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INVESTMENT COMMITTEE PACK

24th July 2018

BLACKWOOD

ASSET MANAGEMENT

Attendees: MTR / RWF / SCG / SMG / TS / AR / AJ

PURPOSE:

This meeting performs part of BLACKWOOD's due diligence in ensuring the model portfolios continue to meet their investment objectives.

The aim of the meeting is to enable BLACKWOOD to:

- discuss the main drivers of the markets and our sentiment on the different asset classes
- to review the model portfolios
- to discuss and decide on a course of action based on the preceding discussions detailing what needs to be done, by whom and by when

DATA SOURCE: Blackwood Asset Management, Bloomberg (unless otherwise stated).

MACRO OVERVIEW

The period leading up to the financial crisis saw an artificial boost to global productivity as western technology met the excess labour and resources of the developing world. This has now ended. A combination of aging demographics, and a lack of transformative innovations mean that productivity growth is below historic levels and will remain that way.

Given that, in the long run, productivity growth is the driver of economic growth (nominal GDP) this means that we are not going to be seeing interest rates rising to historic levels. Central bankers will be constrained in raising interest rates as any movement upwards in rates will act to styme the low levels of GDP growth present. As a result interest rates will remain at 'zero' forever with low levels of inflation persisting.

This has important implications for the allocation of capital within the global economy. Interest rates are the pricing mechanism for an economy’s capital stock. Low levels of interest rates keep so called “zombie” companies, which offer negative returns on capital, alive. This prevents the capitalist process of creative destruction that allows capital to be re-allocated to those tasks that generate the highest returns, in turn creating a self-reinforcing cycle of diminished productivity growth.

From the point of view of investors this means we cannot expect future returns to match those witnessed historically, and must remain aware of the increased risk, and opportunities, generated from the market inefficiencies caused by the misallocation of capital.

TACTICAL POSITIONING AT TIME OF LAST MEETING

The model portfolios are currently positioned to hold a lower proportion of risk assets than the strategic (long term) asset allocation. We hold 12%-13% in cash, dependent on the model, and our debt holdings can be characterised as focusing on high quality sovereign debt. In terms of the equity risk, the model portfolios are underweight overseas equity and we have avoided alternatives assets such as private equity or Venture Capital Trusts (VCTs).

Broadly speaking global equity markets are expensive compared to historic levels. In the US, in particular, recent earnings growth has been driven in large part by companies increasing debt levels to fund equity buybacks. While this has been positive for short term returns, debt acts to makes companies less flexible and amplifies losses in a downturn (you cannot cut interest payments like you can dividends). In a similar vein the low interest rate environment has led to record levels of investor demand for private equity style investments in their search for return, exceeding the level of legitimate investments in the sector.

The models currently have no exposure to emerging markets. The standard investment premise for emerging markets is that economic growth is set to exceed that of the developed world, which will be translated into outsized returns for emerging market investors. This however fails to take into account the poor levels of corporate governance in emerging markets and the often limited access to the companies generating this economic growth. For investors this means being invested into a small number of large companies where risks are poorly understood and the returns do not provide sufficient compensation.

Where we do see the potential for greater shareholder returns is Japan. Japan has spent the last two decades dealing with the debt overhang from the asset price bubble of the late 80s early 90s, but is now beginning to emerge. Corporate governance is being reformed (the number of corporate scandals such as at Toyota and Mitsubishi have been falling) and corporate earnings are on the rise as companies traditionally run to be profitless are forced to take account of shareholders. We do not expect the reforms to be a quick process, but based on the progress seen to date we are comfortable taking a larger allocation to Japanese equity.

CHANGES TO THE TACTICAL ASSET ALLOCATION

We made alterations to the Tactical Asset Allocation on 11th July.

The alterations were:

- begin to acquire an exposure to emerging markets by investing 1% of portfolio in model 4 into Vanguard Emerging Markets Stock Index fund rising to 4% in model 7 (increase of 1% for each increase in risk category)
- corresponding reduction in cash exposure
- reduce UK equity exposure by 1%
- increase US equity exposure by 1%

The new Tactical Asset Allocations, and their variance from the Strategic Asset Allocation can be seen in the tables on the right hand side.

SAA	3	4	5	6	7
cash	3.0%	3.0%	3.0%	3.0%	3.0%
debt	70.0%	50.0%	31.0%	13.0%	
equity	18.0%	33.0%	48.0%	65.0%	97.0%
property	4.0%	4.0%	4.0%	4.0%	
alternatives	5.0%	10.0%	14.0%	15.0%	

