



QUILTER CHEVIOT
INVESTMENT MANAGEMENT

INVESTMENT REVIEW
Q1 2016

OVERVIEW

Uncertainty over the global growth outlook, which caused commodity price weakness and financial market volatility earlier this year, has eased. The oil price has recovered to \$40 - having touched a low of \$27 in January - and with it the share prices of many resource companies and equity markets in general. While this is encouraging, there are few signs of economic activity re-accelerating and global GDP estimates remain around 2%-2.5% which is close to 'recession' on some measures.

The S&P 500 index ended March up slightly at 2,059, close to its 2016 high. The FTSEurofirst (1,326), FTSE100 (6,174), Nikkei 225 (16,758) and other Asian markets finished the quarter below the levels they started the year. The FTSE Emerging Market index was the best performer over Q1 with a gain of more than 8% for sterling investors. The UK 10 year gilt yield closed at 1.4% against 2% in January making bonds the best performing asset class year to date.

WORLD MARKETS	CLOSING LEVEL 31/12/15	CLOSING LEVEL 31/03/16	% CHANGE
31ST DECEMBER 2015 - 31ST MARCH 2016			
FTSE 100	6,242.32	6,174.90	-1.08%
DOW JONES INDUSTRIAL AVERAGE	17,425.03	17,685.09	1.49%
XETRA-DAX	10,743.01	9,965.51	-7.24%
CAC 40	4,637.06	4,385.06	-5.43%
NIKKEI 225	19,033.71	16,758.67	-11.95%
HANG SENG	21,914.40	20,776.7	-5.19%
US DOLLAR (VS. £)	\$1.474	\$1.437	-2.48%
OIL BRENT \$ AUG	\$35.70	\$39.95	11.90%
GOLD \$	\$1,062.38	\$1,234.34	16.19%

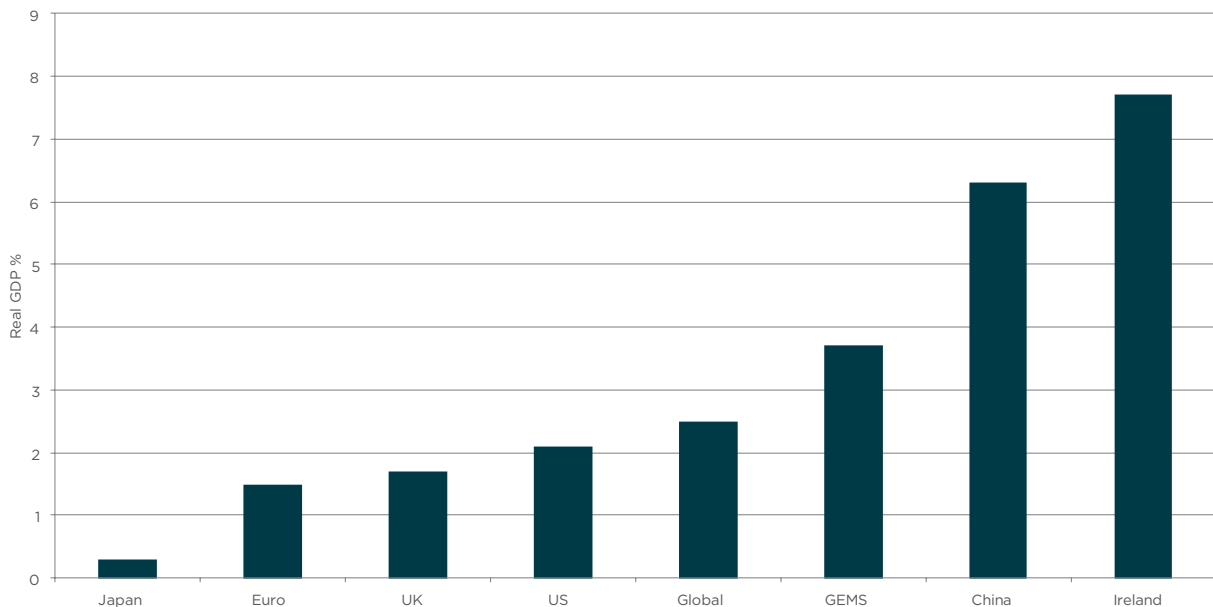
Source: DataStream. As at 31 March 2016.

