Parallel
Investment Management

Quarterly Update – October 2017

Market Backdrop

As the quarter began investor appetite for risk remained robust, causing global equity markets to hover near all-time highs supported by economic data showing continued improvement in global growth. Strong US growth in Q2 led to questions over when, not if, the Federal Reserve Board (Fed) would be tempted to raise interest rates. The European Central Bank kept interest rates unchanged despite virtually all sectors of the region's economy continuing to strengthen. In the UK, the equity market showed little movement largely reflecting mixed signals over the level of economic growth. In contrast, rising incomes and consumer spending, an increase in business investment and overseas demand all contributed to Japan's equity market edging higher in July, with a similar pattern repeated in emerging economies.

The mood in August was far from positive as geopolitical tensions, the seemingly endless struggles of the Trump administration, a further terror attack in Europe and Tropical Storm Harvey dominated the headlines. Nevertheless, global equity markets ended the month higher although the journey was certainly bumpy. On 17 August the US equity market recorded its biggest one-day fall since May reflecting concerns over North Korea, the violence on the streets of Charlottesville, the surprise disbanding of the President's business councils as well as generally stretched share prices. Meanwhile, further disappointing data pointed to weakness in the UK economy, unlike the Eurozone where the pace of growth continues to accelerate. In the Far East, it was perhaps surprising to see the Asian equity markets ending the month higher given the rising geo-political tensions on the Korean peninsula.

There was some relief that September began with global equity markets moving beyond the tensions between North Korea and the US to focus on the continuing, and increasingly synchronised, global economic upswing. In the US, the administration unveiled a sweeping tax reform proposal creating hope that it will aid economic growth, but President Trump's unpredictability and his increasingly fraught relationship with Congress tempered expectations. However, the Fed presented an optimistic outlook for the US economy and announced that it would be raising interest rates as well as paring back its bond-buying programme. Here in the UK, sterling strengthened mid-month after the Governor of the Bank of England hinted at a possible hike in interest rates in November. This caused the UK equity market to retreat, and, for sterling investors, more than eroded a positive return from overseas equity markets for the month. Despite this set-back sterling investors still enjoyed a positive quarter.

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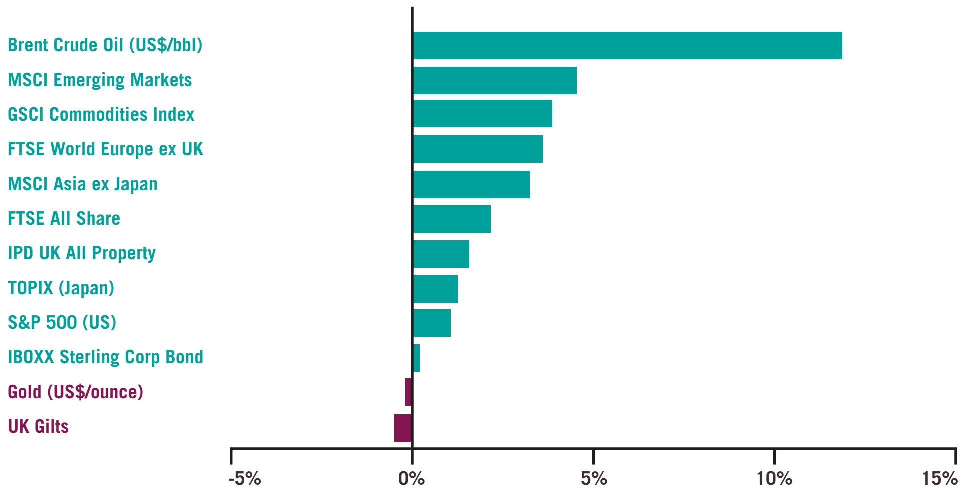
Asset Class Returns – Q3 2017



Data source: FE Analytics – rebased in Pounds Sterling

Market Insights

Following another positive quarter for the Parallel portfolios it would be reasonable for you to ask us if we believe that markets can continue on this trajectory for the remainder of 2017. In truth, we do not know, but it is a distinct possibility.

Since 2012, when we launched our portfolios, it is true that stock markets have performed well, but neither equity markets nor economic cycles die of old age. Major market set-backs tend to occur from a general over-valuation of equities or unsupportable levels of debt in economic systems, the latter being the root cause of the 2008 financial crisis.

Strong economic growth cushions the risks of the rise in debt levels encouraged by cheap borrowing costs, and certainly there is no sign that the synchronised upturn in the world economy is running out of steam. The very fact that the central banks of the US and Europe have even begun to debate when to start the process of withdrawing their emergency support should be seen as evidence that economies are finally on a more sustainable footing.