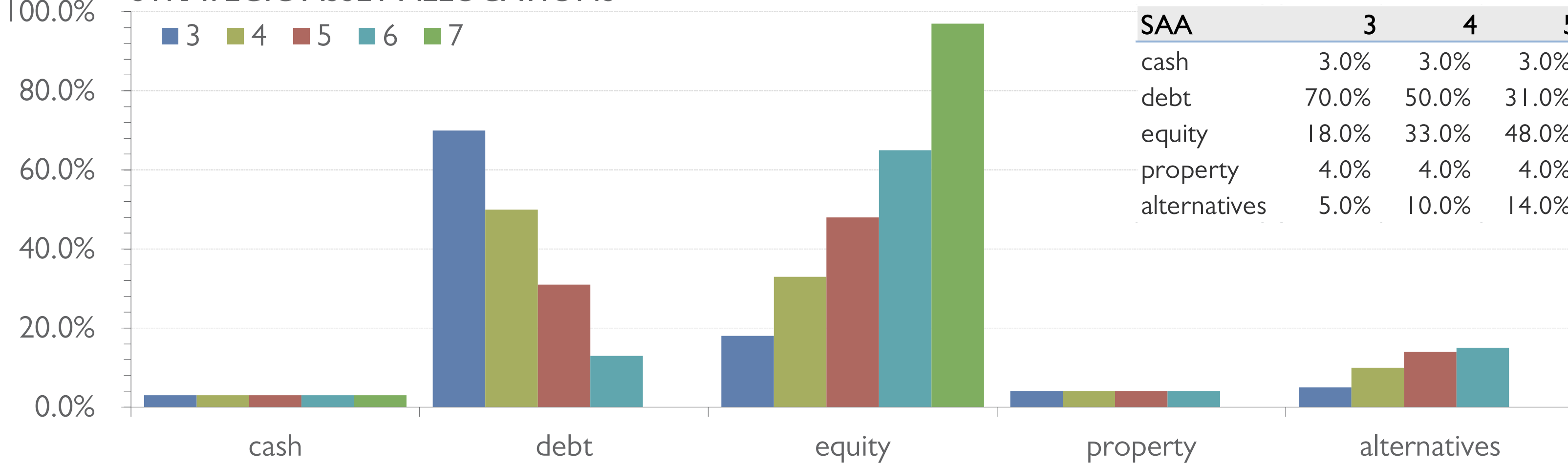
TAA	3	4	5	6	7
cash	12.0%	11.0%	10.0%	9.0%	9.0%
debt	67.0%	50.0%	33.0%	20.0%	
equity	15.0%	30.0%	46.0%	59.0%	91.0%
property	4.0%	4.0%	4.0%	4.0%	
alternatives	2.0%	5.0%	7.0%	8.0%	

VARIANCE	3	4	5	6	7
cash	9.0%	8.0%	7.0%	6.0%	6.0%
debt	(3.0%)	0.0%	2.0%	7.0%	0.0%
equity	(3.0%)	(3.0%)	(2.0%)	(6.0%)	(6.0%)
property	0.0%	0.0%	0.0%	0.0%	0.0%
alternatives	(3.0%)	(5.0%)	(7.0%)	(7.0%)	0.0%