Developed economies are showing signs of relative stability with GDP estimated to grow 1.7% v 1.8% last year. Helped by an unusually mild winter, recent US economic data has surprised on the upside with consumption and housing likely to support GDP growth of 2% in 2016.

Oil-related investment and net exports have softened but strong employment gains and lower energy prices are boosting incomes which will

underpin spending assuming the propensity to save does not increase. Core inflation excluding energy costs is low and stable with the major contribution coming from housing rents rather than wage increases. Interest rate policy remains uncertain and markets are discounting two small rises by the end of the year - a more optimistic outlook than the Federal Reserve's 'dot plot' forecast.

2016 GDP GROWTH FORECASTS

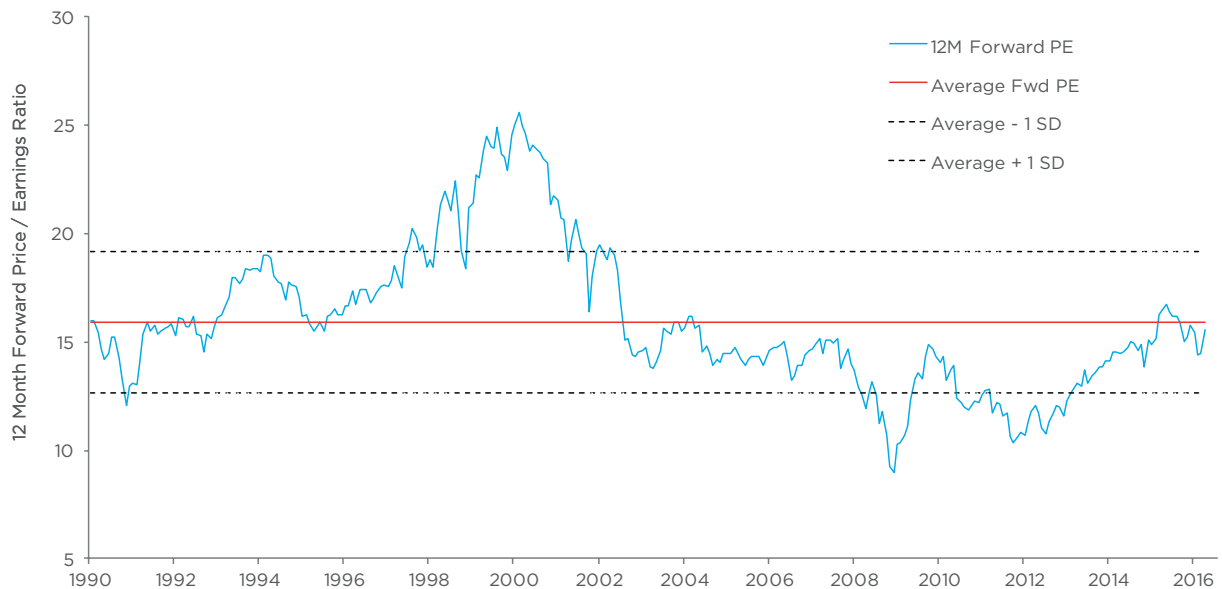


Source: Citi Research. As at 23 March 2016.

Consumer spending and rising house prices are also supporting economic activity in the UK. This is partly reflected in higher real disposal incomes and a strong jobs market but credit growth is once again expanding rapidly, the savings rate has fallen to a record low of 3.8% and the overall ratio of house prices to average earnings is close to its pre-crisis high. Given that the share of consumer spending now exceeds the pre-crisis peak, alarm bells should start ringing although the debt service burden remains the lowest since the 1970's. A mild easing in consumer confidence and the absence of an inflation/interest rate shock suggests it is probably too early to call an end to

the cycle. However, GDP estimates have been cut to 1.7% - which is below trend and compares with 2.2% in 2015 - on the back of tougher austerity and the marked slowdown in export growth. This has fallen to 1% from 5% last year mainly on weaker demand from the eurozone - the UK's largest trading partner. Business investment has also fallen sharply in recent months but this may partly reflect nervousness ahead of the EU referendum. CPI is well below the Bank of England's 2% target but the recent weakness in sterling means inflation will edge up to 1% later this year giving scope to postpone interest rate rises into 2017.

