MID-YEAR INVESTMENT OUTLOOK 2017

HOUSEVIEW | GLOBAL GROWTH SUPPORTS EQUITIES, GOVERNMENT BONDS POOR VALUE

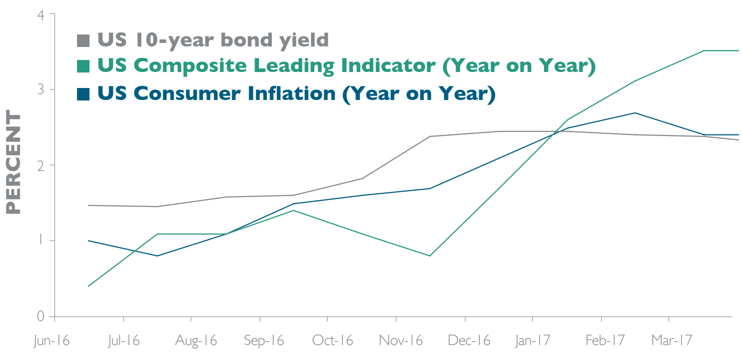
Coutts

WE REMAIN POSITIVE ON EQUITIES AND ALTERNATIVES

The normalising global economic environment (with growth picking up and interest rates rising) has been positive for risk assets and has pushed equity and credit valuations up. We believe this benign environment will continue for a while but are watching closely for signs of slowdown.

Asset Allocation	Very negative	Negative	Neutral	Positive	Very positive
Equities	○	○	○	●	○
Government bonds	○	●	○	○	○
Credit	○	○	○	●	○
Real assets	○	○	●	○	○
Alternatives	○	○	○	○	●

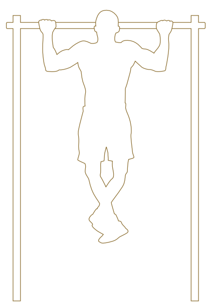
THE GLOBAL REFLATION THEME IN THE LAST YEAR...



SOURCE: BLOOMBERG

US GROWTH, INFLATION AND INTEREST RATES HAVE ALL RISEN

...HAS BEEN POSITIVE FOR RISKY ASSETS



STRONG GROWTH IN RISK ASSETS OVER THE PAST YEAR

SOURCE: BLOOMBERG

Reflation implies that growth and inflation should normalise from their low mid-2016 levels, followed by central bank normalisation. This environment is typically positive for risky assets such as equities (in particular information technology and financials) and high yield bonds. We expect this trend, which started in the US, to persist in the medium term and become more prominent in Europe.

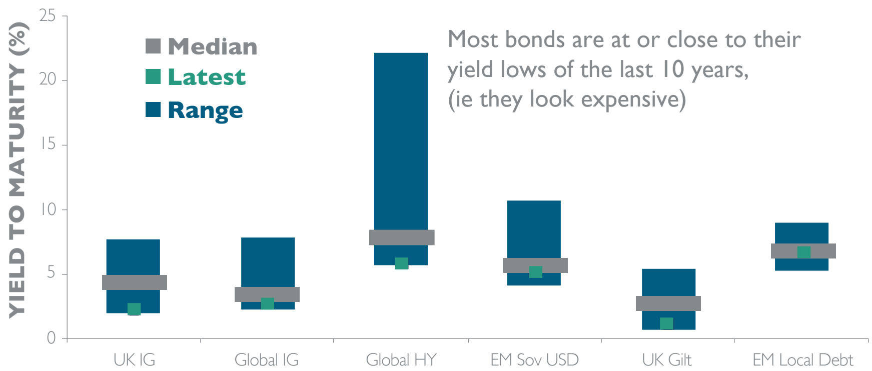
However, valuations across equity markets have become even more extended and some economic and credit indicators indicate we are nearing the end of the business cycle. Hence we remain cautious by having a small equity overweight only and prefer relative value opportunities. We also like alternative investments as they typically provide good diversification, downside protection and attractive risk-adjusted returns.

BONDS

Within bonds, we prefer credit to government bonds. Low yields suggest low returns going forward. Within fixed income, we prefer high yield and emerging market debt to government bonds and investment grade credit for their return potential and lower interest rate sensitivity.

Despite the reflationary environment, bond yields remain very low. This suggests low returns – and the possibility of losing money if yields rise – for long-term investors. In the shorter term, the reflationary environment characterised by rising inflation and rising nominal rates is likely to be negative for bonds, particularly those that are interest rate sensitive (high duration).