note: the variance from the SAAs is capped at ± 10%

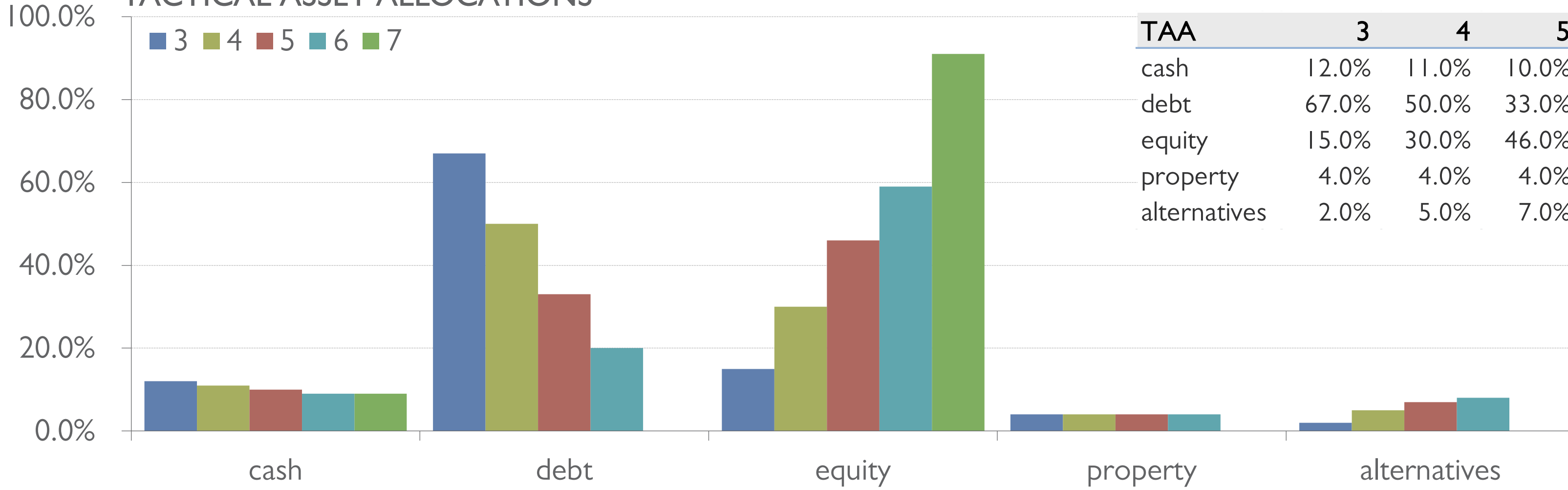
BLACKWOOD MODELS

STRATEGIC ASSET ALLOCATIONS



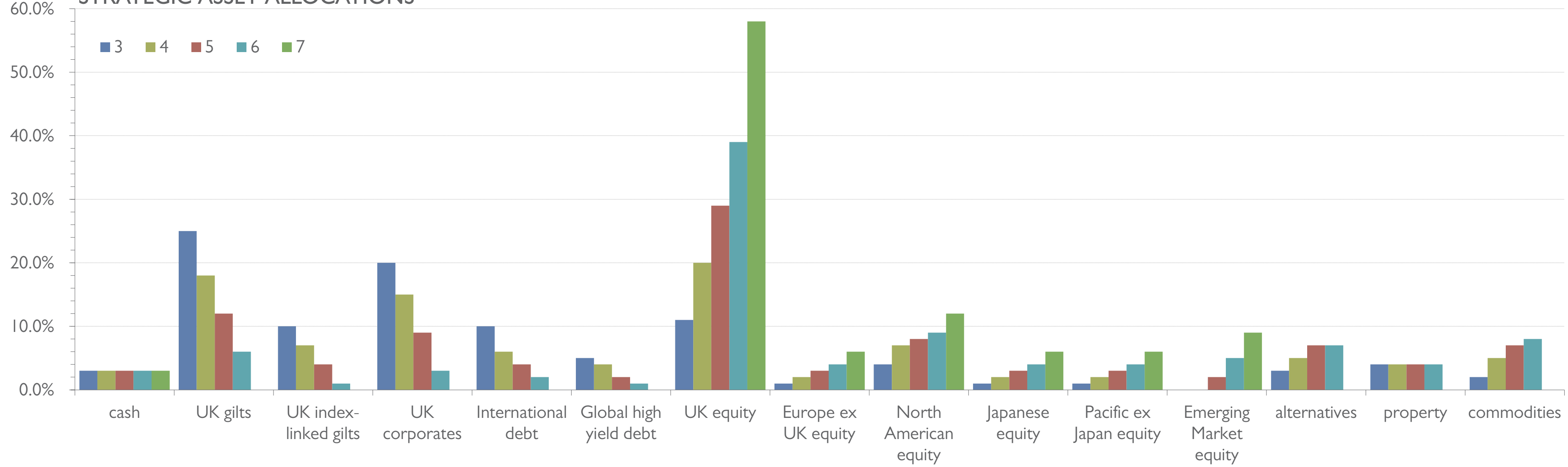
SAA	3	4	5	6	7
cash	3.0%	3.0%	3.0%	3.0%	3.0%
debt	70.0%	50.0%	31.0%	13.0%	
equity	18.0%	33.0%	48.0%	65.0%	97.0%
property	4.0%	4.0%	4.0%	4.0%	
alternatives	5.0%	10.0%	14.0%	15.0%	

TACTICAL ASSET ALLOCATIONS

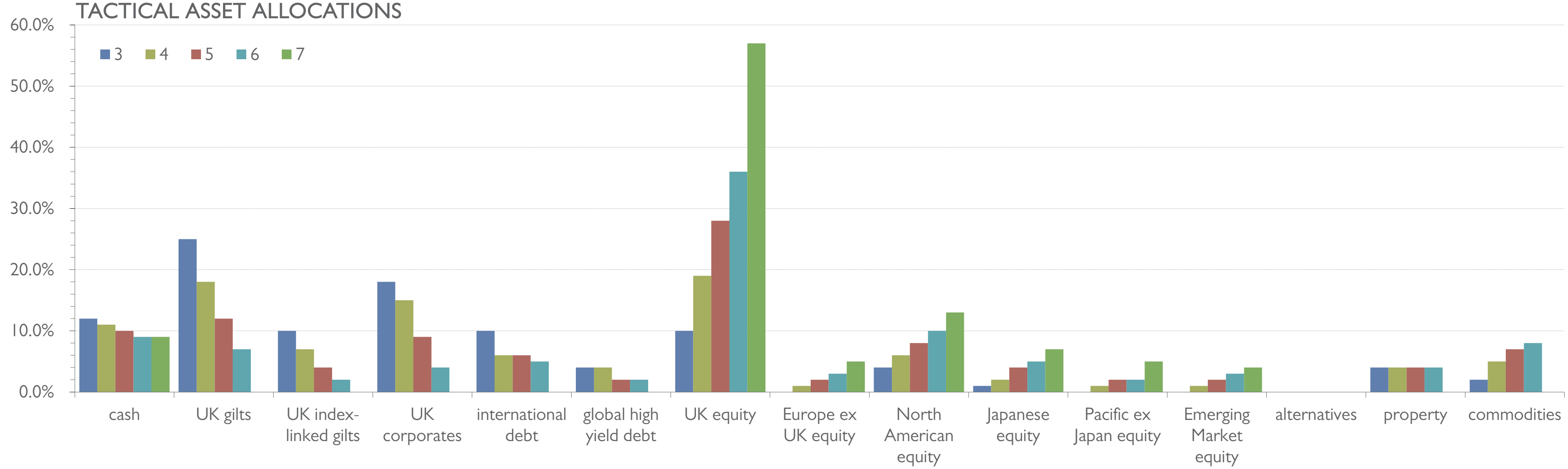


TAA	3	4	5	6	7
cash	12.0%	11.0%	10.0%	9.0%	9.0%
debt	67.0%	50.0%	33.0%	20.0%	
equity	15.0%	30.0%	46.0%	59.0%	91.0%
property	4.0%	4.0%	4.0%	4.0%	
alternatives	2.0%	5.0%	7.0%	8.0%	

