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Manager's Report
For the Quarter to 30 September 2018

The MSCI All World Stock index achieved its entire 2018 return in the 3rd quarter, led by the US market. Contrary to 2017, when most risk assets participated in a broad based rally, this year's returns have been highly dispersed.
European and UK stock markets have been lackluster, in spite of decent earnings growth (though at lower levels than in the US) and relatively cheap valuations. Developing markets, especially in Asia, have had a negative return in US dollar terms year to date and are trading at valuations well below historic averages. Dispersion has also been high between industry sectors, with technology, (selected) consumer discretionary, and healthcare sectors providing double digit total returns year to date (until 30 September) while materials, financials and consumer staples returns have been negative.

1) The MSCI World (MSCI ACWI) Index achieved its entire gain for the year in Q3, led by the US Market, while Emerging Markets lagged.

	Security	Currency	Price Change	Total Return	Difference	Annual Eq
1)	SPX Index	USD	8.99%	10.56%	6.32%	14.37%
2)	MXWD Index	USD	2.19%	4.24%	--	5.72%
3)	SXXE Index	EUR	-1.88%	.92%	-3.32%	1.23%
4)	UKX Index	GBP	-2.31%	.92%	-3.32%	1.23%
5)	NKY Index	JPY	5.95%	7.69%	3.44%	10.41%
6)	EEM US Equity	USD	-8.63%	-8.02%	-12.27%	-10.58%

The first weeks of October have lived up to the month's unfavorable reputation. There has been a spike in volatility and a sharp correction in stock markets. We think it is most likely that markets will recover into year-end on the back of a robust US earnings season. S&P 500 operating profits are estimated to have grown by over 28% this year thanks to a strong US economic environment, high consumer confidence, increased government spending, a still favorable lending environment, and tax cuts – see graph below.

2) The US market remains well supported by earnings growth

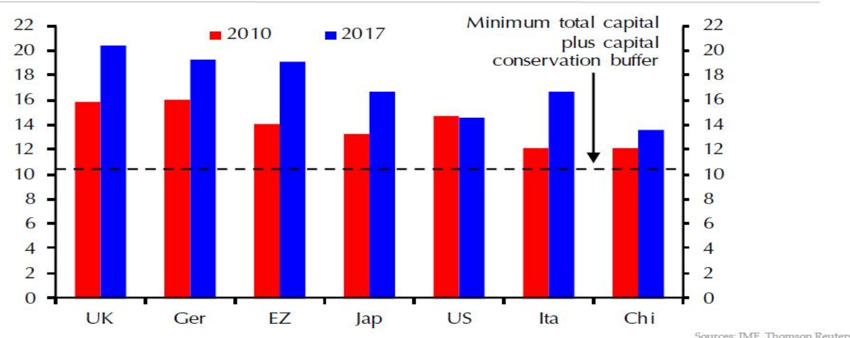
Last data point: 12/10/2018. Source: Datastream, Credit Suisse / IDC

As we indicated in previous reports, the US economy can now be considered "late cycle" – we have heard one well known fund manager compare it to a fifth set at Wimbledon – it can go on indefinitely as there is no tie break.
The tax cuts provided by the Trump administration while the economy was already quite strong are an "experiment" that has no historic precedent – it has certainly prolonged the cyclical upswing of the US economy. As the global expansion has very much been led by the US, we have extended and augmented our monitoring of the US business cycle. We are gradually seeing more lights on that dashboard turning from solid green to amber, even to red, but not yet sufficient in number to warrant a further reduction in equity risk (we adopted a 5% underweight in January this year).

Past cycles have usually ended through a combination of factors, often including excessive monetary tightening by the Federal Reserve, plus a sudden shock – an oil price shock, a collapse of an asset bubble, an endogenous shock such as war, etc.
What kind of shock is likely to cause the next down turn?
On the face of it, many of the "usual culprits" do not seem too alarming at the moment.

