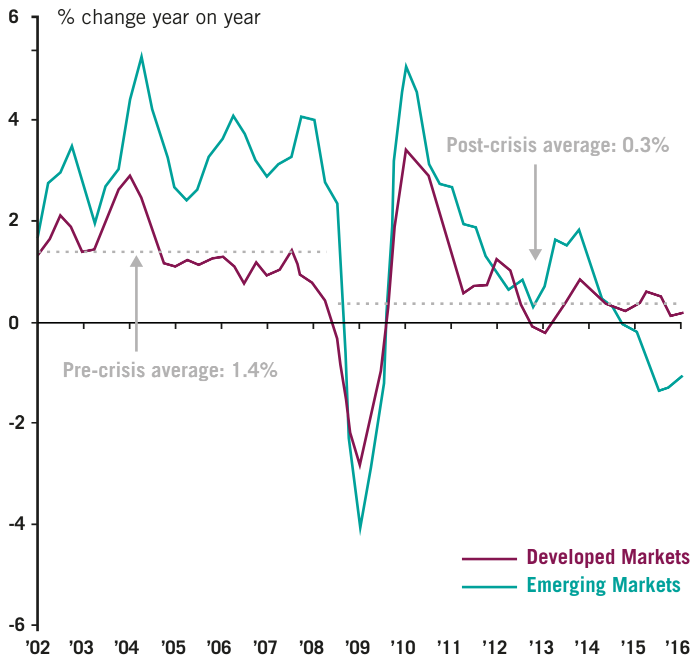
Even discounting the impact of a weaker sterling it is reasonable to ask why markets have reacted this way. After all, we expect Brexit-uncertainty to dampen growth in the UK because of reduced business investment and trade over the next year, whilst the fall in the value of sterling is expected to add to inflation. There is also likely to be a modest knock-on effect for the eurozone economy, whilst other economies may be impacted by currency movements and disruption to trade flows. As such, recent market movements may simply reflect investors' thirst for yield, given the paltry returns from other liquid assets such as cash and bonds, rather than supreme confidence that a recovery is just around the corner because clearly many headwinds exist. Although the Brexit vote will undoubtedly have an impact some commentators believe that productivity or output per head is a far greater threat to the recovery (see chart). This is a global problem, but given that the US economy is further along the cycle it is also where the problem may already be starting to have an effect. With US unemployment now standing at just 4.7% and wages having firmed, companies have limited options in pursuing profit growth, namely: raise prices, cut costs or allow profit margins to weaken. To date US companies have chosen to cut capital spending and hired staff, but, with profit margins weakening, if productivity does not improve we could see unemployment begin to rise again.

At the start of the year China was a key cause for concern as investors fretted over the authorities' efforts to cope with the volatility in the stock market and a change in the value of the Chinese currency. Since then the situation in the economy and the exchange rate would appear to have stabilised and the previous significant monthly capital outflows have reduced markedly. There remain justified concerns about excessive credit growth (particularly relating to the property market) and so the authorities are likely to pull back on further monetary stimulus, as long as the economy is deemed to be growing strongly enough. The stronger risk appetite for emerging equity markets over recent months partly reflects these reduced worries over China, but there is still a need for some developing economies to get used to the fact that China's future growth will be at a lower level.

Since the 2007-09 financial crisis central banks have adopted loose monetary policy, including quantitative easing, to keep interest rates low and to encourage commercial banks to increase lending and economic activity, as well as to boost inflation. The effectiveness of this policy is debatable as, according to Bloomberg, we now have 74% of global government bonds trading at an implied yield of less than 1% and by the end of June an estimated $11.7 trillion bonds had negative yields. It is certainly likely that interest rates will stay lower for longer, and even in the US there has been a considerable shift in the expectations for rate hikes. We believe that the UK's decision to leave the EU should have a limited impact upon the world as a whole because any economic damage will be containable, even though there may be some political fallout. The UK accounts for only a small share of exports for the US, Japan and most emerging economies and, given that global equity markets are back to levels reached before the Referendum, the impact on investor confidence may turn out to be more muted than first feared.

It is a fool's errand to try and call the market direction in the short term simply because there are too many economic and political unknowns. As such, it is important to avoid being too influenced by short term noise and to remain focused on the medium to long term investment objectives, continuing to make use of a blend of different asset classes to ensure sufficient levels of diversification of both risk and opportunity.

Labour Productivity



Source: JP Morgan, Guide to the Markets – UK, June 2016

Investment Views

Asset Class	Current View	Outlook	Comment
Equities	⊕	▼	Despite the initial shock to the markets following the referendum result levels have recovered and equities continue to look attractive on a relative basis, given investors' thirst for yield. However, lacklustre growth and heightened volatility reflecting the economic and political uncertainties are likely to act as headwinds at present valuation levels.
Fixed Interest	⊗	▶	The global bond market does not offer sufficient compensation for the risk carried and a relatively modest sell-off would result in significant capital loss. As such active management is a must to identify value whilst negotiating risk.
Property	⊕	▼	Rental yields in developed markets offer attractive returns relative to developed market bonds. The referendum result certainly caused a hiccup but the asset class continues to offer selective investment opportunities.
Commodities	⊗	▶	2016 has seen a steady recovery in prices and signs that the commodity bear market is coming to an end. However, a dramatic turnaround is not anticipated given the expectation of low global growth.
Absolute Return	⊕	▶	This sector provides exposure to alternative investment strategies and techniques acting as a useful diversifier to provide additional forms of 'safety' as well as potentially contributing to returns.
Cash	⊗	▼	The referendum result is likely to push further out a rise in UK interest rates and so the asset class only has merit through its defensive qualities.