STRATEGIC ASSET ALLOCATIONS

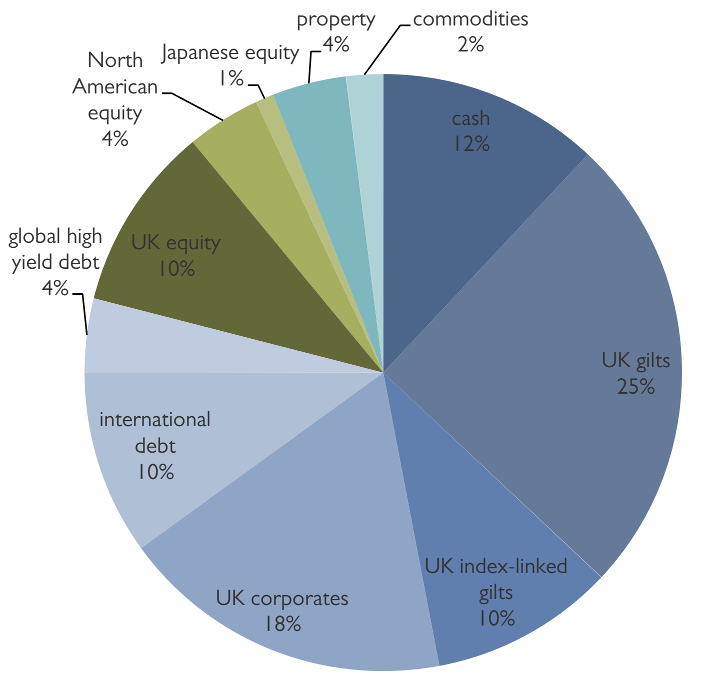


TACTICAL ASSET ALLOCATIONS

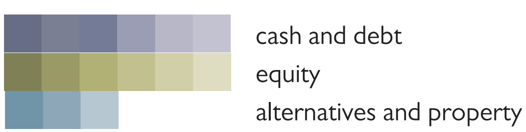


BLACKWOOD MODEL 3 TACTICAL ASSET ALLOCATION

number of holdings	12
total cost of investment	0.72%

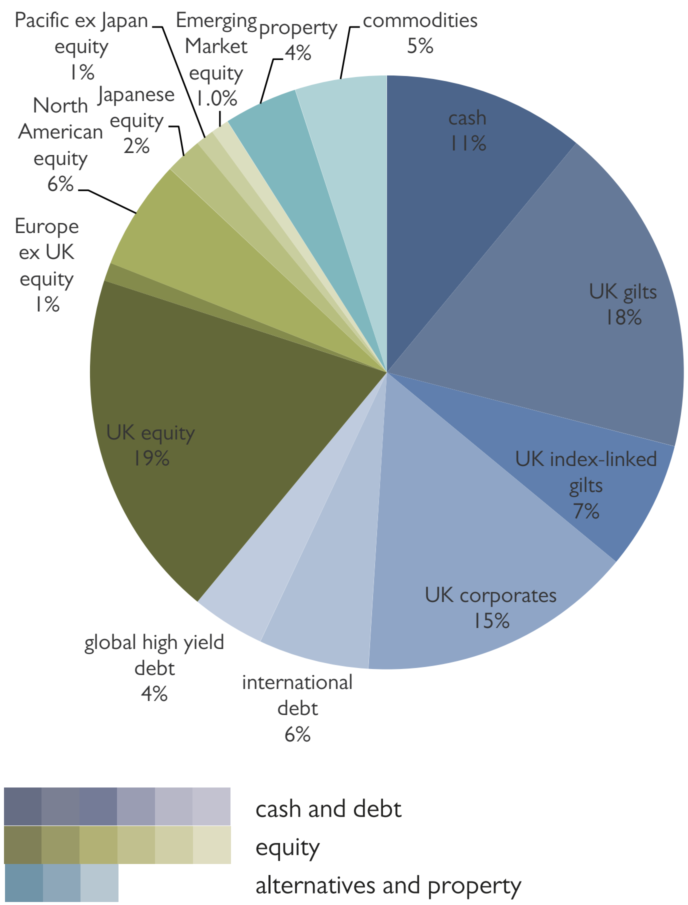


asset class	fund holding	% total
cash		**12.0%**
cash	sterling	12.0%
bonds		**67.0%**
UK gilts	Vanguard U.K. Government Bond	25.0%
UK gilts	L&G All Stocks Index-Linked Gilt	10.0%
UK corporates	Vanguard UK Investment Grade Bond	18.0%
international bonds	TwentyFour Dynamic Bond	5.0%
international bonds	TwentyFour Monument Bond	5.0%
international bonds	AXA US Short Duration High Yield	4.0%
equity		**15.0%**
UK equity	iShares 100 UK Equity	7.0%
UK equity	SORBUS VECTOR	3.0%
North American equity	Vanguard U.S. Equity	4.0%
Japanese equity	iShares Japan Equity	1.0%
alternatives		**2.0%**
commodities	Investec Global Gold	2.0%
property		**4.0%**
property	iShares Global Property Securities Equity	4.0%