- There is no generalized overheating of asset prices, or an asset bubble in any area. Also, banks have been strongly recapitalized since the financial crisis and are much more able to weather a potential decline in asset prices than before.

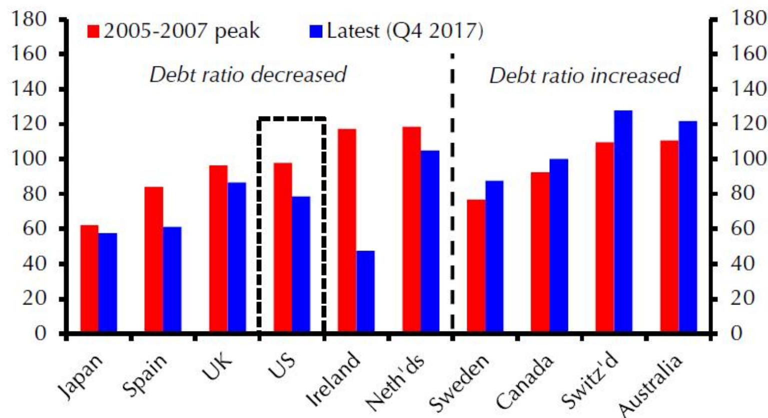
3) Banks' Regulatory Capital as % of Risk Weighted Assets



Source: Capital Economics, IMF, Thomson Reuters

- Debt is also not a big problem. Household debt as a % of GDP has decreased in the larger economies. Corporate debt is benign in most markets, as companies have by and large been hoarding cash, retiring high coupon debt and refrained from overspending (with the exception of parts of the energy and telecom sectors, and China's state owned companies).

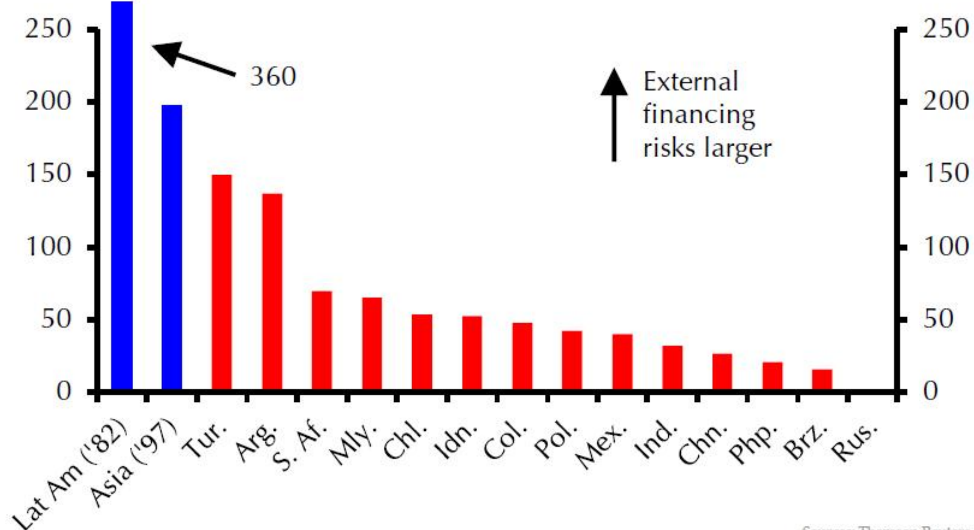
4) Household debt as a % of GDP is mostly lower than in 2008, except in a small number of economies



Source: Capital Economics, BIS, Thomson Reuters

- Risks emanating from Emerging Market crises also seem low. It is true that the strength of the US dollar combined with the threat of a global trade war has caused many emerging market currencies and bond markets to suffer this year. But with the exception of Turkey and Argentina, where economic fundamentals are negative, most developing countries are in much better economic shape than before and, crucially, their dependence on external financing has greatly reduced compared to the EM Currency crises of 1982 and 1997.

