

HOUSEVIEW | GLOBAL GROWTH SUPPORTS EQUITIES, GOVERNMENT BONDS POOR VALUE

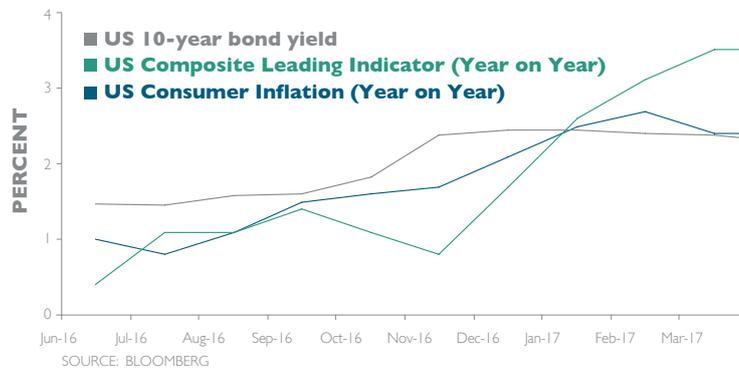


WE REMAIN POSITIVE ON EQUITIES AND ALTERNATIVES

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	○	○	○	○	●

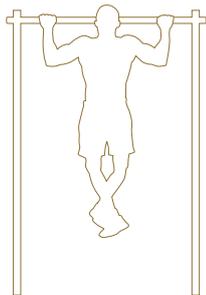
THE GLOBAL REFLATION THEME IN THE LAST YEAR...



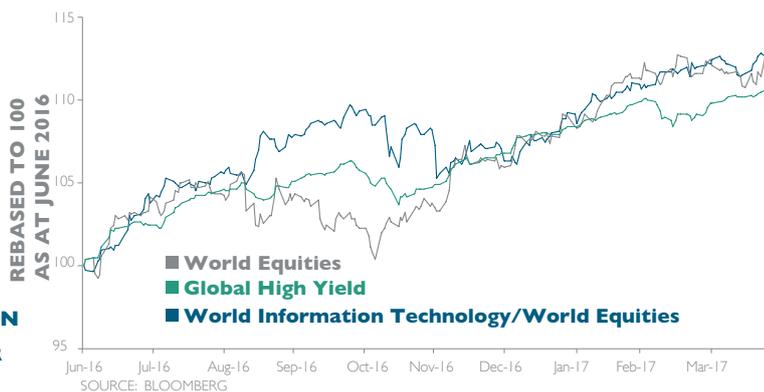
US GROWTH, INFLATION AND INTEREST RATES HAVE ALL RISEN

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.

...HAS BEEN POSITIVE FOR RISKY ASSETS



STRONG GROWTH IN RISK ASSETS OVER THE PAST YEAR



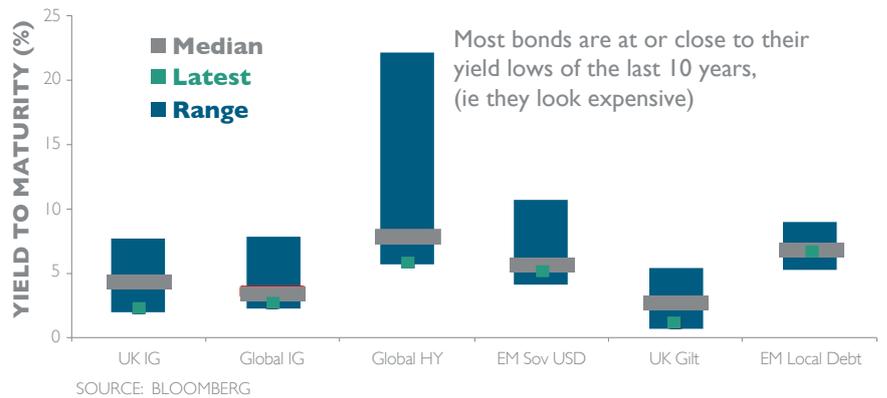
However, valuations across equity markets have become even more extended and some economic and credit indicators indicate we are nearing the end of the business cycle. Hence we remain cautious by having a small equity overweight only and prefer relative value opportunities. We also like alternative investments 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)

