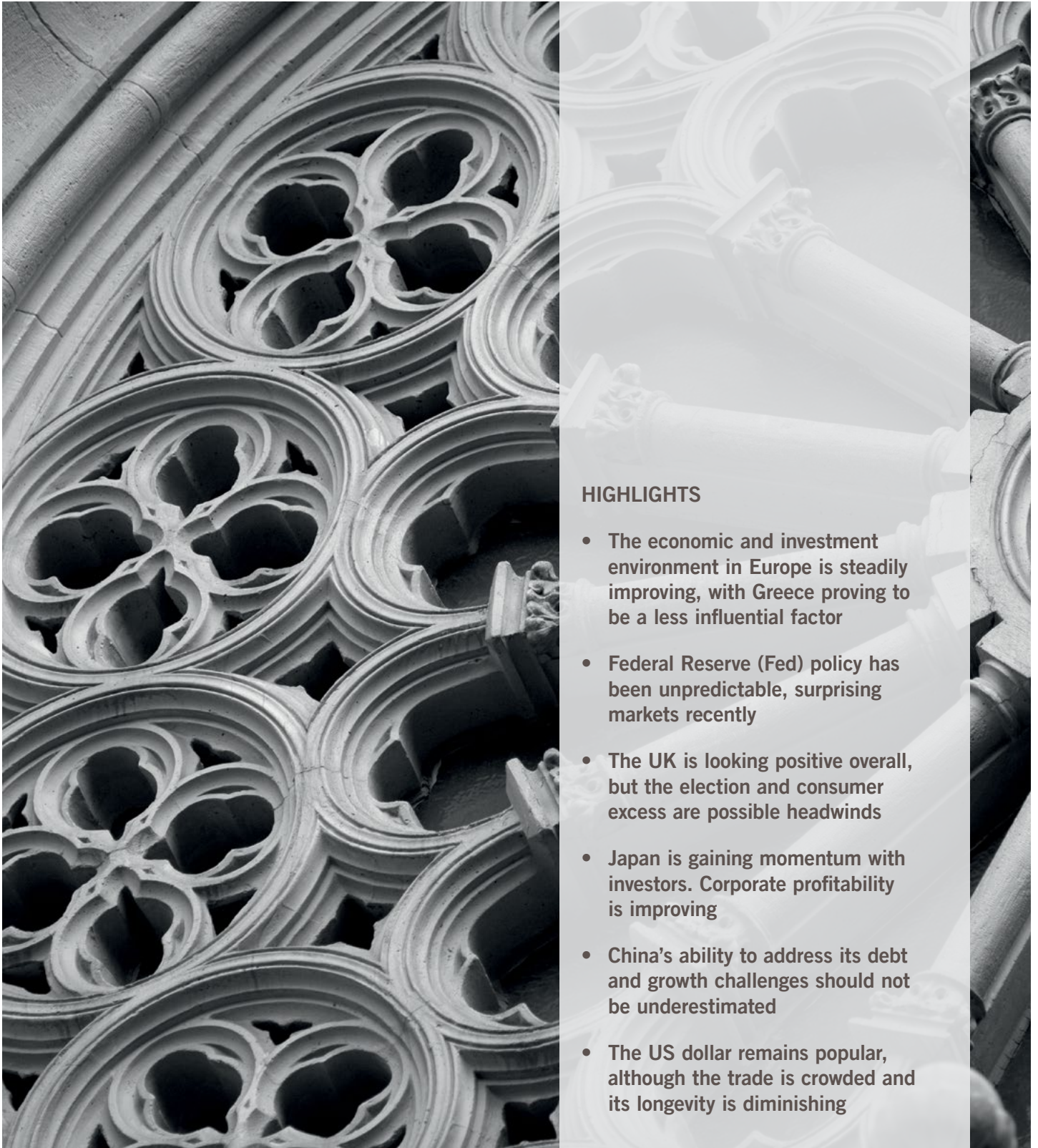


Multi-Asset Class Solutions

Q1 2015 Investment Advisory Board Meeting Summary

April 2015



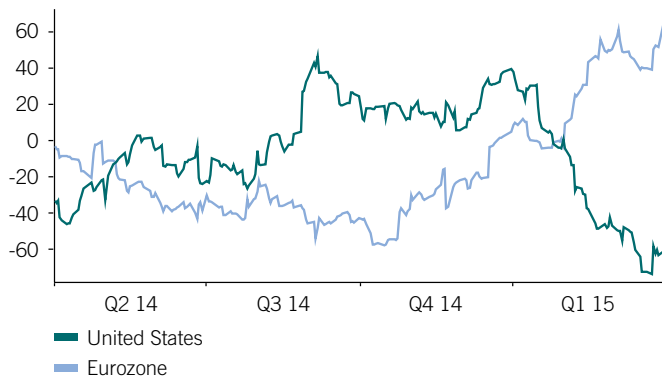
HIGHLIGHTS

- The economic and investment environment in Europe is steadily improving, with Greece proving to be a less influential factor
- Federal Reserve (Fed) policy has been unpredictable, surprising markets recently
- The UK is looking positive overall, but the election and consumer excess are possible headwinds
- Japan is gaining momentum with investors. Corporate profitability is improving
- China's ability to address its debt and growth challenges should not be underestimated
- The US dollar remains popular, although the trade is crowded and its longevity is diminishing

The overall tone of the meeting was broadly positive on risk assets, equities in particular and the prospects for the global economy. While market-specific risks remain, a number of positive trends have emerged in the opening months of 2015. While policy statements from governments and monetary authorities remain important, fundamentals are starting to matter more. A cautious consumer revival and the pressing need for economies to embrace the technological revolution are starting to distinguish winners from losers in stock markets. This is clearly evident both in the US and the eurozone. While some of the stronger investment trends of the past six months are now beginning to look less compelling, the Board identified a number of opportunities for active managers able to transcend the noise and focus on pockets of value.

Citigroup Economic Surprise index

31 Mar 2014 to 31 Mar 2015



Past performance is not indicative of future performance.

Source: GAM

US

The dropping of the all-important “patient” from the Fed’s latest policy statement changed the projected path of US interest rates. The Board noted that while investors had begun to price in a rate rise in June, the sudden softening of sentiment had not been anticipated. The Fed has become very data-dependent and quite prepared to move the goalposts as the labour market improves, with the non-inflationary rate of unemployment revised downwards. Equity markets reacted well to the renewed dovishness.

The Board’s view was that the US labour market would strengthen and ultimately this would translate into higher inflation later this year

or into 2016. The domestic housing market is also poised to recover, with inventories low and prices accelerating accordingly due to the lack of supply. One Board member suggested **US homebuilders would be a good way to gain exposure to US recovery** without bluntly holding the S&P 500 index. The ‘millennial’ generation (born from 1982) have chosen to postpone house buying so far, but are set to have a significant impact once they move out of the parental home. Exposure to this trend can be captured through specific index allocations. Looking briefly at the impact of lower oil prices, the general view was that positive surprises can be expected. These will take around nine months to fully manifest in the data, but indications suggest that consumers are definitely spending at least a portion of their energy bill savings, albeit in a more restrained manner than in the past. This bodes well for the ultimate sustainability of the US economic recovery and has validated the overweight exposure to consumer related spending that many managers are positioned for.

