Parallel

Investment Management

Quarterly Update – October 2016

Market Backdrop

After the sharp rise in global equity markets immediately following the EU Referendum there was only a momentary pause for breath before markets rallied again, with investors buoyed by the prospect of central banks keeping interest rates lower for longer and a relatively more confident mood about the outlook for the global economy.

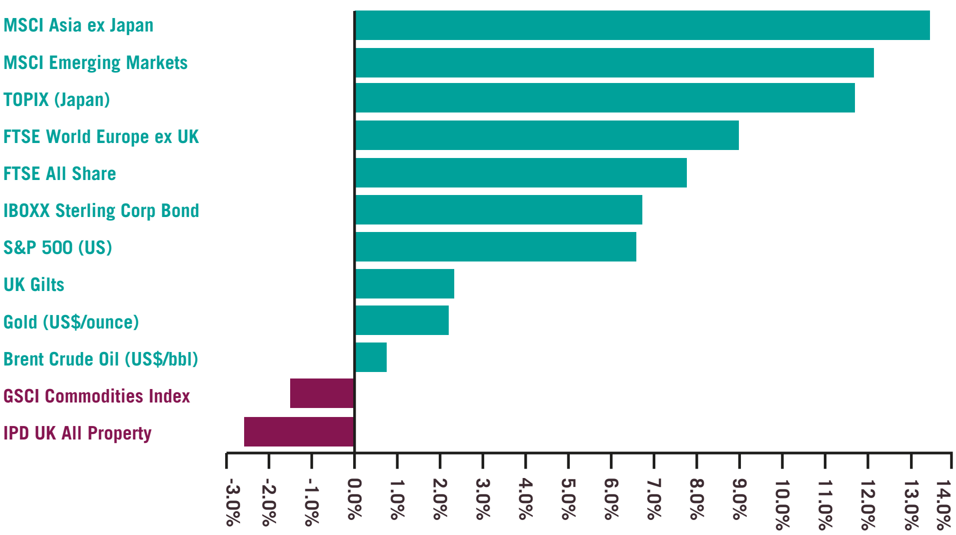
In the UK the FTSE 100 Index climbed to a 12-month high, helped by a weakened sterling which would benefit companies with overseas earnings. The markets appeared reassured by the speedy appointment of Theresa May as UK Prime Minister, although this was partly dampened by some worsening economic data. Outside of Brexit uncertainty, much of the focus in July was on how soon and by how much the Fed would tighten US rates, but a dovish tone nurtured investors' risk appetite.

Several markets nudged their all-time highs in August as investors rotated out of perceived 'safer' bond-like equities into cyclical and more economically sensitive areas of the markets. Global emerging markets continued their strong performance, notably emerging Asia, on the back of improving economic data from China. Asset prices in the UK market were supported by a 0.25% cut in interest rates by the Bank of England, and an announcement that it would apply additional stimulus measures to support the economy. Both the Euro-zone and Japanese equity markets moved marginally higher but this was largely in the expectation that their respective central banks would extend and expand their asset purchase programmes.

The dominating factor influencing market trading in September was uncertainty about the path of global monetary policy. Major developed market central banks, particularly the US Fed, displayed a reluctance to raise interest rates as concerns resurfaced over the slowdown in global growth. Despite market sentiment lifting, regional returns varied with both the US and Euro-zone equity markets in retreat, although sterling investors benefitted as a consequence of a weakened sterling with Japanese equities producing the best returns. Speculation over the terms of the UK's eventual trading position following its exit from the European Union weighed on the sterling sovereign and corporate bond markets, causing them to give up some of the recent strong returns.

We believe that valuations in many parts of the market have become 'divorced from reality' and so overleaf we share some thoughts on the global economy and on the short-term outlook for the markets.

Asset Class Returns – Q3 2016



Data source: FE Analytics – rebased in Pounds Sterling

Parallel Investment Management Ltd.

Alexander House
James Street West
Bath BA1 2BT
Telephone 0345 128 6699

www.parallel-im.co.uk

2016 marks the fifth consecutive year with global growth below its long-term average.

It is reasonable to ask how we have ended up in this position when for 30 years global firms have benefited from the tailwinds of falling interest rates, making debt cheaper, and globalisation which has meant that they have been able to freely manufacture and sell around the world and even manipulate the jurisdictions in which they pay tax. Add to this the clear evidence that since the 2008 financial crisis the gap between the rich and poor has widened and there is little wonder that populism is on the rise.

With interest rates at historic lows, albeit with the possibility, certainly in the US, that they may shortly begin to rise, and increasing signs of protectionism beginning to creep back in, it is questionable whether politicians and central bankers will be able to create a climate that supports a significant rebound in trade. It would also be foolish to ignore the almost inexorable rise in public debt and the possibility that governments may begin to target businesses for their cash piles through various forms of taxation, thereby reducing the capital available for investment to grow future profits. Couple this with the growing application of a minimum wage and the outlook for profits (and dividends) looks poorer.