YIELDS ACROSS FIXED INCOME ASSETS (LAST 10 YEARS)



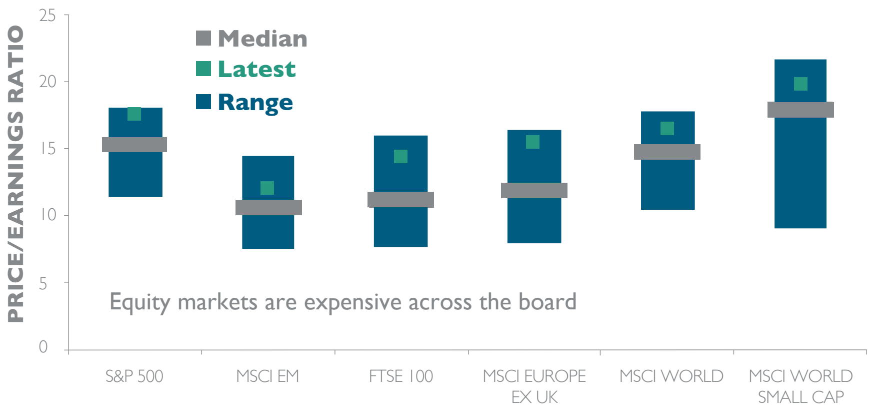
SOURCE: BLOOMBERG

EQUITIES

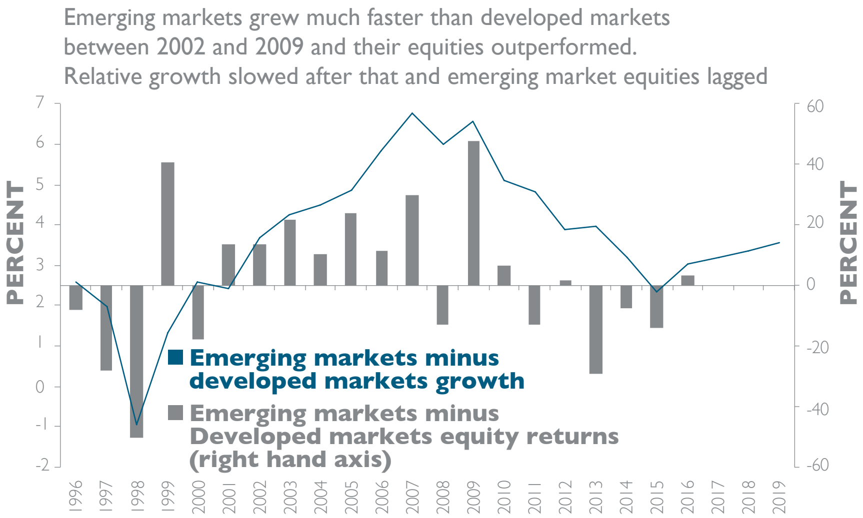
Despite expensive valuations, the economic environment remains supportive for equities. We remain slightly overweight on the back of the positive macroeconomic backdrop and receding political risks. We are cautious however, and favour relative value within the asset class.

For example, we continue to prefer European and emerging market equities over the US, as markets are cheap and the cyclical backdrop looks more favourable. After six years of disappointing economic growth and underperformance of developed markets, emerging markets equities now look much cheaper. They should re-rate if relative GDP growth and earnings per share improve, as predicted by analysts.

FORWARD PRICE/EARNINGS RATIO ACROSS EQUITY REGIONS (LAST 10 YEARS)