Europe

The Board was broadly positive on Continental Europe. While recognising that not all areas of the eurozone economy would strengthen in tandem, the general view was that the bloc was moving in the right direction and **continued to offer equity market upside** – at the very least as an attractive tactical trade if not a longer-term strategic theme.

Eurozone consumer confidence levels are now close to the 2008 pre-crisis high, and quantitative easing (QE) has provided a boost to an already-improving economy. The Board highlighted the thoughtful policy decisions of ECB President Mario Draghi, and agreed that comment and reaction will continue to influence markets in addition to fundamentals. In terms of the QE programme the logistics of purchasing huge amounts of bonds should not negatively impact the ECB’s efficacy, even if targets are missed simply because there are not enough bonds to buy. The multiplier effect should ensure that the cost of borrowing in the real economy ultimately comes down, although an investment boom by European companies is likely to be some way off yet.

One member, while positive on the overall story, cautioned that soft patches were inevitable and the likelihood of positive surprises to replenish the current strong trajectory from this point was diminishing. Another member was more optimistic, highlighting that it was important not to over-intellectualise what was happening, namely; momentum and sentiment was strong and there were gains to be had by selective participation in a broadly good news story.

However, the Board concurred that the long-term success of Europe was ultimately dependent on a broad-based willingness to reform and outside of a few countries this was not much in evidence. The adoption of new technologies should not be seen as employment threats; those economies that embrace change will ultimately triumph, creating more jobs as they strengthen.

In terms of allocations, **a blanket eurozone holding might not be the smartest way of capturing upside**. The region is multi-market, with some standout players within it, such as Spain and Germany, while Italy is also beginning to look interesting. Conversely, Greece

remains the laggard. The Board's overarching view was not to let Greece's failures taint the rest of the region, especially given the likelihood of 'extend and pretend' being the response to debt resolution. QE bond purchases are likely to continue until the end of the year at the very least and this should maintain confidence regardless of the politics. The probability of 'Grexit' now looks slim at 15–20%. One positive outcome of the Greek disaster is that peripheral countries previously seen as willing to try to repudiate austerity are showing more willingness to make the required sacrifices.

