Quarterly Strategy

Economic improvement has been more widespread over the past quarter, with positive signs in most developed economies, including Europe. Central banks have reiterated their intentions to maintain interest rates at low levels for the foreseeable future. Indeed, the US Federal Reserve surprised markets in September by announcing that they were not yet ready to taper asset purchases.

We believe this will be a favourable environment for equity markets, especially the more cyclical sectors, such as basic materials, which are now relatively cheap and should benefit from further economic recovery.

Bonds, on the other hand, could be susceptible to further rises in yields, although probably not by the same amount as we have seen in recent quarters.

We continue to position portfolios accordingly.

C. Hoare & Co.
PRIVATE BANKERS SINCE 1672

Overview and current strategy

We have a positive outlook on the global economy and financial markets, although we are mindful that recoveries are often slower and bumpier than expected. Some of the recent concerns about Europe and China have faded, which should allow businesses and consumers to begin to invest and to spend a little more freely, which will be positive for corporate earnings. With interest rates remaining low, equity markets are attractive, particularly in sectors with cyclical potential and modest valuations.

We have been increasing exposure to these economically sensitive areas of the market, especially in Europe, through specialist funds. We increased our allocation to Japan last quarter and believe the Bank of Japan will continue providing support to markets there. In fixed interest, we maintain a preference for corporate bonds.

Economic and political news

We welcomed the return of a more traditional summer season, with less of an emphasis on late night political negotiations. This has been due in part to the run-up to the German elections, and Angela Merkel now has the mandate to continue with her European policy of encouraging structural reform across the peripheral countries. Otherwise, news has revolved around economic recovery in the majority of developed economies, albeit with subtle distinctions.

Naturally, investors look to the US for confirmation of the economic cycle, and improvement has been seen in the all important property and jobs markets there. Federal Reserve chairman Bernanke surprised markets in September, however, by announcing that the current $85 billion a month asset purchases would not yet be tapered. He cited concerns over the pace of improvement in the labour market, a rise in the cost of mortgages, and the risks still being posed by lower government spending, with another Congressional debate over the debt ceiling looming.

The UK, meanwhile, has had an unambiguously positive summer, with activity across all sectors showing significant improvement. This has coincided with Mark Carney's arrival, with the new Bank of England governor introducing forward guidance to interest rate policy. The Bank's attempts to persuade businesses and consumers that rates will remain low for some time is a risk worth taking, in our view, given the cautious approach to spending and investment that has taken hold in recent years.

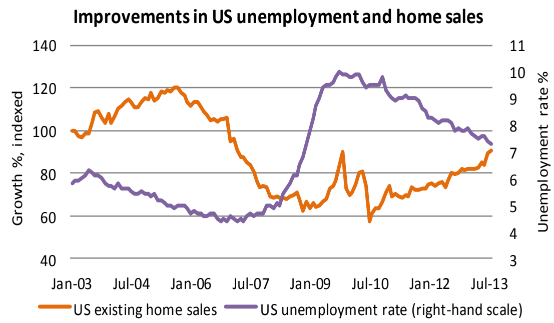
Europe has also seen an improvement in economic indicators and growth is now broadening out into the domestic sectors, although the region will remain vulnerable to downturns and fiscal slippage. Stabilisation in the peripheral economies and improved business confidence can lead to an increase in corporate profitability.

Japan continues to demonstrate a marked improvement in its economic growth, with asset purchases introduced by the central bank helping to weaken the yen, thereby improving export competitiveness. We expect a consumption tax increase in April 2014, which would assist public finances in the medium term, and may be complemented by a corporate tax cut.

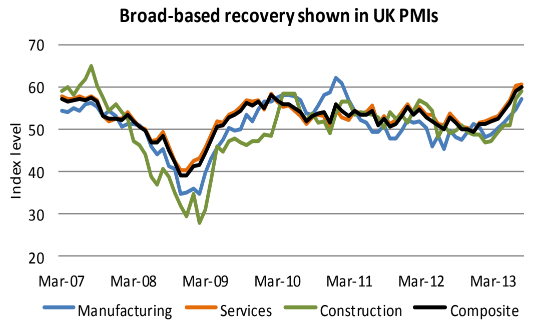
Asia and emerging markets have endured a more difficult quarter, with the price and availability of US dollar finance worsening.

The following table shows our current position in each of the major asset classes and regions, as well as an indication of what our next portfolio change might be

Asset class	Current position	Expected next move
Equities	+ +	
UK	-	
US	-	▼
Europe	++	
Japan	+	
Asia Pacific	neutral	
Emerging Markets	+	
Bonds	- -	
Government	- -	
Corporate	+	
Alternatives	-	
Property	-	



Source: Bloomberg, as at 31st August 2013



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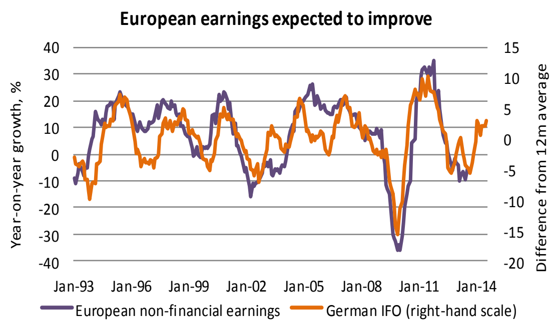


Sources: ASR, Datastream, as at 31st August 2013

This has particularly proved the case in countries with trade and current account deficits, and includes Brazil, India, Indonesia, Turkey and South Africa (with the newly coined acronym, BIITS). China, on the other hand, has seen prospects improve, with Premier Li Keqiang committing to 7.5% growth this year, which has helped alleviate concerns over a credit crunch.