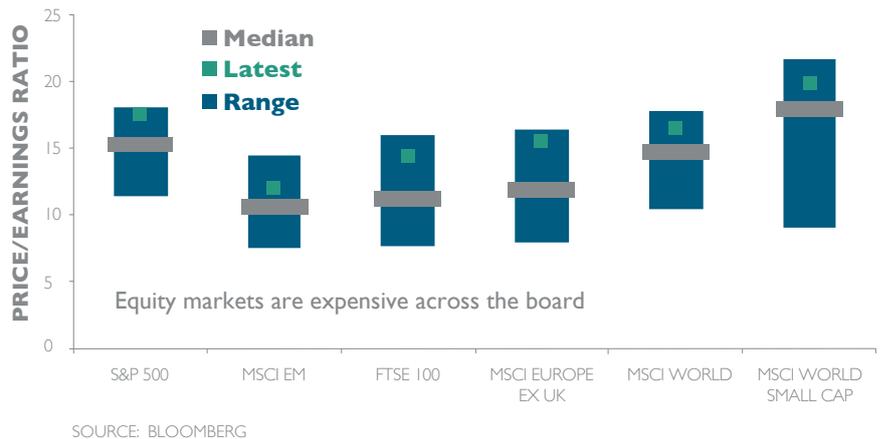


EQUITIES

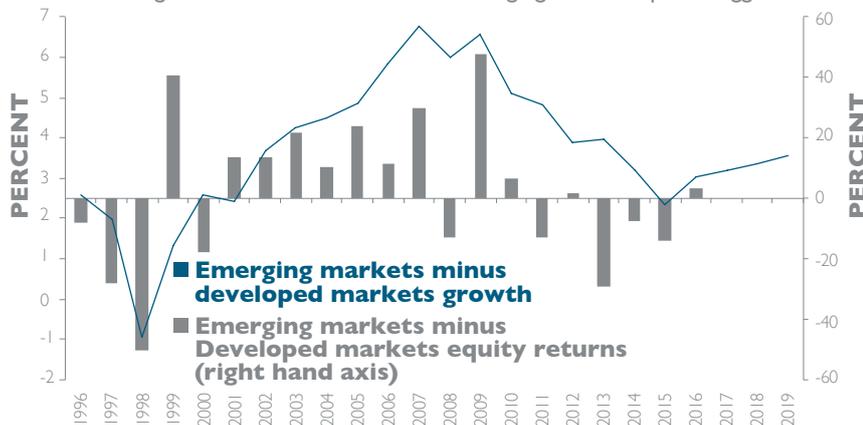
Despite expensive valuations, the economic environment remains supportive for equities. We remain slightly overweight on the back of the positive macroeconomic backdrop and receding political risks. We are cautious however, and favour relative value within the asset class.

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)



Emerging markets grew much faster than developed markets between 2002 and 2009 and their equities outperformed. Relative growth slowed after that and emerging market equities lagged



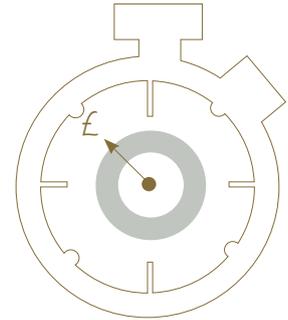
ALTERNATIVES

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



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

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.

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.



FINANCIAL DEBT

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

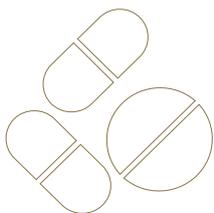
Financial debt consists of senior and subordinated debt (such as “Contingent Convertibles”) of banks and insurers.

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.



HEALTHCARE

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.