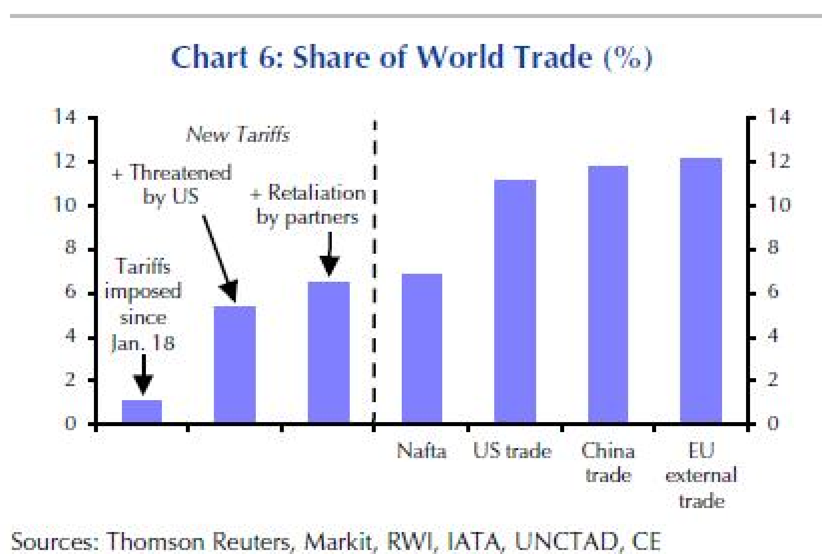
5) Emerging Market external financing requirements, % of Forex Reserves



Source: Capital Economics, Thomson Reuters

- One risk that is undoubtedly present is the risk of a full blown global trade war, and this is certainly something to monitor. As the low interest rate environment and Quantitative Easing policies by central banks after the "Great Financial Crisis" have reflated asset prices more than wages, there has been a growing wealth gap between those who own capital and those who do not, and a sharp rise in populism and nationalist, anti "globalization" sentiment, in many countries.
  The trade tariffs enacted and threatened so far, plus the retaliatory measures taken, are not sufficient yet to dent global economic growth seriously; tariffs effect 6% of global trade, though a somewhat higher percentage (10% - 12%) of trade for the US, China and EU external trade. Exports account for roughly 22% of global GDP. So an increase of tariffs from the current 2% average to 25% would shave roughly 0.3% off global growth, on currently enacted and threatened measures.

