

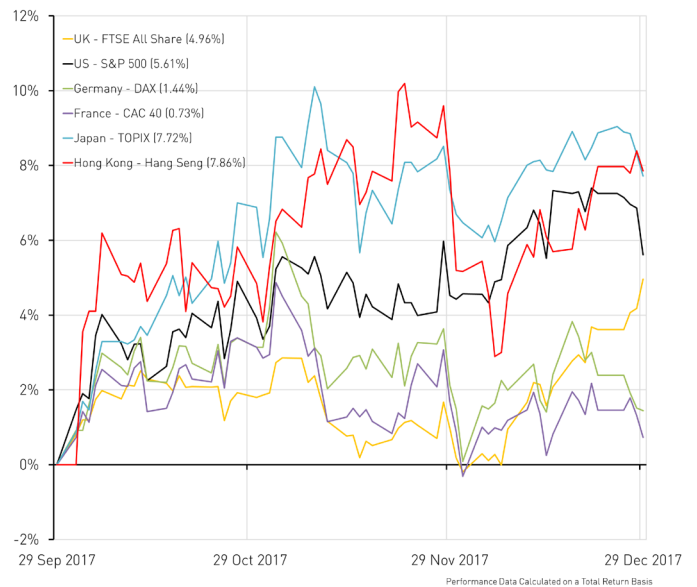


REVIEW OF THE PAST QUARTER:

November saw the Bank of England raise interest rates to 0.5 per cent, marking the start of the policy-normalisation process. The autumn budget came later in the month and contained significant downgrades to growth forecasts for 2017-2022. The gloom was somewhat offset in December, when a deal was reached between the UK and the EU, putting an end to a tumultuous first phase of Brexit negotiations. On the continent, October saw the European Central Bank extend a less generous version of its quantitative easing programme while keeping interest rates on hold.

In the US, expansionary tax reforms were passed by Congress and the House of Representatives, leading the Federal Reserve to raise its growth forecasts for 2017 and 2018 to 2.5 per cent, shortly after raising interest rates by 0.25 per cent. The reforms include a cut to corporate tax from 35 to 21 per cent. The quarter also saw US President Donald Trump nominate Jerome Powell as Janet Yellen's successor. He will take over as Chair of the Federal Reserve in February.

In October, Japanese Prime Minister Shinzo Abe secured a strong mandate for his hard line against North Korea with a convincing majority. Elsewhere in Asia, after what was deemed President Trump's successful tour of the continent, North Korea launched its most powerful missile ever - allegedly putting the entire US in range.



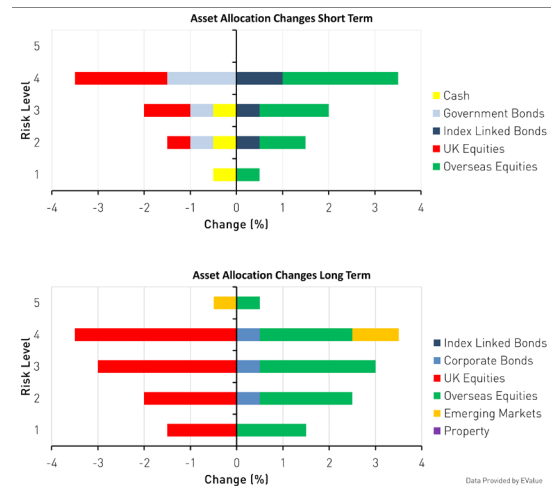
ASSET CLASS RETURNS

UK	US	Japan	Europe	Emerging Markets	Commodities	Property	Corporate Bond	Gilts	Cash
+4.96%	+5.61%	+7.72%	+0.19%	+6.55%	+9.00%	+1.91%	+2.07%	+1.97%	+0.08%

THE ACTUARIAL VIEW:

The last three months have seen little in terms of concrete developments to move markets, yet markets remain buoyant. For the first time in years, however, we are seeing accelerating growth almost uniformly across the globe. The global picture has generally been one of falling unemployment levels and low inflation. This is a slightly curious phenomenon, as high employment would be expected to stoke demand, but can perhaps be explained by low wage growth.