BLACKWOOD MODEL 4 TACTICAL ASSET ALLOCATION

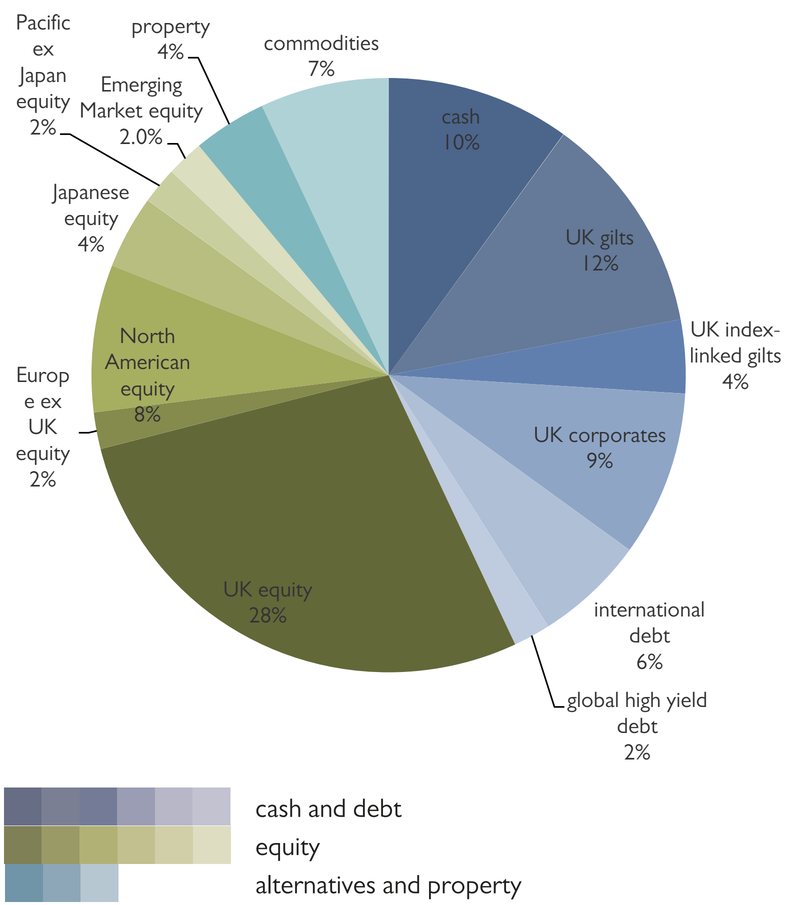
number of holdings	16
total cost of investment	0.84%



asset class	fund holding	% total
cash		**11.0%**
cash	sterling	11.0%
bonds		**50.0%**
UK gilts	Vanguard U.K. Government Bond	18.0%
UK gilts	L&G All Stocks Index-Linked Gilt	7.0%
UK corporates	Vanguard UK Investment Grade Bond	15.0%
international bonds	TwentyFour Dynamic Bond	3.0%
international bonds	TwentyFour Monument Bond	3.0%
international bonds	AXA US Short Duration High Yield	4.0%
equity		**30.0%**
UK equity	iShares 100 UK Equity	13.3%
UK equity	SORBUS VECTOR	5.7%
Europe ex UK equity	Vanguard FTSE Developed Europe ex UK Equity	1.0%
North American equity	Vanguard U.S. Equity	6.0%
Japanese equity	iShares Japan Equity	2.0%
Pacific ex Japan equity	Invesco Perpetual Asian Z	0.5%
Pacific ex Japan equity	Stewart Investors Asia Pacific Leaders B	0.5%
Emerging Market equity	Vanguard Emerging Markets	1.0%
alternatives		**5.0%**
commodities	Investec Global Gold	5.0%
property		**4.0%**
property	iShares Global Property Securities Equity	4.0%