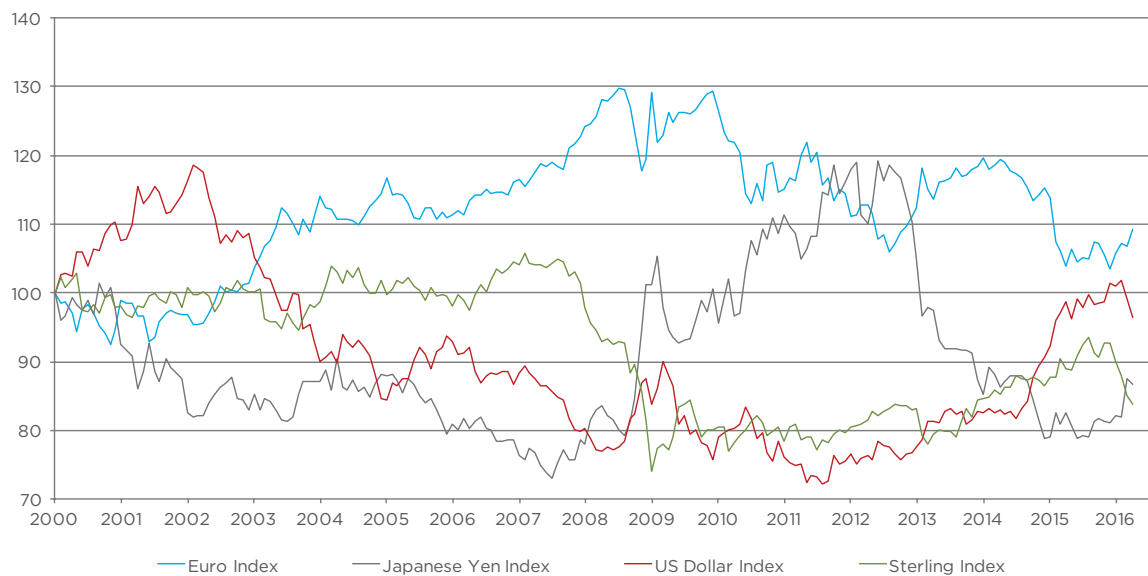
DEVELOPED MARKET EQUITY VALUATIONS



Source: DataStream. As at 1 April 2016.

The political distraction of the migrant crisis has not impacted economic activity in the eurozone with GDP estimated to grow 1.5% this year. As in other advanced economies, exports have slowed but not to the extent experienced in developing countries such as China, Taiwan and Korea. Growth in private consumption is more modest than in the US but investment and construction have picked up. Near zero inflation has forced the European Central Bank to continue its aggressive monetary policy - including the unprecedented move to negative interest rates. This may yet prove a mistake as it has not increased inflation expectations, weakened the Euro or boosted GDP and could derail the nascent recovery in the commercial banking sector. Ireland is the exception with growth in excess of 7% supported by strong employment, retail sales and housing. However, given the significant trade and investment links with the UK, in the event of Brexit it could suffer more than other EU countries.