The exceptions to this are the US and the UK. The US has been raising interest rates for some time, and the UK has recently raised rates for the first time in years. This, in some ways, is also curious as raising rates would generally signify strong growth activity. In the US, however, growth is expected to slow whilst the UK is experiencing a period of high inflation and growth falling much faster than expected, as the fallout from the EU Brexit referendum and an impasse in the subsequent negotiations begin to bite. Overall, changes for asset allocations are modest, with a slight move away from the UK into other equities. The prospects for property have decreased as higher rates generally put pressure on capital values.



WHAT TO LOOK FOR IN Q1 2018:

- Japan:** There is a Bank of Japan meeting on January 22-23. An outlook report will be published the same day. The next meeting will be on March 8-9.
- US:** Federal Open Market Committee meetings will take place on January 30-31 and March 20-21. February 3 will see Jerome Powell take over from Janet Yellen as Chair of the Federal Reserve..
- Europe:** There is a European Central Bank meeting on January 25 with a press conference later in the day. The 2018 Russian presidential election takes place on March 18.
- UK:** Monetary Policy Committee announcements with minutes are scheduled for February 8 and March 22. An inflation report will be published on February 8. Talks on a trade deal between the UK and the EU are currently expected to begin in March, the same month that a two-year EU Brexit transition deal is expected to be agreed.
- Other Data:** The Office for National Statistics is set to release its UK productivity bulletin for July to September on January 5. The UK consumer price inflation bulletins for December, January and February will be released on January 16, February 13 and March 20 respectively. The US Census Bureau will release its US International Trade in Goods and Services reports for November, December and January on January 5, February 6 and March 7 respectively.

ASSET CLASS SCENARIOS:



UK EQUITY

Most Likely: EU Brexit sentiment will continue to drive UK sterling, which in turn will move large-cap exporters. Recent positive developments, with Brexit talks moving into the second round, mean further UK sterling strength from here is limited, so large caps will close the gap with recent outperforming smaller and medium sized companies. Coming off the back of recent strength, we would expect oil and commodities to trade sideways from here, which is profitable and positive for stocks within these sectors.

Worst Case: Chinese de-levering will halt demand in commodities and oil, which will result in price weakness and falls in those large sectors. Further EU Brexit posturing may weaken UK sterling (with exporters doing relatively better) as real wages continue to fall and inflation bites. Any sustained imported inflation will raise short term rates dragging income stocks lower.

Best Case: Sustained progress in EU Brexit talks encourages businesses back into capital investment that, at long last, begins to stimulate growth. Stronger UK sterling is a drag on exporting stocks in this scenario - expect domestics to outperform like in 2016. Softer Chinese monetary policy will be positive to commodities and oil stocks as OPEC cuts are maintained.



GLOBAL EQUITY

Most likely: The economic backdrop is supportive and moderate growth looks set to continue in 2018 across Europe, Japan and the US. Despite late-cycle dynamics in the US, short-term recession risk is low - wages and rates have room to rise before it becomes problematic for the economy. Japan is in the 'sweet spot' of the economic cycle, allowing the best of corporate Japan to perform well.

Worst case: Markets could price in regulatory uncertainty around data privacy and anti-trust, derailing the technology rally. Risk of new elections in Germany may lead voters towards right-wing populist party AfD ('Alternative for Germany'), which has thrived on dissatisfaction with established parties, leaving European equities vulnerable. Slowing buybacks and dividend growth with little margin improvement, may imply unspectacular returns for Japanese equities.

Best case: US earnings could see a boost, with the largest beneficiaries being banks, airlines and oil refiners resulting from proposed tax cuts. European equities should benefit from continuing profit margin expansion, low inflation and falling stockmarket correlations. Japanese equities should benefit from healthy earnings and progressive corporate reform.