Currencies and interest rates

Central banks have continued to stress that interest rates should remain low as the recovery progresses. Most investors expect the first rate rises in 2015, probably in the US. Europe and Japan may well be a year or two later. With little in the way of rate changes to move currency markets, the focus has been on relative growth changes. With the UK and Europe surprising positively versus the US, the dollar has weakened. We expect the dollar to improve as this differential stabilises.

Bond markets

Bond yields have continued to rise as a result of improving economic news. This has particularly been the case in the 5-10 year part of the yield curve, given ongoing low interest rates. If economic growth continues at current levels, we expect the pace of yield increases to begin to level off. The early stages of recovery are being marked by low inflation, due to ongoing spare capacity. This environment is also beneficial to credit, with few instances to date of companies taking risks with their balance sheets, although this is reflected in spread levels, which are no longer cheap.

Equity markets

Earnings forecasts in the US are fairly stable, with a respectable 11% growth in 2014 expected. In the UK and Europe, earnings forecasts have declined this year, and growth is expected to be around zero. With an improvement in economic activity, however, we believe there is room for upgrades and earnings growth in 2014 to exceed 10-15%. Given cheaper valuations, relative to other regions, we are positive on the UK and Europe.

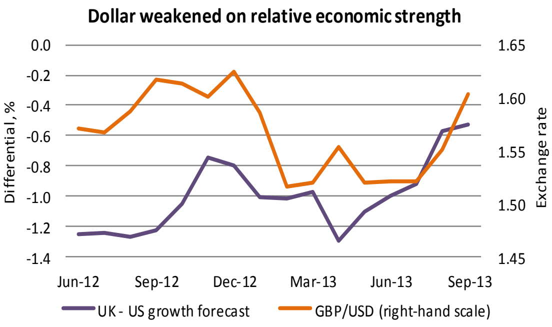
We continue to see steady earnings upgrades in Japan, which support our positive view. Valuations remain cheap in Asia, but vulnerabilities to earnings remain.

From a sector point of view, we continue to favour financials, given exposure to strengthening domestic economies and still attractive valuations. We also favour basic materials, as demand recovers and returns are supported by new found capital discipline. We are cautious on the defensive sectors such as consumer goods and utilities, which remain expensive and less exposed to recovery.

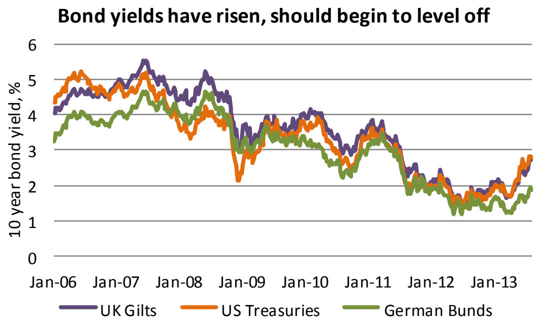
Alternative Investments

Commercial property has begun to show signs of improving rents and activity, although higher bond yields have impacted returns over the quarter. We expect the property asset class to deliver positive total returns going forward.

We are seeing developing opportunities in long-short equity strategies, which should benefit from markets returning to more normal behaviour patterns.



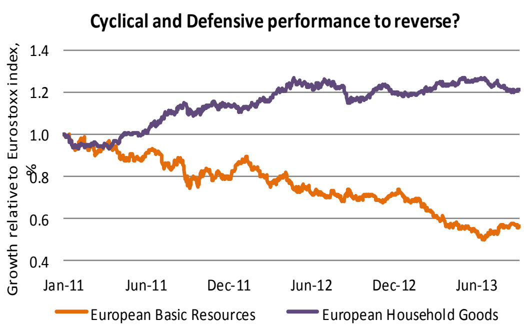
Source: Bloomberg, as at 31st August 2013



Source: Bloomberg, as at 31st August 2013

	Earnings growth		Price/Earnings	
	2013e	2014e	2013e	2014e
UK	-0.8%	11.0%	13.6	12.3
US	6.1%	10.7%	15.5	14.0
Europe ex UK	0.0%	14.9%	14.7	12.7
Japan	62.0%	9.5%	15.0	13.7
Asia ex Japan	12.4%	12.7%	12.3	10.9
Latin America	9.3%	14.2%	14.1	12.4
Eastern Europe	-5.2%	-0.1%	6.5	6.5
World	7.2%	10.8%	15.3	13.8
Cons discretionary	17.7%	12.9%	16.8	14.8
Cons staples	6.3%	10.2%	18.4	16.7
Energy	-2.3%	9.3%	11.7	10.7
Financials	13.4%	9.2%	12.6	11.5
Healthcare	0.5%	9.2%	16.8	15.4
Industrials	9.0%	13.9%	16.4	14.4
IT	9.3%	12.2%	15.1	13.5
Materials	-5.2%	18.1%	15.9	13.4
Telecoms	-0.3%	7.2%	14.3	13.3
Utilities	24.7%	7.1%	14.8	13.8

Source: Deutsche Bank, as at 25th September 2013



Source: Bloomberg, as at 31st August 2013

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Important Information

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