BLACKWOOD MODEL 5 TACTICAL ASSET ALLOCATION

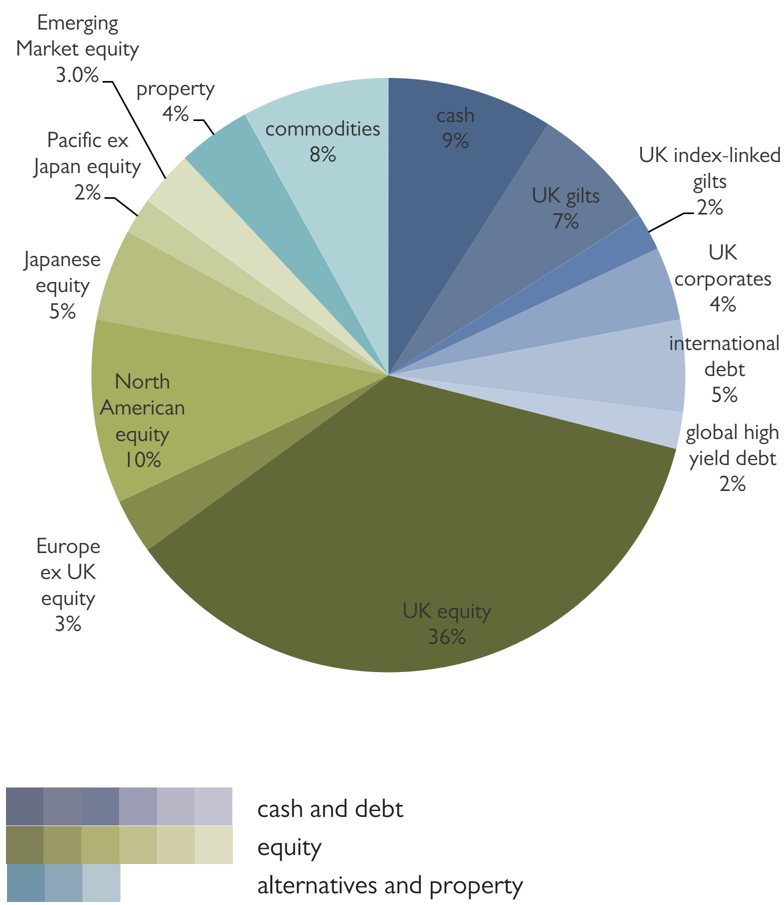
number of holdings	16
total cost of investment	0.96%



asset class	fund holding	% total
cash		**10.0%**
cash	sterling	10.0%
bonds		**33.0%**
UK gilts	Vanguard U.K. Government Bond	12.0%
UK gilts	L&G All Stocks Index-Linked Gilt	4.0%
UK corporates	Vanguard UK Investment Grade Bond	9.0%
international bonds	TwentyFour Dynamic Bond	3.0%
international bonds	TwentyFour Monument Bond	3.0%
international bonds	AXA US Short Duration High Yield	2.0%
equity		**46.0%**
UK equity	iShares 100 UK Equity	19.6%
UK equity	SORBUS VECTOR	8.4%
Europe ex UK equity	Vanguard FTSE Developed Europe ex UK Equity	2.0%
North American equity	Vanguard U.S. Equity	8.0%
Japanese equity	iShares Japan Equity	4.0%
Pacific ex Japan equity	Invesco Perpetual Asian Z	1.0%
Pacific ex Japan equity	Stewart Investors Asia Pacific Leaders B	1.0%
Emerging Market equity	Vanguard Emerging Markets	2.0%
alternatives		**7.0%**
commodities	Investec Global Gold	7.0%
property		**4.0%**
property	iShares Global Property Securities Equity	4.0%

BLACKWOOD MODEL 6 TACTICAL ASSET ALLOCATION

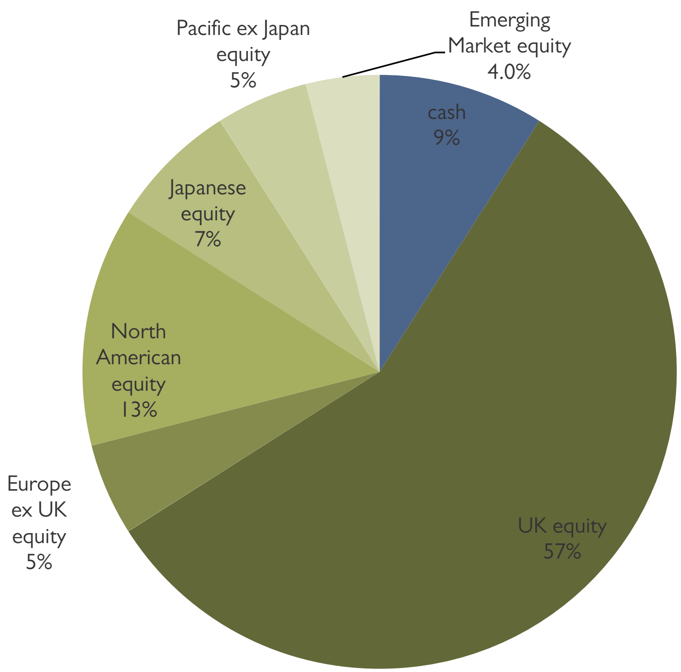
number of holdings	16
total cost of investment	1.03%



asset class	fund holding	% total
cash		**9.0%**
cash	sterling	9.0%
bonds		**20.0%**
UK gilts	Vanguard U.K. Government Bond	7.0%
UK gilts	L&G All Stocks Index-Linked Gilt	2.0%
UK corporates	Vanguard UK Investment Grade Bond	4.0%
international bonds	TwentyFour Dynamic Bond	2.5%
international bonds	TwentyFour Monument Bond	2.5%
international bonds	AXA US Short Duration High Yield	2.0%
equity		**59.0%**
UK equity	iShares 100 UK Equity	26.0%
UK equity	SORBUS VECTOR	10.0%
Europe ex UK equity	Vanguard FTSE Developed Europe ex UK Equity	3.0%
North American equity	Vanguard U.S. Equity	10.0%
Japanese equity	iShares Japan Equity	5.0%
Pacific ex Japan equity	Invesco Perpetual Asian Z	1.0%
Pacific ex Japan equity	Stewart Investors Asia Pacific Leaders B	1.0%
Emerging Market equity	Vanguard Emerging Markets	3.0%
alternatives		**8.0%**
commodities	Investec Global Gold	8.0%
property		**4.0%**
property	iShares Global Property Securities Equity	4.0%