EMERGING MARKET EQUITY

Most Likely: Emerging markets are likely to make positive returns this quarter, although less than they saw in 2017 as valuations in the market start to normalise following a strong period. South Africa is likely to have a strong quarter thanks to the results of the ANC leadership election in December, while Brazil is likely to lag as the president is unlikely to succeed in getting pension reform through before elections. Local factors are likely to become critical to returns in each country.

Worst Case: A global downturn, led by the US, could lead to serious headwinds for the region. The US dollar would likely rise, which would be mostly negative for emerging market economies, while investors would seek out the safety of developed world government bonds and equities.

Best Case: If the developed world continues to grow slowly and rate rises are delayed, then emerging markets are likely to remain in favour. The whole region could become more richly-valued if equity markets in the developed world are sluggish while economic growth is steady, encouraging investors into the developing region.



CASH

Most Likely: It is likely there will be no changes to interest rates and inflation will start to fall. This means that losses on cash will narrow in real terms. Inflation will remain above target if the significant depreciation of the pound following the Brexit vote has not yet had its full effect on consumer prices. However, it should come down from the 3.1 per cent reached in the year to November, barring any significant currency movements.

Worst Case: While interest rates are put on hold, inflation could rise, pulling real returns further into negative territory. One likely explanation would be a depreciation of the pound following a breakdown in Brexit talks. This would raise import prices for UK firms and it is likely that they would pass some proportion of their increased costs onto consumers, as they have done since the Brexit vote.

Best Case: For cash savers is that inflation falls while rates are raised by 0.25 per cent in January, meaning that losses narrow in real terms. A rise in the price of UK sterling would be the most likely explanation. Any consequent fall in inflation would raise real returns to cash. However, it seems likely they would remain negative even in this best-case scenario.



FIXED INCOME

Most Likely: The market's view of EU Brexit is likely to determine the course of gilt yields over the next quarter. When a deal or a softer Brexit looks more likely, yields are likely to rise; whereas when a 'no-deal' or 'hard' Brexit looks more likely, yields are likely to fall as domestic investors seek the safety of government bonds. Slight gains in corporate bonds are likely as the UK is unlikely to tip into recession.

Worst Case: A collapse of the Conservative government and a new election could lead to Labour's Jeremy Corbyn either leading in the polls or winning the vote by the end of the quarter. This would lead to an expectation of much greater public spending and a weaker economy, which could lead to gilts selling off as international investors flee and domestic investors look to diversify. Corporate and high-yield bonds would also do badly in this environment.

Best Case: For gilts, the best case would be a collapse in the EU Brexit talks and a severe downturn in UK economic data, both of which should lead to risk-aversion and higher demand for safe-haven assets. For corporate and high-yield bonds, the best case would be the opposite, which would lead to lower default risks and higher corporate bond prices.



PROPERTY

Most Likely: Pressure from the EU Brexit negotiations eases following a late-hour divorce deal being struck. Not much change is expected in the UK as companies wait for clarity. Income should continue to drive returns, with disparity among sectors. Capital values might compress a little but should remain localised, with London offices being the most at risk. Low to mid-single digit returns are the most likely outcome for the asset class.

Worst Case: Rapidly-rising rates are a threat to property markets as they reduce the yield gap between bonds and property, and make the asset class less attractive. This is a risk for US real estate investment trusts (REITs) in particular, as the US Federal Reserve shows confidence in the strength of the economy's growth. In the UK, fundamentals have not changed but a stalemate in EU Brexit negotiations, or any sort of bad news, will likely depress investors further.

Best Case: In the UK, early progress on a new trade agreement with the EU would lift investor sentiment and help companies plan for office-space requirements. This would be supportive of capital values. Low interest rates for longer also support the attractiveness of the asset class, and Europe is well positioned in this respect.