TRADE WEIGHTED CURRENCIES

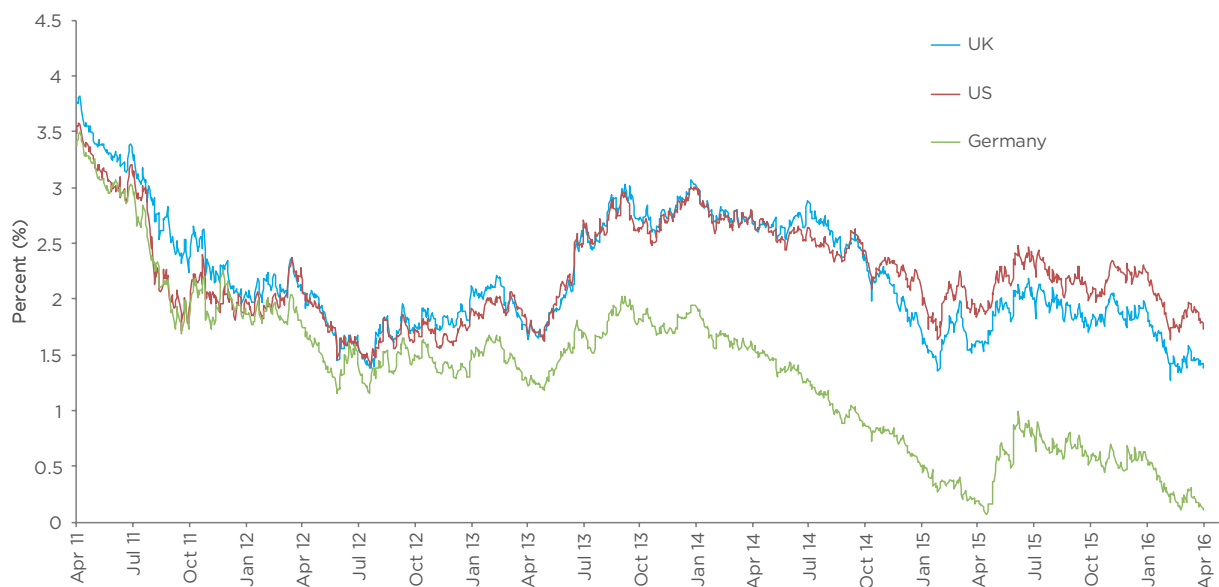


Source: DataStream/Factset. As at 1 April 2016.

Negative interest rates have also not had the desired effect in Japan where the Yen appreciated and consumer confidence dropped sharply following the policy announcement. GDP and inflation expectations are now close to zero. Pushing rates deeper into negative territory might be an option but the Bank of Japan could be the first central bank to embark on the next stage of unconventional monetary policy by printing 'helicopter money' to buy up and then cancel outstanding government debt. This could provide the Abe government with additional fiscal flexibility to offset the proposed consumption tax rise in April 2017 or increase spending with the specific aim of generating inflation. Meanwhile, corporate Japan is busy cutting costs and hoping for a revival in exports.

While most of the recent data from China, Asia and other developing economies has been relatively disappointing, there are one or two glimmers of hope. The first to catch our eye and suggest a modest upturn may be underway was the jump in Chinese loan growth earlier this year followed by an improvement in manufacturing and service purchasing manager business surveys. We also noted a small improvement in Korean exports (often a good proxy for global trade) where, contrary to expectations, the rate of decline has slowed. As emerging economies are still in the early stages of deleveraging, none of this indicates a return to strong global growth but at the margin the probability of a cyclical upturn has increased.

GOVERNMENT BOND YIELDS



Source: DataStream. As at 5 April 2016.

OUTLOOK

Seven years on from the financial crisis, central bank policy actions have extended the deleveraging process with few signs of a sustained improvement in global growth. Apart from relatively minor adjustments to the US and European financial systems, restructuring has been concentrated on commodities where prices have fallen and surplus capacity is being retired. However, there are still significant imbalances - particularly oil where geopolitical uncertainties could still derail the assumption demand and supply will come into balance naturally later this year. The UK referendum on EU membership is likely to increase uncertainty particularly in currency markets.

BRENT CRUDE OIL PRICE



Source: DataStream. As at 5 April 2016.

The low inflation and zero/negative interest rate environment will continue to suppress bond yields albeit credit spreads are widening to reflect the balance sheet risk of increased corporate debt. The main challenge facing equity investors and companies is that decelerating nominal GDP as a result of deleveraging impacts sales growth and puts greater emphasis on cost cutting as well as 'self-help' measures. Ahead of the results season, estimates for 2016 global earnings growth have been reduced to 3% - a more severe adjustment than usual at this point in the financial year - with downgrades across most sectors, not just energy. Unless the Chinese/Asian global trade upturn proves more significant than we expect, this leaves relatively high equity valuations (P/E 16x) vulnerable to earning disappointments. Some companies, of course, are continuing to grow and offer attractive and sustainable dividends, especially in the UK where the 4% yield compares favourably with a global average of 2.8%.

FTSE ALL WORLD \$ - PRICE INDEX



Source: DataStream. As at 5 April 2016.

CONTACT US

QUILTER CHEVIOT

One Kingsway
London
WC2B 6AN
t: +44 (0)20 7150 4000

OTHER QUILTER CHEVIOT OFFICES:

Belfast	t: +44 (0)28 9026 1150
Birmingham	t: +44 (0)121 212 2120
Bristol	t: +44 (0)117 927 3377
Dublin	t: +353 1 799 6900
Edinburgh	t: +44 (0)131 221 8500
Glasgow	t: +44 (0)141 222 4000
Jersey	t: +44 (0)1534 506 070
Leicester	t: +44 (0)116 249 3000
Liverpool	t: +44 (0)151 243 2160
	t: +44 (0)1492 530 677
Manchester	t: +44 (0)161 832 9979
Salisbury	t: +44 (0)1722 424 600

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