SOURCE: BLOOMBERG



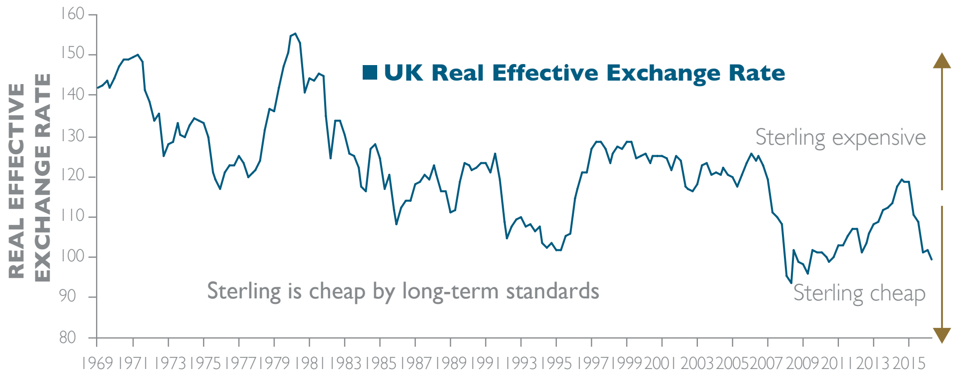
SOURCE: IMF, BLOOMBERG

ALTERNATIVES

Alternative investment strategies offer an attractive risk-adjusted return and provide diversification away from equities at a time when traditional diversifiers – such as bonds – offer little upside and a high level of risk. On average, alternatives strategies – like trend-following strategies – have had a lower correlation to equities than government bonds. So, when equities fall they perform better than bonds, offering superior protection against equity corrections.

OPPORTUNITIES | UPDATE ON OUR KEY INVESTMENT THEMES

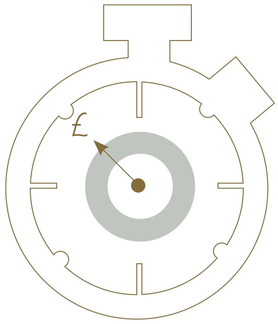
POUND STERLING IS ATTRACTIVE



SOURCE: BANK OF INTERNATIONAL SETTLEMENTS

Many investors have a negative view on sterling based on Brexit risks to the UK economy and the reliance on foreign capital inflows. But, post-referendum, economic activity in the UK has proved more resilient than anticipated.

Sterling is undervalued on a medium to long-term horizon versus the US dollar, similar to the extremes of 2008 and 1985. Over the long term these valuation measures have a fair track record for forecasting sterling performance over the medium to long term.



STERLING IS UNDERVALUED ON A MEDIUM TO LONG-TERM HORIZON VERSUS THE US DOLLAR, SIMILAR TO THE EXTREMES OF 2008 AND 1985

EUROPEAN EQUITY

European equity is cheap relative to the US and the fundamental outlook is positive.

Economic growth and earnings growth have picked up in Europe over the last year.

With political risks easing, international investors who abandoned Europe in 2016 are now purchasing European assets again.

HEALTHCARE

THE SECTOR BENEFITS FROM MAJOR GLOBAL DEMOGRAPHIC TRENDS LIKE GLOBAL AGEING AND INCREASING LONGEVITY

The pharmaceuticals and healthcare sector has performed well since the US election. It combines attractive valuations with a positive fundamental outlook.

After the uncertainty prior to last year's US presidential election the sector has stabilised, but investors remain under-invested.

Earnings and sales are improving steadily.

Valuations remain cheap by long-term standards – traditionally this sector trades at a premium to the S&P 500.

FINANCIAL DEBT

Financial debt offers an attractive income and potentially some capital appreciation on the back of an improving fundamental picture for banks.

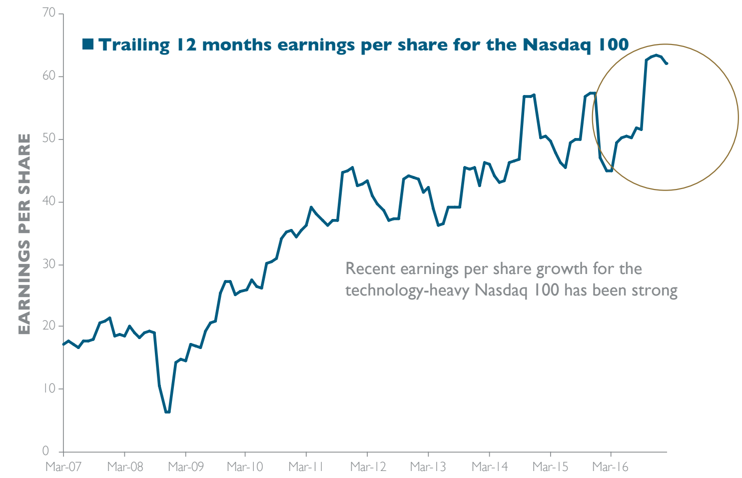
Financial debt consists of senior and subordinated debt (such as "Contingent Convertibles") of banks and insurers.

Profitability has stabilised and returns on equity are turning upwards again.

Asset quality is improving.

Banks have retained lots of earnings since the financial crisis and made progress deleveraging their balance sheets.

Regulatory pressures are slowly subsiding.



SOURCE: BLOOMBERG

TECHNOLOGY

Technology is one of the best performing sectors so far in 2017 boosted by healthy earnings.