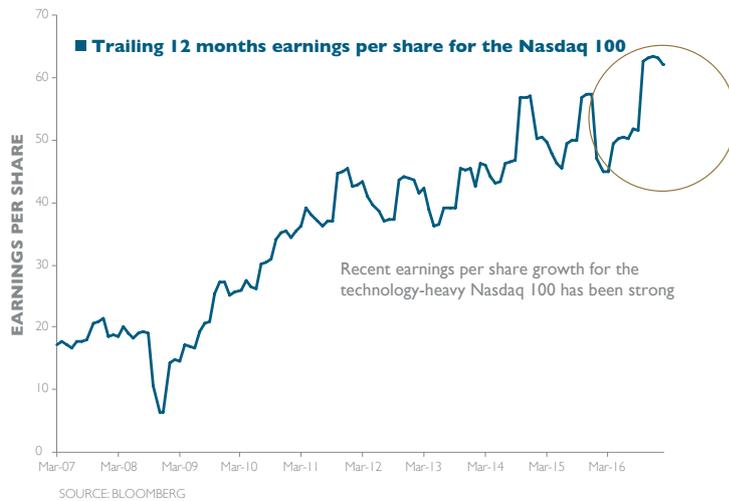
THE SECTOR BENEFITS FROM MAJOR GLOBAL DEMOGRAPHIC TRENDS LIKE GLOBAL AGEING AND INCREASING LONGEVITY

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



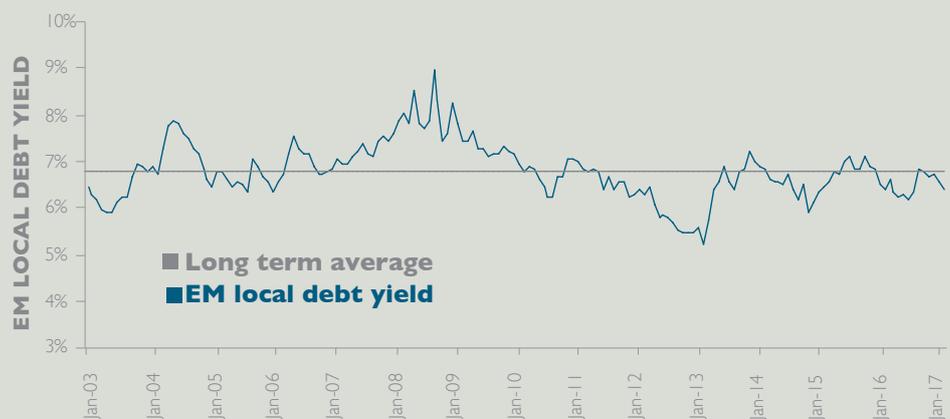
EMERGING MARKET DEBT

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

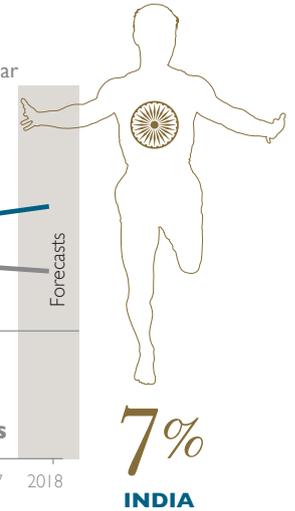
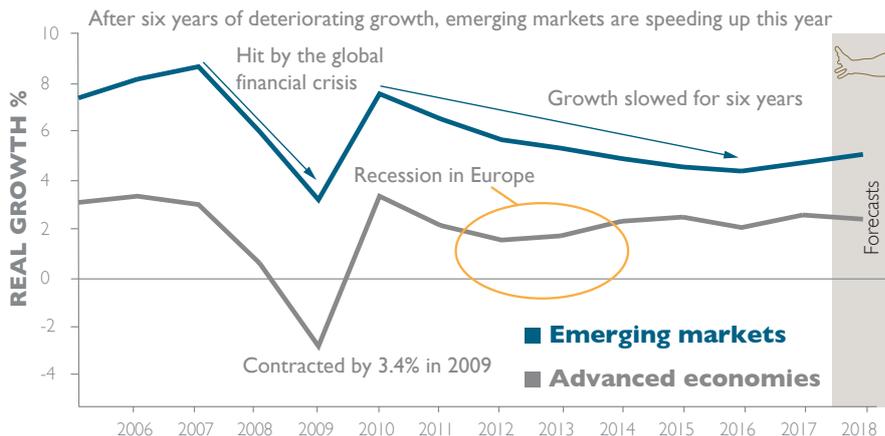
ECONOMIC UPDATE | THE RACE FOR GROWTH