At present, it would seem that the biggest risks affecting the investment outlook are not economic but political. The rise in populist politics, the uncertain outcome of the Brexit negotiations, the heightened tensions in places such as North Korea and Turkey, are but a few of the factors, both individually and collectively, that create uncertainty and ultimately could have negative implications for markets.

Such a backdrop, whilst making some investors nervous, is really no different from the myriad of issues that the markets have had to contend with through the years; and history shows that, despite periodic shocks to the system, adopting the appropriate time horizon and ensuring adequate diversification within a portfolio continues to offer the best opportunity for generating a better return than cash, as well as beating inflation.

News Update

Socially Responsible Investing (SRI) Portfolios

Since April 2012 we have offered a Socially Responsible Growth Portfolio (SRG) for investors who wish to adopt an ‘ethical’ approach to investment and to date the Portfolio has generated strong returns. We believe that interest in SRI is growing and so we have recently conducted a review of our approach to ensure that we offer an investment solution that is both current for the changes taking place in society, as well one that is transparent in the methodology applied to its construction.

There is increasing evidence to counter the commonly held view that investors who adopt such an approach inevitably sacrifice performance, even though performance is likely to be of secondary importance to ensuring strict adherence to their investment principles and criteria.

Furthermore, the widening investment universe allows us now to gain access to screened investment vehicles which encompass a broader range of asset classes than has previously been the case. This has created the opportunity to provide a portfolio with a better balance of risk and return and so, to reflect this, we have changed the name of the SRG Portfolio to the SRI Balanced Growth Portfolio and made some relatively small adjustments to the asset allocation.

We are also conscious that despite the strong track record of the SRG Portfolio its risk/return profile makes it unsuitable for some investors who wish to adopt a more cautious approach to risk, and so we have therefore launched the SRI Cautious Growth Portfolio to complement the SRI Balanced Growth Portfolio. Details of our SRI Portfolios together with our screening criteria can be found on our website, www.parallel-im.co.uk.

Passive Portfolios

Passive investing, where funds attempt to match the returns from an index and make no active bid to choose stocks or other securities, has transformed markets over the past 25 years.

At present, passively invested funds account for an estimated 7% of global equities and index funds currently dominate flows of new money into the market. Passive investing can be done more cheaply than active investing and this, together with the fact that so few active managers consistently outperform their benchmark index has further stimulated interest.

A good active manager uses stock selection skills to attempt to outperform the index as well as provide some protection in falling markets. This compares with a passive fund which can only provide performance similar to that of the index in rising and falling markets. In our core portfolios we seek to identify active managers who consistently outperform the indices, but we acknowledge that for some investors cost is a significant factor in selecting their preferred method of investing, and for this reason we have launched three passive portfolios: Passive Cautious Growth, Passive Balanced Growth and Passive Adventurous Growth.

The portfolios were launched on 01 July 2017 and adopt very similar asset allocation to our core portfolios, but are populated entirely with passive instruments. Full details can be found on our website, www.parallel-im.co.uk.

Investment Views

Asset Class	Current View	Comment
Equities	⊕	Healthy global growth is supportive of equities. On a global basis loose accommodative monetary policy and fiscal policy are expected to outweigh any headwinds from slower Chinese growth, the tightening of monetary policy in the US and the Eurozone, and political uncertainty. However, at current market prices the capacity to absorb bad news is diminishing.
Fixed Interest	⊖	Strong global growth together with the risk of cyclical inflationary pressures and gradual monetary policy normalisation create an unfriendly environment for bonds. On a relative basis the corporate bond sector is more attractive than government debt, especially given such low current default rates, but overall returns are unattractive.
Property	●	Real estate offers attractive medium term returns relative to developed-market government bonds. Stronger global growth should lead to rising rental income. However, Brexit uncertainty is likely to act as a headwind in the UK, and even in overseas markets a highly selective approach is required.
Commodities	⊖	The asset class offers diversification benefits as well as some inflation-hedging characteristics. With global growth accelerating demand should remain buoyant although further gains from the asset class remain dependent on the direction of China's economy, and consequently a cautious approach is required.
Absolute Return	●	Although Absolute Returns funds provide a useful diversifying tool to reduce portfolio risk in what may prove to be a 'bumpy' period, the wide range of returns within the sector tempers our enthusiasm.
Cash	⊖	Despite indications from the Governor of the Bank of England that UK rates will shortly be on the rise we expect any increase to be small, and any future increases to be gradual. Consequently, the return on cash is expected to remain disappointing although the asset class continues to offer defensive qualities