- Latest earnings results confirm the strong underlying growth trend as many technology companies continue to surpass earnings forecasts.
- The "disruption" of economic activities via new technology remains a long-term investment theme

The balance sheets of tech companies are strong, margins are healthy

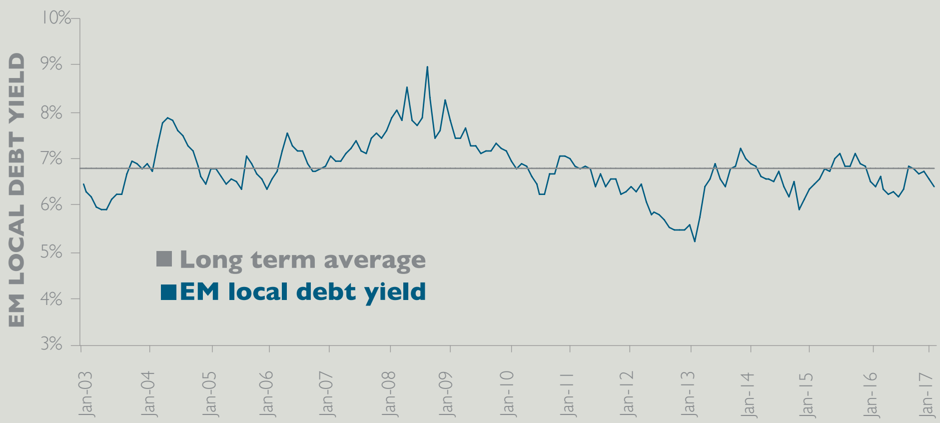
EMERGING MARKET DEBT

Recently we allocated to emerging market local currency debt following a sustained period of underweight exposure.

The combination of attractive yields, potential capital gains from falling inflation and interest rates as well as normalizing currencies are aligned with our macro, value and contrarian principles.

Emerging market debt nominal yields are still at attractive levels.

EMERGING MARKET DEBT YIELDS ARE AT ATTRACTIVE LEVELS



SOURCE: BLOOMBERG

SHORT-DATED BONDS

The normalising global economic environment (with growth picking up and interest rates rising) has been positive for risk assets since the second half of 2016.

As economic conditions improve around the world all major central banks are starting to come under pressure to normalize their central bank policies (ie raise interest rates).

This process is already underway in the US where the Federal Reserve has started to raise rates. While UK and European central banks are still expanding their balance sheets, there is already speculation that the European Central Bank will soon start to change its guidance towards a normalization of its policy.

This process will likely push bond yields further up during the year. This leads us to maintain our positive view on short-dated bonds, as detailed in our 2017 outlook.

As economic conditions improve around the world, major central banks are starting to come under pressure to normalize their central bank policies

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ECONOMIC UPDATE | THE RACE FOR GROWTH

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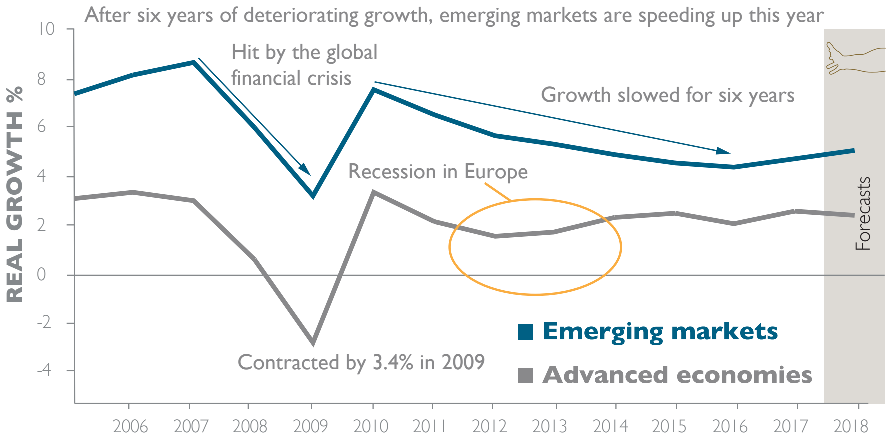
THE WORLD ECONOMY IS IN REASONABLE SHAPE

- Emerging markets are picking up, led by India (likely to grow at 7% plus in 2017) and China (6.5%)
- The advanced economies are growing, helped by strong consumer spending in the USA and Europe