Given this backdrop, companies can no longer rely on falling costs of capital or labour, or some form of financial engineering to grow profits and must seek alternative solutions.

We do not consider that it is all doom and gloom and believe that there are plenty of opportunities for investors, even if the future returns are likely to be muted compared with previous years. After all, there are currently some 7.5 billion consumers in the world and this is forecast to grow at a rate of about 1% each year.

In the short term, we anticipate further market volatility with no clear direction of travel until we have more clarity on the prevailing drivers of interest rates and corporate earnings, and are thus focussed on ensuring that we are selectively positioned within our portfolios. The consensus view is now questioning the efficacy of quantitative easing and September saw none of the speculated changes in monetary easing or even tightening that had previously so excited markets. Indeed, a number of governments may now be quietly mulling the when/if questions on applying fiscal stimulus, whether this be through infrastructure spend or dropping notes from helicopters, to boost lacklustre growth in their local economies. In this context, in the UK there is much anticipation over the detail of the Chancellor's autumn statement due on 23 November.

It is estimated that during the post-crisis period of economic austerity the amount of infrastructure spend has fallen below that required to meet growing demand, and by as much as $1trillion globally (Financial Times citing World Economic Forum 9th November 2015 – see chart). As such, there is possible scope to provide stimulus to flagging economies by 'green-lighting' investment in targeted projects that would themselves add economic value to a country.

The oil price has been given a boost at the prospect of a cut in OPEC production, and whether this rallies markets on the basis of a stimulus to oil stock earnings or acts as a 'tax' on consumption we will see over the coming quarters. However, it is worth noting that the oil price is likely to remain around the cost of producing shale oil. When the oil price rises production becomes attractive for those higher cost oil producers such as shale producers in the US who re-start or ratchet-up production which in turn dampens the oil price increase.

Chinese Debt has risen dramatically from 140% of GDP in 2008 to 249% (2015), with Fitch estimating non-performing bank loans (NPLs) at 20%. However, taking account of net debt, affordability, the 'two-speed' Chinese economy, and the question of how a command economy reacts to insolvency, all suggest that the uncertainty of the China story may run for some time.

Banking concerns have recently shifted from Italy to Germany, the Euro-zone's powerhouse economy. Whilst this casts a shadow over the European Central Bank's favoured stimulus transmission method, the EU has a successful track record to date in 'kicking the can' further down the road and we would anticipate more of the same.

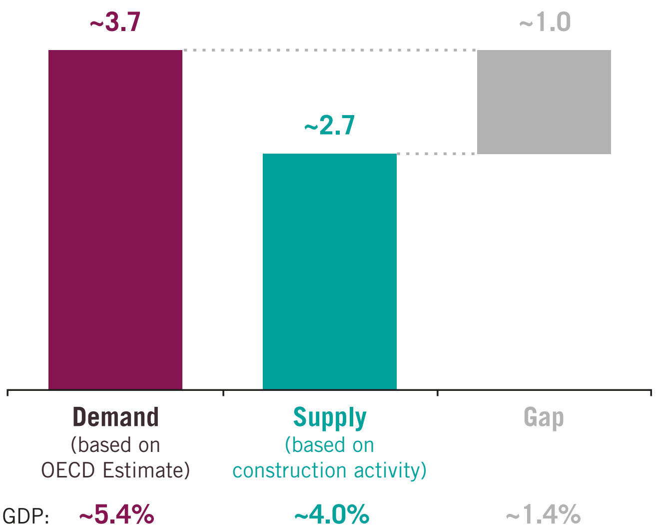
Despite the above uncertainties consumer spending is currently resilient whether you live in Bath, Boston or Beijing, with both UK and US retail sales notably returning to growth in September and consumption contributing almost three-quarters of China's economic expansion in the first half of 2016.

In summary, there is no doubt that there are many (and significant) risks to contend with, both economic and political. We will continue to try and manage the balance between risk and return within the portfolios by employing diversification to avoid too much concentration of risk, understanding where investment fund managers are allocating capital, and by adopting a nimble approach as we navigate these increasingly challenging conditions.

We believe that opportunities remain to achieve an investment return in excess of cash deposits and inflation, but that investors' expectations of the likely future returns need to be realistic.