Equity Regions	Current View	Outlook	Comment
UK	⊖	▼	Sterling's fall following the referendum result may provide support given the high dependence upon foreign earnings. However, economic growth is expected to weaken given heightened uncertainty although looser monetary and fiscal policy may offset this.
US	⊖	▼	Profit momentum continues to slow given the strong dollar, weakness in energy prices and growing wage inflation. Parts of the market are beginning to look expensive and capital gains from here may be harder to achieve.
Europe	⊖	▶	The early stage in the recovery cycle and support from the ECB's aggressive stimulus package are beneficial, although the region is vulnerable to any fallout from referendum result.
Japan	⊖	▶	Earnings momentum has slowed given external headwinds and poor domestic fundamentals. Further significant central bank support is expected along with structural reform.
Asia Pacific	⊖	▲	Supportive domestic macro policies, a more benign Fed outlook, near-term growth stabilisation in China, and reduced currency risks are supportive for the region, with valuations relatively attractive. Tepid global trade and debt levels may act as headwinds.
Emerging Markets	⊖	▲	Given expected longer-term currency appreciation markets are attractive for sterling investors. However, a selective approach is demanded at both country and corporate level and volatility is likely should US rates rise and depending upon the pace of economic adjustment in China.

KEY

Current View: ⊕ Positive ⊖ Neutral ⊗ Negative

Outlook: ▲ Improving outlook ▶ No change in outlook ▼ Deteriorating outlook

Portfolio Overview

Performance (%) for the period ending 30 June 2016

Portfolio	Descriptor	Quarter	1 Year	3 Years	Since Launch*
Parallel Multi Asset A	Defensive Growth	0.52	1.73	7.60	12.81
Parallel Multi Asset B	Conservative Growth	0.39	1.47	12.33	22.00
Parallel Multi Asset C	Cautious Growth	1.62	3.06	16.85	30.25
Parallel Multi Asset D	Balanced Growth	2.52	4.36	22.63	39.53
Parallel Multi Asset E	Adventurous Growth	3.48	5.07	23.27	40.12
Parallel Multi Asset F	Global Opportunities	4.96	5.94	24.14	38.39
Parallel Multi Asset B Income	Conservative Income	0.99	3.22	10.95	17.43
Parallel Multi Asset D Income	Balanced Income	2.12	5.55	16.85	31.92
Socially Responsible Growth		3.02	3.56	20.74	38.10

Figures quoted net of management fee. Source: FE Analytics

*Inception date: 1 April 2012

Fund Selection: Contributing Funds

Legg Mason Japan – This was again the best performing fund in the Parallel portfolios, with much of the gains attributable to the strengthening of the Japanese yen which translated into strong returns for sterling investors.

Stewart Investors Asia Pacific Leaders – Asian markets as a whole were a key beneficiary of the UK's decision to leave the EU and this Fund was well placed to capitalise on this, outperforming the index over the period.

Newton Global Income – This Fund performed well over the quarter outperforming both its benchmark index and sector average. The Fund continues to be positioned for a challenging period of low growth, deflationary pressures and volatile returns.

Fund Selection: Detracting Funds

Kames Property Income and L&G UK Property – Most 'bricks and mortar' property funds experienced a difficult time after the EU referendum as uncertainty over the future of UK commercial property values prompted Funds to implement downward pricing adjustments. This translated into a fall in the value of these funds over the period, with Kames and L&G being among those that were affected by such measures.

Unicorn Income – This Fund has a bias towards high quality small and mid-cap stocks that are exposed to long term structural growth themes, backed by sound company fundamentals. However indiscriminate selling in this area of the market immediately following the outcome of the referendum has impacted short-term performance.

Portfolio Activity

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

Reduction in UK and European equity exposure – In the run up to the UK's referendum vote the Investment Committee decided to remove some risk from the portfolios in case of a 'Leave' result that could see markets sell-off heavily. This was achieved through trimming exposure to UK and European equities across all portfolios and increasing the holding in cash.

Sale of direct property fund holdings – As highlighted above, the property sector has been one of the hardest hit as a result of the UK's decision to leave the EU. Uncertainty around commercial property made many nervous investors exit their positions in the sector. In response, many large property funds imposed a block on redemptions in order to stem outflows. Whilst we are still positive on the asset class and still like the Kames and L&G funds, we felt it was in the best interests of our clients to sell both holdings in view of a possible closure that would see clients' money being stuck in the funds for an indeterminate period of time.

Risk warnings

Investors should be aware that past performance is not a reliable indicator of future results and that the price of shares and other investments, and the income derived from them may fall as well as rise and the amount realised may be less than the original sum invested. The content of this newsletter is for your general information and use only, and it reflects the general market view of Parallel Investment Management Ltd., and should not be interpreted as recommendations or advice. The content should not be relied upon in its entirety and shall not be deemed to be, or constitute, advice. Although endeavours have been made to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No individual or company should act upon such information without receiving appropriate professional advice after a thorough examination of their particular situation. We cannot accept responsibility for any loss as a result of acts or omissions taken in respect of the content. The value of your investments can go down as well as up and you may get back less than you invested.