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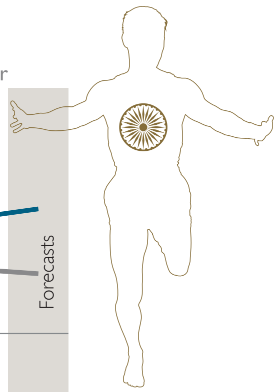
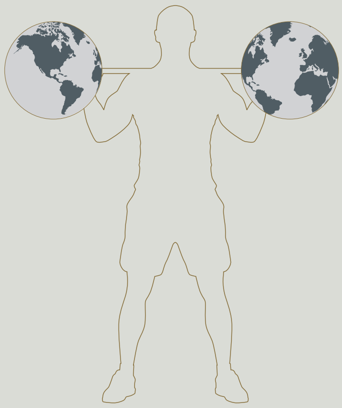


7%

INDIA



DON'T WORRY ABOUT US RECESSION

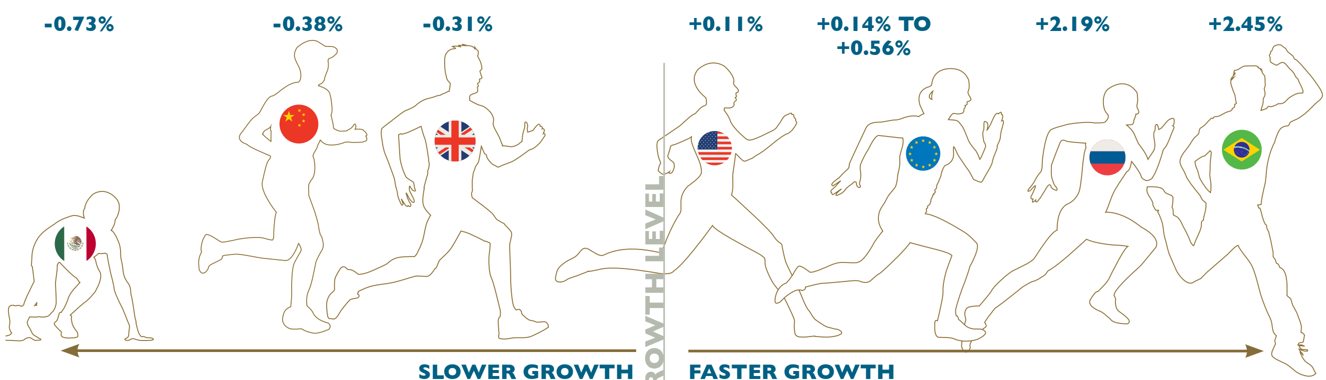
Historically, many big global equity crashes have accompanied US recessions. There's little chance that the US is close to recession:

- Growth numbers and leading indicators are firmly positive.
- The US yield curve (10-year less 2-year rates) has steepened recently, to over 1%; it tends to go negative when recessions approach
- The US economy doesn't have big macro imbalances (eg soaring inflation or current account deficits) that could lead to trouble soon

Data indicates there is a low risk of US recession

THE BIG MOVERS

Eleven of the world's 16 biggest economies are likely to grow faster in 2017 than in the previous three years.



SLOWER GROWTH

Mexico is trapped by US politics.

China's headlong growth is slowing, but no crash is likely anytime soon.

UK slowing after the strong 2014-15 recovery; Brexit's likely negative effects to be felt in 2018 or later.

FASTER GROWTH

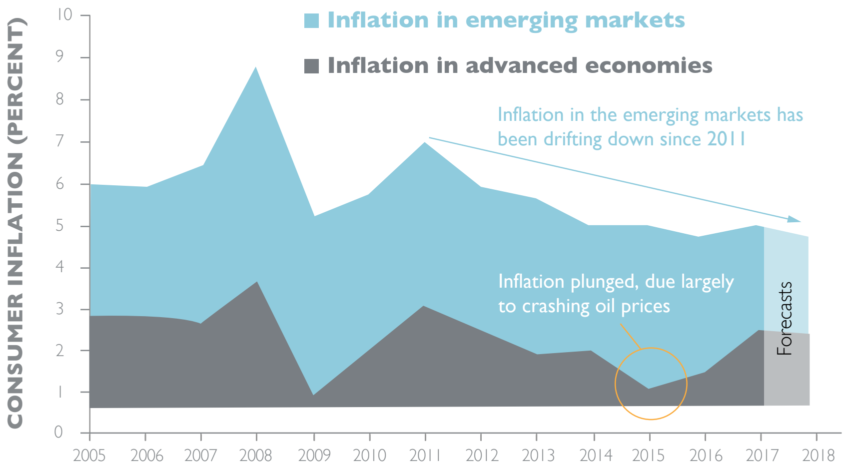
The IMF says US growth could reach 2.3% in 2017.