6) Share of Global Trade effected by enacted and threatened tariffs



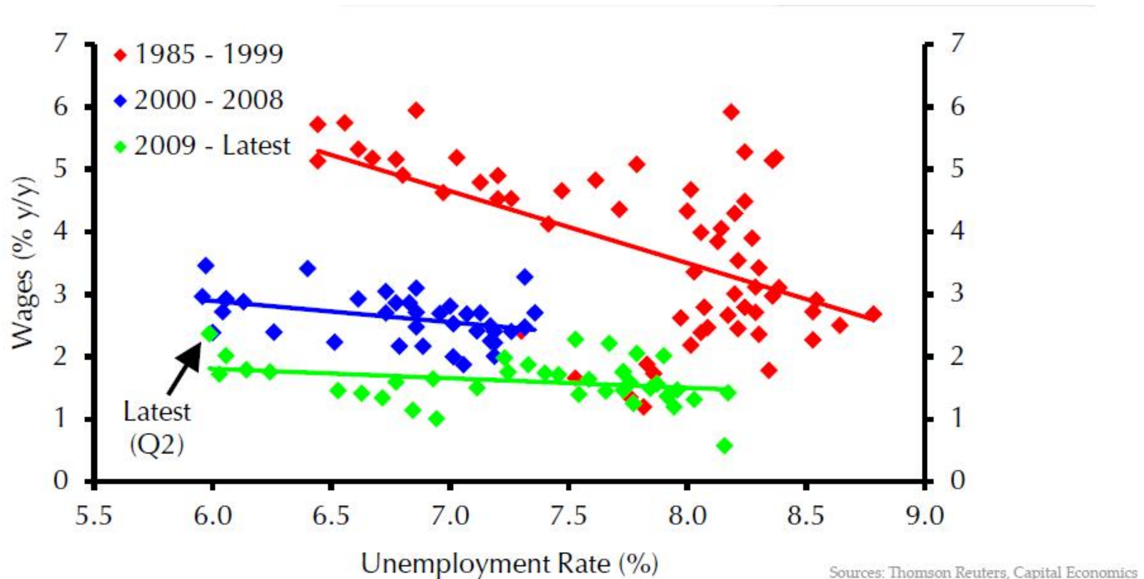
Source: Capital Economics

By the same token, there are no "winners" in a trade war, only losers. Also, the losses are spread unevenly. The US is a relatively "closed" economy, and will be less effected than very open economies such as Asia. Among industries there will be large discrepancies, with those that have complex supply chains (such as autos, aircraft, consumer electronics) being relatively more effected.

- The risk of inflation, and of monetary policy being tightened too far, too fast.
  In spite of a strong decline in unemployment in most developed economies since the Great Recession, especially in the US, wages have not (yet) risen as much as could be expected, and usually higher wages are a key driver of inflation. This has led some economists to declare that the "Phillips Curve" (the traditional reverse correlation between unemployment and wages) is all but dead. Indeed, when looking at the "Phillips curve" over different time periods it seems it has become flatter – probably due to secular factors that suppressed wage growth such as globalization, decrease in unionization, and automation. Very recent data points from the US however do point to a pick up in wage growth, as can be seen on the graph on the next page. Stronger wage growth is a key reason that US consumer confidence is at a multi-year

high, so bodes well for consumer spending and corporate revenues. It will however at some point have a dampening impact on corporate profit margins.

7) The Phillips Curve has recently steepened somewhat



Source: Capital Economics, Thomson Reuters

- With regards to monetary tightening: the US Federal Reserve seems very much on track to continue increasing the Federal Funds rate with 0.25% increments each quarter. US domestic growth is strong, labor markets are tight, and inflationary pressures seem to be increasing – the CPI index is currently 2.3% and the core prices PCE index (the Fed's favored measure) has reached the Fed's target rate of 2% and is likely to trend higher. Most Federal Open Market Committee members see 3% as the new "neutral" Federal Funds rate – which would be achieved by June 2019 in the above hiking scenario. In the previous report we highlighted a possible inversion of the US yield curve (short rates moving above the 10 year bond yield) as a bellwether signal for an imminent US recession. This indicator currently looks a bit more sanguine as the gap between the 2 year and 10 year Treasury yield has widened – the 10 year yield is now firmly above 3%, reflecting the strength in the economy. We believe the yield curve will steepen a bit further, before flattening and inverting, and are keeping a close eye on this indicator.
  As for other major central banks: The Bank of England has little room for maneuver as long as the uncertain outcome of the Brexit negotiations clouds the picture. The UK economy has been surprisingly resilient in spite of this uncertainty and the UK labor market, and wage growth, is similar to that in the US. We expect the Bank of England to start raising rates once there is clarity on Brexit. The European Central Bank is tapering asset purchases, will stop its asset purchases at the end of this year, but only raise interest rates (from negative levels) in late 2019. The Bank of Japan, meanwhile, is expected to keep rates at 0% indefinitely.

Conclusion and Portfolio Strategy:

- Global growth continues to be strong, especially in the USA - the cycle "leader" and still the world's largest stock market. There are signs that we are in the latter stages of the recovery cycle in the US. Monetary policy is being tightened and real interest rates have already risen by around 2% (from very low levels). Wage growth and higher input prices (also due to an

increase in tariffs) are likely to effect corporate profit margins sooner rather than later.

- China's economy is slowing, probably more pronouncedly than is shown by the official figures published by the government. China is a key target of the "Trump Trade War". The Chinese government has responded by some targeted measures to ease monetary policy to support the domestic economy.