Equity Regions	Current View	Comment
UK	●	With the domestic economy showing signs of weakness, poor labour productivity, sterling-induced inflationary pressures, Brexit-related uncertainty and the risk of the consumer being squeezed, we have tilted UK exposure towards larger companies where overseas earnings are more prevalent.
US	●	Despite the lack of delivery (as yet) of the much vaunted fiscal stimulus the economy remains robust with strong earnings. Wage growth pressures are building but are not expected to heighten the recession risk in the short term. Too aggressive policy tightening by the Fed could upset the equilibrium.
Europe	⊕	With a recovery in industrial production alongside the strong consumption growth the outlook for the region is positive, despite the recent strengthening of the Euro. Headwinds remain in the form of Brexit, the extent of any tightening by the ECB, and politics (especially Catalonia and forthcoming Italian elections).
Japan	●	Economic data continues to show an improving, albeit sluggish, economy, but with the likely continuation of loose monetary policy and fiscal stimulus earnings momentum is positive.
Asia Pacific and Emerging Markets	⊕	Despite geopolitical tensions, a number of key emerging economies have returned to growth, with receding fears of US protectionism and exchange rates with the US dollar also adding support.

KEY:
⊕ Positive ● Neutral ⊖ Negative

NOTE: The opinions expressed in this document do not constitute investment advice or a recommendation nor investment research

Portfolio Overview

Performance (%) for the period ending 31 September 2017

Portfolio	Descriptor	Quarter	1 Year	3 Years	5 Years
Parallel Multi Asset A	Defensive Growth	0.65%	5.51%	12.88%	19.76%
Parallel Multi Asset B	Conservative Growth	0.97%	6.69%	16.53%	30.36%
Parallel Multi Asset C	Cautious Growth	1.60%	8.27%	23.46%	42.75%
Parallel Multi Asset D	Balanced Growth	2.22%	9.91%	30.51%	56.59%
Parallel Multi Asset E	Adventurous Growth	2.52%	11.09%	33.92%	61.15%
Parallel Multi Asset F	Global Opportunities	2.60%	12.00%	36.96%	64.67%
Parallel Multi Asset B Income	Conservative Income	0.94%	7.60%	17.84%	25.78%
Parallel Multi Asset D Income	Balanced Income	1.33%	9.26%	27.11%	46.69%
SRI Cautious Growth*		–	–	–	–
SRI Balanced Growth		1.40%	12.03%	33.68%	64.85%

Figures quoted net of management fee. Source: FE Analytics

*Model launched on 1st August 2017

Fund Selection: Contributing Funds

GS Emerging Markets Equity – The Fund's bias towards companies with strong cash flow, competitive advantage and the ability to withstand inflationary pressures helped it to outperform both its MSCI benchmark and peer group during the quarter. The managers take a view on each emerging market region and then seek to identify potential mispricing opportunities after intensive analysis at company level.

GAM Star Credit Opportunities – The Fund's strategy of investing in corporate bonds lower down the capital structure of high quality issuers enabled it to outperform both its peer group and the Barclays Sterling Aggregate Corporate Index in Q3. The managers are cognisant that rates may rise in the near-term but believe hikes will be limited in absolute terms as growth remains weak and structural deflationary forces remain in place.

Fund Selection: Detracting Funds

Newton Real Return – The Fund delivered a negative return and underperformed the MSCI World Index in the period reflecting its defensive stance. Despite providing an element of downside protection during periods of heightened volatility, we believe that the Fund's underperformance in calmer market conditions does not outweigh its capital preservation benefits and so we have removed the holding from our portfolios.

Evenlode Income – Despite posting a return in the quarter the Fund lagged the FTSE All-Share Index due to its quality bias and underweight to both resources and financials. The Fund focuses on companies with sustainable real dividend growth, high returns on capital and strong free cash-flow. We are confident the Fund's performance will improve once the current rotation into value/cyclical sectors is reversed.

Portfolio Activity

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

Reduction of Targeted Absolute Return exposure – Even though the holdings used within this element of our portfolios are used primarily to minimise risk and preserve capital during periods of heightened market volatility, we've become concerned that some of our holdings are not providing a consistent positive contribution to returns. We therefore decided to lessen our exposure to this sector by reducing the number of holdings.

Increase in allocation to fixed interest – Despite continuing to prefer equities over bonds at present, we believe that fixed income still plays an important role within our portfolios. Having decreased our exposure to Target Absolute Return, we increased our asset-backed credit exposure and also our allocation to strategic bonds, where the fund managers apply their expertise to navigate an increasingly difficult backdrop.