Europe's big economies are speeding up.

Russia and Brazil should grow in 2017 after two down years; Brazil's economy contracted by more than 7% 2014-15.

WORLD INFLATION IS NORMALISING

Inflation is drifting up, but the factors keeping it subdued (eg demography, price competition from the internet, weak trade unions, conservative fiscal policies in most countries) remain in place.



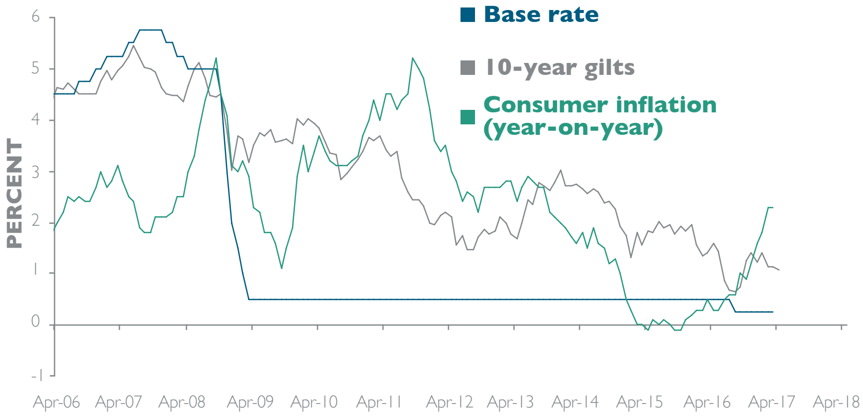
SOURCE: IMF

2011

INFLATION IN THE EMERGING MARKETS HAS BEEN DRIFTING DOWN SINCE 2011

UK INTEREST RATES SHOULD REMAIN SUBDUED

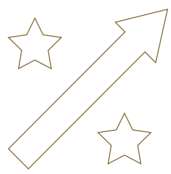
UK base lending rate has been 0.5% or less since the financial crisis. It's unlikely to rise until uncertainties around Brexit are resolved. After falling to zero in 2015 due to plummeting oil prices, inflation (CPI) is normalising in the 2-3% range. Gilt yields are low, losing money for buy-and-hold investors in real terms, but supported by pension funds and insurers.



SOURCE: BLOOMBERG

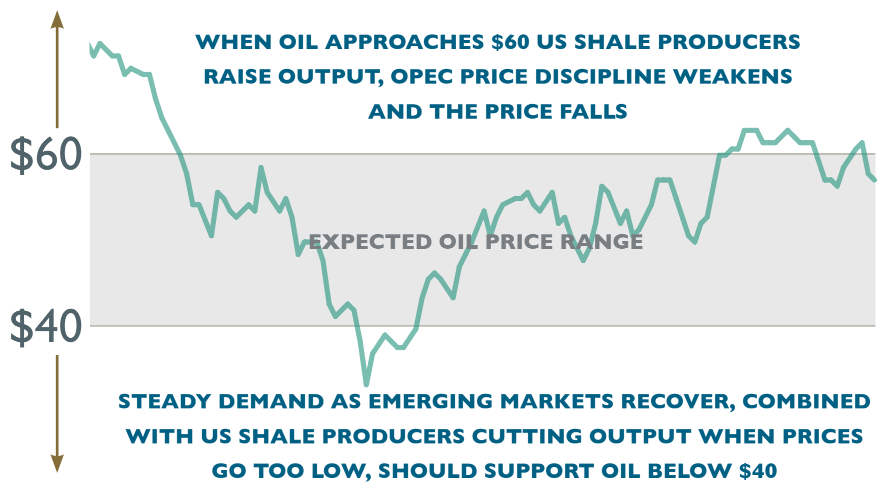
US INTEREST RATES ARE DRIFTING UP

US policy rates (the rates at which banks can lend reserves to one another) were slashed in 2008 and have remained depressed since. Rates have been raised three times since December 2015, but we expect the tightening cycle to remain gradual, due to inflation remaining subdued.



OIL TO QUIETEN DOWN

After big ups and downs in the last 10 years, we expect the oil price to stabilise in the $40-60 range for the next year or two. This is partly due to the stabilising effects of US shale production, which becomes profitable with oil at about $50 per barrel. As a result we don't expect the oil price to move far from this level.



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