- There is a growing list of global geo-political uncertainties that muddy the medium term outlook. These include the ongoing trade skirmishes, the still entirely uncertain Brexit negotiations, Italy's clash with the EU about their wish to increase the budget deficit, the renewed US sanctions on Iran that influence global oil supply, and now also new tensions between the US and Saudi Arabia around the disappearance of journalist and US resident Jamal Khashoggi.

- Our Cycle and Market monitors are still predominantly "green", favoring equity risk, but amber and red lights on our dashboard are increasing. We are likely to use a year end rally to decrease equity risk in portfolio by a further 5%, to a total of 10% below clients' "neutral" allocation.

- Fixed income markets have largely provided negative returns year to date as government bond yields have risen in all currencies. We currently see value arising in parts of the US dollar bond market as we believe the secular forces that suppress core inflation are still at play, and US rates are likely to peak around 3% this cycle.

- Profits taken in equity portfolios will continue to be reinvested in Alternative investments, especially for non-US dollar investors as euro and sterling bond markets are not very attractive at current levels. Within the Alternatives sub accounts we select investments with a low or no correlation to stock and bond markets, as well as private markets (private equity, real estate) that are less dependent on daily fluctuations in market prices.

While the short term investment outlook, as ever, contains uncertainties, we firmly believe that a well-diversified global portfolio, exposed to the risk premia offered by stocks, fixed income and selected alternative investments, will out perform bank interest rates over the medium and long term. We are excited by, and invested in, the investment opportunities offered by new technologies, increasing adoption of clean energy, breakthroughs in health care, and other powerful secular trends.

As always, please do not hesitate to contact us if you have any questions or comments, about the contents of this report or your portfolio in general.

Portfolio Management Team ISGAM AG

Performance Table – 30 September 2018

Index / Fund	% Total return local currency Q3 2018	% Total Return in USD Q3 2018	% Total Return in EUR Q3 2018	% Total Return in GBP Q3 2018	% Total Return in USD YTD	% Total Return % in EUR YTD	Total Return in GBP YTD
S&P 500 Index	7.7%	7.7%	8.5%	9.2%	10.6%	14.4%	14.7%
Nasdaq Index	7.4%	7.4%	8.2%	8.9%	17.5%	21.5%	21.8%
FTSE 100 Index	-0.7%	-2.0%	-1.4%	-0.7%	-2.7%	0.6%	0.9%
DJ EuroStoxx Index	0.6%	-0.1%	0.6%	1.3%	-2.4%	0.9%	1.2%
Nikkei 225 Index	8.8%	5.9%	6.7%	7.4%	6.7%	10.4%	10.7%
DJ Pacific Excl Japan	-2.9%	-2.9%	-2.2%	-1.5%	-8.0%	-4.8%	-4.6%
MSCI Emerging Net Total Return USD Index	-1.1%	-1.1%	-0.4%	0.3%	-7.7%	-4.5%	-4.3%
FT World Index	4.9%	4.9%	5.6%	6.3%	4.8%	8.5%	8.7%
T Rowe Price US Large-Cap Growth Equity Fund		6.2%	7.0%	7.7%	19.0%	23.1%	23.5%
Vanguard Dividend Appreciation		9.5%	10.2%	11.0%	10.1%	13.9%	14.2%
Vanguard US Opportunities		8.3%	9.0%	9.8%	15.7%	19.7%	20.0%
iShares S&P 500 Min Vol		6.9%	7.6%	8.4%	7.5%	11.2%	11.5%
Vanguard S&P 500 UCITS ETF (LN)		7.6%	8.3%	9.0%	10.2%	14.0%	14.3%
iShares Edge MSCI USA Multifactor UCITS ETF		5.5%	6.2%	7.0%	6.6%	10.3%	10.6%
Powershares QQQ Trust Series 1		8.6%	9.3%	10.0%	20.0%	24.1%	24.4%
Vanguard S&P 500 UCITS ETF		7.6%	8.3%	9.0%	10.2%	14.0%	14.3%
Schroder International Selection Fund - US Small & Mid-Cap Equity		4.5%	5.2%	6.0%	3.1%	6.6%	6.9%
T Rowe Price US Smaller Companies Equity Fund		4.4%	5.1%	5.8%	11.7%	15.5%	15.8%
Liontrust Special Situations		-0.1%	0.6%	1.3%	4.7%	8.2%	8.6%
Majedie UK Equity		-4.0%	-3.4%	-2.7%	-2.4%	0.9%	1.2%
Invesco Perpetual UK High Income Fund		-1.3%	-0.6%	0.0%	-4.7%	-1.4%	-1.1%
Threadneedle - UK Equity Income Fund		-2.1%	-1.4%	-0.8%	1.8%	5.3%	5.6%
BNY Mellon - Newton UK Opportunities Fund		-2.8%	-2.2%	-1.5%	-2.8%	0.5%	0.8%
Ishares MSCI Japan Index		3.6%	4.3%	5.0%	1.4%	4.8%	5.1%
Matthews Asia Funds - Japan Fund		0.1%	0.8%	1.4%	-0.4%	3.0%	3.3%