BLACKWOOD MODEL 7 TACTICAL ASSET ALLOCATION

number of holdings	8
total cost of investment	0.82%



asset class	fund holding	% total
cash		**9.0%**
cash	sterling	9.0%
equity		**91.0%**
UK equity	iShares 100 UK Equity	47.0%
UK equity	SORBUS VECTOR	10.0%
Europe ex UK equity	Vanguard FTSE Developed Europe ex UK Equity	5.0%
North American equity	Vanguard U.S. Equity	13.0%
Japanese equity	iShares Japan Equity	7.0%
Pacific ex Japan equity	Invesco Perpetual Asian Z	2.5%
Pacific ex Japan equity	Stewart Investors Asia Pacific Leaders B	2.5%
Emerging Market equity	Vanguard Emerging Markets	4.0%

cash and debt
equity
alternatives and property

FUND SELECTION

We structure our model portfolios almost entirely from passive funds. This reflects the evidence that actively managed funds cannot consistently beat the market (Cremers et al. 2014, Blake et al. 2015, S&P, 2014). This allows SORBUS to keep the underlying investment costs low and thus boosting the portfolio returns.

The occasions where SORBUS PARTNERS uses active funds represents a specialist market where markets are not efficient and an investment house is able to add value through their deeper understanding of market conditions.

active fund choices

bond funds

- TwentyFour Asset Management Monument bond fund
- TwentyFour Asset Management Dynamic bond fund
- AXA US High Yield short duration bond fund

Asia pacific equity funds

- Invesco Perpetual Asian
- Stewart Investors Asia Pacific Leaders

ACTIVELY MANAGED FUNDS

TWENTYFOUR ASSET MANAGEMENT

TwentyFour asset management is a fixed income specialist that provides two of the externally active managed funds that the model portfolios invest in. They operate in niche market areas that offer benefits of diversification to client portfolios.

Monument Bond Fund

This is a low risk bond fund that invests in a selection of floating rate asset backed securities (largely mortgage backed). The investments are plain vanilla (not a repeat of the subprime versions from 2008). As the fund invests in floating rate securities it naturally provides a degree of protection from rising interest rates.

Dynamic Bond Fund

This fund is higher risk than the Monument fund. It operates on an unconstrained basis. It aims to provide an attractive level of income along with the opportunity for capital growth, by investing in a broad range of bonds and fixed income assets, including investment grade bonds, high yield bonds, government bonds and asset-backed securities.

Axa US High Yield short duration bond fund

This fund provides a degree of further diversification for the model portfolios. Its use is to provide a risk adjusted approach to the high yield segment of the US bond market.

ASIA PACIFIC EQUITY FUNDS

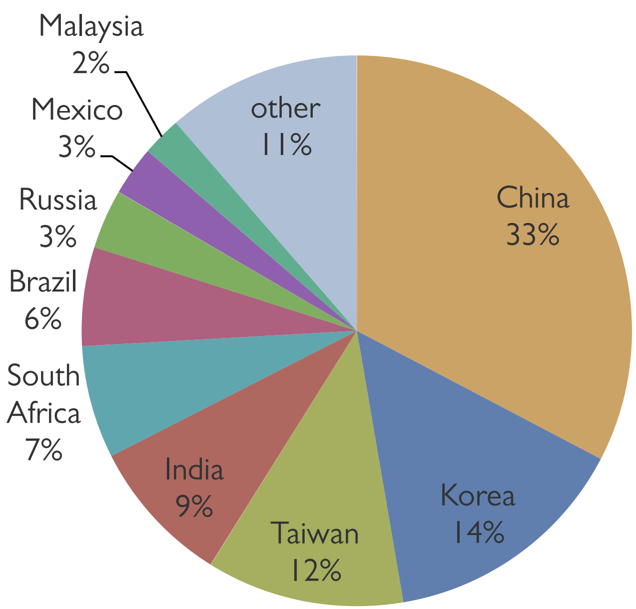
The Asia Pacific region (ex. Japan) is an example of an inefficient market. Both fund selection choices have a strong track record of outperformance against their peer group and against the FTSE Asia Pacific ex Japan indices.