The Global Infrastructure Gap

US$ trillion, annual (average 2010–2030)



Source: World Economic Forum

Investment Views

Asset Class	Current View	Comment
Equities	+	We remain selectively positive on equities based on relative valuation to other asset classes and the support of real cash-flow through dividends in a yield-starved world. We see particular opportunities in strategies supported by resilient domestic consumption, and with the change in sentiment towards loose monetary policy in infrastructure spending.
Fixed Interest	−	With little potential upside from Treasury stocks around the world, and higher yield bonds more exposed to default risk, our preference is for managers with active strategic mandates, or investment grade bonds where the historical returns in market downturns has been more defensive than in equities.
Property	+	Whilst there may initially appear less potential for capital appreciation than in previous years, property is well supported by real yields and the current turmoil with sterling may present an attractive return point for overseas investors, boosting demand.
Commodities	−	Industrial commodities are still transitioning from a position of oversupply, and only if spare capacity can be found to mop up the glut should investors add to the asset class unless they have a long time horizon.
Absolute Return	+	This area should not only provide a useful diversifying tool to reduce portfolio risk in volatile times but also the opportunity to achieve positive returns in what could prove a testing economic environment over the next 18 months.
Cash	−	With negligible rates of return on cash we see cash as a temporary tactical holding ahead of potential politically-driven volatility in developed markets.

Equity Regions	Current View	Comment
UK	●	Ongoing sterling weakness should provide further revaluations for overseas earners and possible changes necessitated by Brexit are likely to provide both challenges and opportunities supporting a more active approach to fund management.
US	+	Though the US business cycle is now ‘long in the tooth’ we may see a US interest rate rise before year end. That said, it is worth noting US equities have historically outperformed peers in economic downturns though it will pay to buy selectively.
Europe	−	European monetary policy would appear to have some legs in it yet, which should provide support for risk and non-risk assets alike. Questions over delivering this support to European domestic economies through bank lending does temper our enthusiasm.
Japan	●	Japanese monetary policy is running out of stock to buy, suggesting that a migration to fiscal rather than monetary stimulus may be close, which would provide a fillip to domestic consumption.
Asia Pacific and Emerging Markets	+	Headlines surrounding high levels of debt and poor growth in industrials mask strength in the region’s service sector and opportunities created by evolving domestic consumption, suggesting a selective approach is more important than ever.

KEY:

+ Positive ● Neutral − Negative

Portfolio Overview

Performance (%) for the period ending 30 September 2016

Portfolio	Descriptor	Quarter	1 Year	3 Years	Since Launch*
Parallel Multi Asset A	Defensive Growth	3.21	5.73	10.83	16.43
Parallel Multi Asset B	Conservative Growth	3.65	6.26	15.75	26.46
Parallel Multi Asset C	Cautious Growth	5.05	10.82	21.91	36.83
Parallel Multi Asset D	Balanced Growth	5.78	14.01	27.23	47.59
Parallel Multi Asset E	Adventurous Growth	6.74	17.60	28.68	49.57
Parallel Multi Asset F	Global Opportunities	8.07	22.07	30.73	49.56
Parallel Multi Asset B Income	Conservative Income	4.01	8.18	14.80	21.98
Parallel Multi Asset D Income	Balanced Income	6.04	15.11	23.13	39.75
Socially Responsible Growth		8.15	18.92	26.38	49.35

Figures quoted net of management fee. Source: FE Analytics

*Inception date: 1 April 2012

Fund Selection: Contributing Funds

Unicorn Income – After falling significantly in the immediate aftermath of the Brexit vote the Fund was the best performing UK fund in our portfolios over the quarter. The Fund provides a diversified portfolio with a mid/small cap bias but its process driven approach to stock selection with low correlation to its peer group supports its continued inclusion.

Fidelity Emerging Markets – Although marginally underperforming the strong returns of its benchmark the Fund has made a positive contribution to our primary growth portfolios whilst maintaining a relatively cautious approach. The Fund continues to target consumer-related stocks which are market leaders but which operate in under-researched areas with significant structural growth potential.

Fund Selection: Detracting Funds

Legg Mason Japan – Over the quarter Japanese stocks focused on the domestic economy were out of favour compared with financials and large-cap manufacturers, and this presented significant headwinds for the Fund. However, at the start of September the market re-focussed on fundamentals and the performance of the Fund has improved markedly.

Investec UK Total Return – Despite producing a positive return in the quarter the Fund only produced half of the performance of its benchmark, the FTSE All-Share Index. This reflects its focus on 'value' rather than 'momentum' stocks which is likely to lead to underperformance in buoyant markets, such as witnessed after the Brexit vote.

Portfolio Activity

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

Changes to Target Absolute Return holdings – The Investment Committee took the decision to sell the Standard Life GARS Fund across each of the portfolios following a sustained period of poor performance, concerns over the significant size of the Fund, as well as an increasing correlation of its strategy to equities. The opportunity was taken to revise the strategy and choice of absolute return funds within each of the different portfolios to more closely align with their respective risk tolerances.

Changes to UK Equity Income holdings – The extraordinary measures introduced following the 2008 financial crisis have impacted on the normal business cycle against which the investment strategy of the Schroder UK Alpha Income Fund is aligned. The Investment Committee took the decision to sell the Fund in favour of the Evenlode Income Fund and the Royal London UK Equity Income Fund, which are considered to be more appropriately positioned.