The Board's **overweight stance on Europe was confirmed**, with members believing that the market had plenty more scope for appreciation while significant asset flows are expected. In addition, liquidity constraints in the regional fixed income markets could redirect asset flows towards equities. The Board also confirmed a **tactical bias towards Spain and Italy**.

UK

Rising employment has become one of the lead drivers of the UK economic recovery. The unemployed claimant count has fallen to extremely low levels, and job vacancies are rising. Tax revenues are also rising, and export numbers have grown recently. The goods and services deficit is improving and the economic landscape is looking resoundingly positive. The UK's openness to the technological revolution remains a major positive for the economy, with London's booming tech industry attracting international as well as home-grown talent.

The one potential short-term negative for the UK is the May general election. While the betting odds (historically a more accurate predictor than the polls) suggest a Conservative win, the prospects of a messy coalition arrangement with attendant policy paralysis is very real. Nevertheless, the Board felt that if the UK could navigate past the turbulence of May, then the economy should continue to prosper on positive momentum. The Bank of England is doing little to trigger monetary policy concerns and mortgage debt is beginning to stabilise, though the property shortage remains a major

economic sticking point, particularly in London and the South East. One member expressed concern that consumer strength was perhaps unsustainable and it was noted that credit card debt was rising.

Japan

The Board shared the view that there was much to like about Japan. The economy is enjoying high corporate profitability and a related boom in hiring. If this trend continues, wage growth should pick up. Cultural shifts in the corporate sector are having positive ramifications and further QE is probably unnecessary as overseas production levels soar and R&D spending continues to rise.

Specifically, companies in the robotics, technology and healthcare sectors are doing particularly well, and tax revenues are growing by twice as much as predicted. The Board viewed the high savings rate among the Japanese as unsustainable over the long term; when confidence in job security reaches a certain level then saving rates should soften and spending should pick up. This in turn will fuel a steady economic recovery.

Following a research trip, one Board member noted that the local asset management community was becoming excited about the **domestic equity market story, seeing particular promise in the mid-cap sector**. The yen and the JGB story are no longer the primary focus.

Asia and emerging markets

Elsewhere, China continues to slow, with a cooling of the property market proving a notable drag. The government is making attempts to shift animal spirits from property into equities and this could serve equity investors well, with the Board noting **select buying opportunities**. The valuation and performance discrepancy, for example, between A and H shares is particularly interesting. Indeed this sentiment extends to the **broader Asian region**. While members were not resoundingly positive on emerging markets as a whole, **nimble, smart allocations could prove fruitful**.

Strategic and tactical views - summary

As at 31 Mar 2015

	Low Conviction	Cautious	Neutral	Positive	High Conviction
Equities Positive		UK EM – Lat Am	US EM - Asia	Europe Japan Global - income	
Fixed Income & Credit Neutral	G4 Gov't bonds			Insurance-linked Absolute Return MBS	Financial credit
Alternatives Positive			Equities L/S	Macro traders	
Tactical Asset Allocation (TAA)		US Small Cap US Technology		US Equities US Home Builders Chinese Equities	Europe Equities Spain/Italy Equities Japan Equities
TAA - FX	GBP / USD GBP / EUR	EUR / USD JPY / USD			

Source: GAM

The views are those of the manager at the time of publication and are subject to change.

Currencies

The US dollar remains the currency *du jour*, with fourth-quarter eurozone data showing outflows of EUR 104 billion into the US dollar. Investors have got used to the dollar trending steadily, but such enormous asset flows along with the surprisingly dovish Fed statement mentioned, suggests that the next quarter will be volatile. The Board predicted the currency will remain attractive in the long term. Beyond the short term outflows, if Europe continues on its positive trajectory then a rising euro is a distinct possibility in the future. This would accompany higher bond yields too as investors perceive inflation and monetary tightening. However, such a path is by no means certain at this stage.

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IAB members



Graham Wainer

Global Head of Investments,
GAM Managed Portfolios



Tim Haywood

Investment Director,
GAM



Graham Turner

Founder and Chief Economist,
GFC Economics

James Aitken

Founder,
Aitken Advisors LLP



Anthony Lawler

Head of Portfolio Management,
GAM Alternative Investment Solutions

IAB contributors

Rotating specialist advisers and guests

Alexander Friedman, Group CEO

Multi-Asset Class Solutions (MACS) Investment Team

Source: GAM unless otherwise stated. (Unless otherwise noted, where shown, performance is shown net of fees, on a NAV to NAV basis).

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