NEW FUND SELECTION

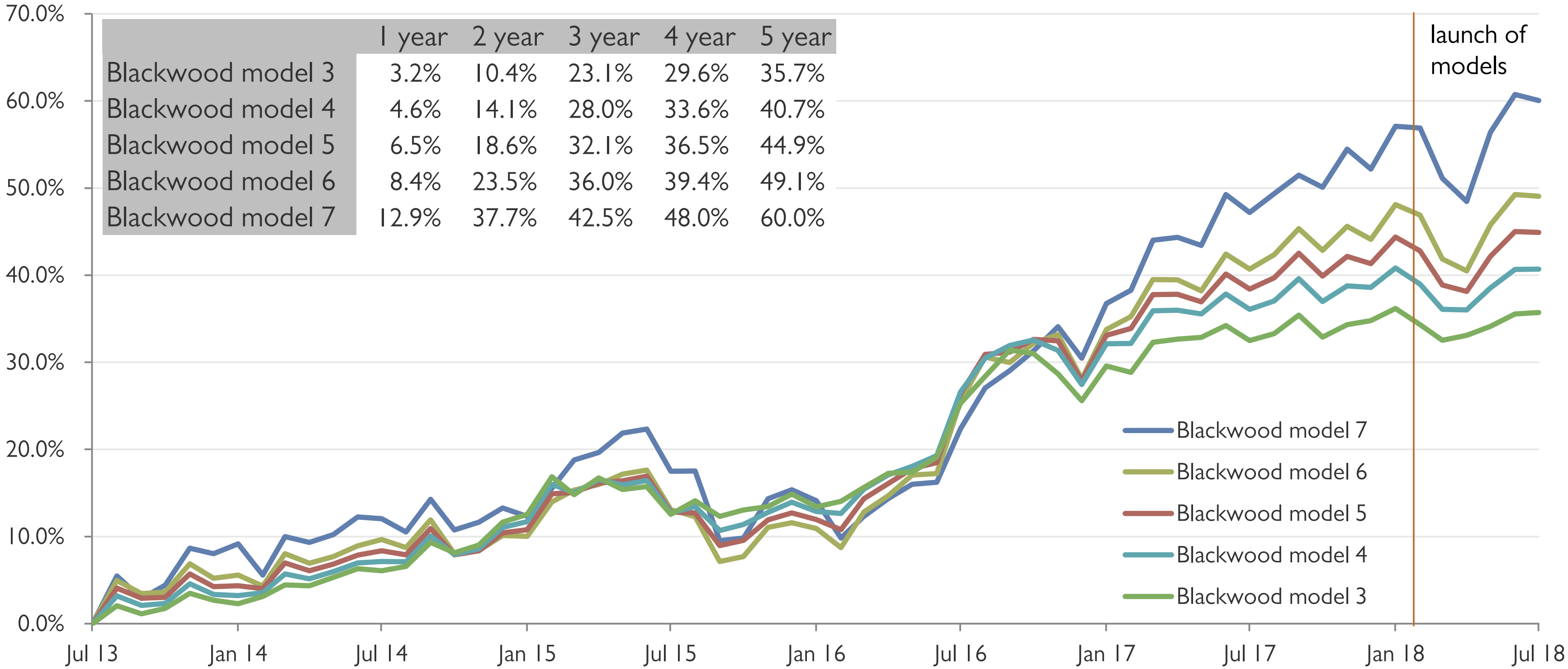
VANGUARD EMERGING MARKETS STOCK INDEX

This fund tracks the performance of the MSCI Emerging Markets Index. Unlike many of its peers it seek to fully replicate the index, as opposed to employing an optimised sampling method and/or derivatives. It is also of a sufficient size to provide the level of liquidity required by investors in the model portfolio.

fund name	fund type	investment strategy	replication strategy	expense ratio	tracking error	net assets, millions	securities lending	derivatives used
Vanguard Emerging Markets Stock Index	OEIC	passive	full replication	0.27%	2.49%	£1,300	n/a	no
iShares Emerging Markets Equity Tracker fund	OEIC	passive	optimised sampling	0.25%	2.62%	£1,200	n/a	yes
Fidelity Index Emerging Markets	OEIC	passive	full replication	0.20%	4.43%	£228	n/a	no



5 YEAR PERFORMANCE OF BLACKWOOD MODELS (BACKDATED)



	1 year	2 year	3 year	4 year	5 year
Blackwood model 3	3.2%	10.4%	23.1%	29.6%	35.7%
Blackwood model 4	4.6%	14.1%	28.0%	33.6%	40.7%
Blackwood model 5	6.5%	18.6%	32.1%	36.5%	44.9%
Blackwood model 6	8.4%	23.5%	36.0%	39.4%	49.1%
Blackwood model 7	12.9%	37.7%	42.5%	48.0%	60.0%

period: 1st July 2013 to 1st July 2018

note: all figures are gross of DFM fees but net of fund manager charges

Performance figures prior to the launch of the models on the 25/01/2018 have been derived based on the underlying index returns of the funds currently constituting the models and the strategic (long term) asset allocation for each model. Past returns are not a guide to future performance and this graph is not intended to set expectations of the potential future returns on the models. It is intended solely to provide information on the historic variance in the returns of the models. The actual asset allocation of the models at any time and for an extended period of time may differ significantly from the strategic asset allocations, reflecting the dynamic investment and market conditions.

APPENDIX

LEGAL NOTICE

Note

This is provided for information purposes only at your request and does not constitute a formal valuation. While we have used all best endeavours to ensure that the performance figures and/or the values in this report are correct, it has been produced manually and has not been independently validated and we take no responsibility for any loss you may suffer as a consequence of your relying upon the information in this document.

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