Index / Fund	% Price Change local currency Q3 2018	% Price Change in USD Q3 2018	% Price Change in EUR Q3 2018	% Price Change in GBP Q3 2018	% Price Change in USD YTD	% Price Change in EUR YTD	% Price Change in GBP YTD
Ishares MSCI Emerging Markets		-1.2%	-0.5%	0.2%	-8.0%	-4.9%	-4.6%
First State Global Emerging Markets Leaders		-5.0%	-4.4%	-3.8%	-10.1%	-7.0%	-6.7%
BNY Mellon - Newton Global EM Fund		-8.0%	-7.4%	-6.7%	-17.1%	-14.3%	-14.1%
Allianz Euroland Equity Growth		-1.3%	-0.6%	0.0%	-2.7%	0.7%	1.0%
Alken European Absolute Return		2.4%	3.1%	3.8%	-1.7%	1.7%	1.9%
Candriam Equities Europe Innovation Fund		0.6%	1.3%	2.0%	2.4%	5.9%	6.2%
T Rowe Price European Smaller Companies Equity Fund		-3.4%	-2.8%	-2.1%	0.0%	3.5%	3.8%
Threadneedle European Select		0.9%	1.6%	2.3%	-0.8%	2.6%	2.9%
BlackRock Continental European Income Fund		1.0%	1.7%	2.4%	-4.3%	-1.0%	-0.8%
Oyster Funds - Continental European Selection		-6.1%	-5.5%	-4.9%	-14.1%	-11.1%	-10.9%
Invesco Continental European Small Cap Equity		-2.8%	-2.1%	-1.5%	-11.9%	-8.9%	-8.6%
Schroder Asian Alpha Plus		-4.5%	-3.9%	-3.2%	-6.2%	-3.1%	-2.8%
Newton BNY Asian Income		2.4%	3.1%	3.8%	-0.1%	3.3%	3.6%
Blackrock Global Funds - Asian Growth Leaders		-7.8%	-7.2%	-6.5%	-14.7%	-11.8%	-11.6%
Quaero Funds CH - Swiss Small&Mid Cap		-1.1%	-0.4%	0.3%	-0.4%	3.1%	3.3%
New Capital Fund - China Equity Fund		-11.7%	-11.1%	-10.5%	-17.0%	-14.2%	-14.0%
iShares EUR Aggregate Bond UCITS ETF EUR Dist			-0.76%			-0.61%	
(Benchmark Euro Aggregate Bonds)							
iShares Core UK Gilts UCITS ETF GBP Dist				-1.77%			-1.44%
(Benchmark Sterling Total Gilts)							
Ishares Core US Aggregate Bonds		-0.08%			-1.73%		
(Benchmark US All Bonds)							
3 month Libor USD, per 06/30/2018, annualized		2.34%					
3 month Euribor, per 06/30/2018, annualized			-0.321%				
3 month Libor GBP, per 06/30/2018, annualized				0.67%			