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



DON'T WORRY ABOUT US RECESSION

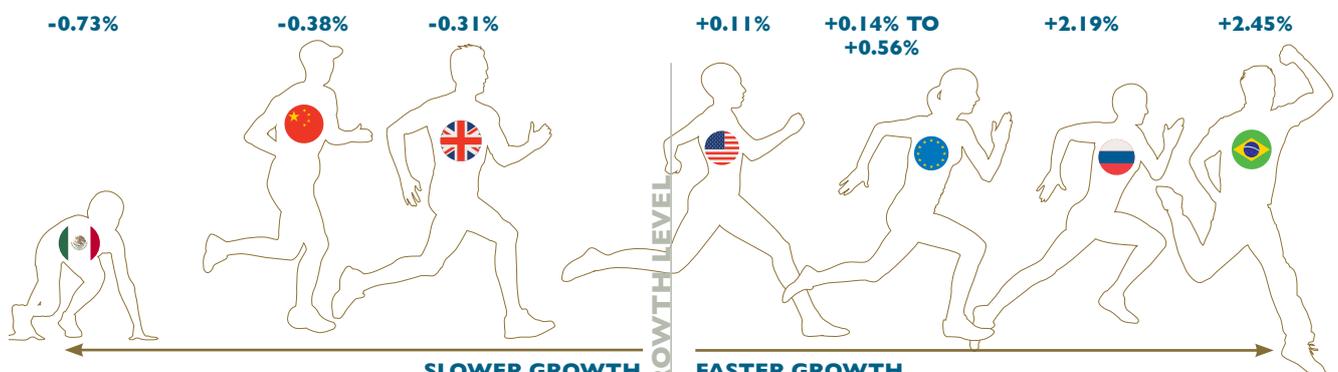
Historically, many big global equity crashes have accompanied US recessions. There's little chance that the US is close to recession:

- 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.



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.

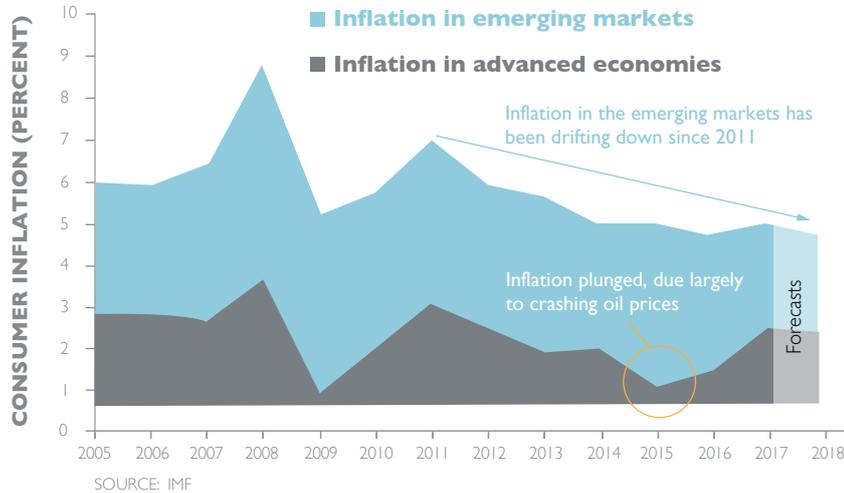
The IMF says US growth could reach 2.3% in 2017.

Europe's big economies are speeding up.

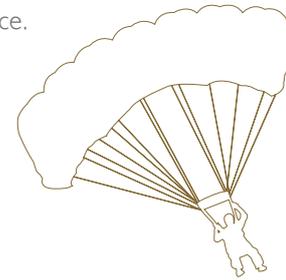
Russia and Brazil should grow in 2017 after two down years; Brazil's economy contracted by more than 7% 2014-15.

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

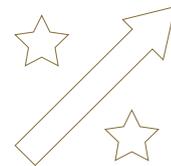
UK base lending rate has been 0.5% or less since the financial crisis. It's unlikely to rise until uncertainties around Brexit are resolved. After falling to zero in 2015 due to plummeting oil prices, inflation (CPI) is normalising in the 2-3% range. Gilt yields are low, losing money for buy-and-hold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



SOURCE: BLOOMBERG

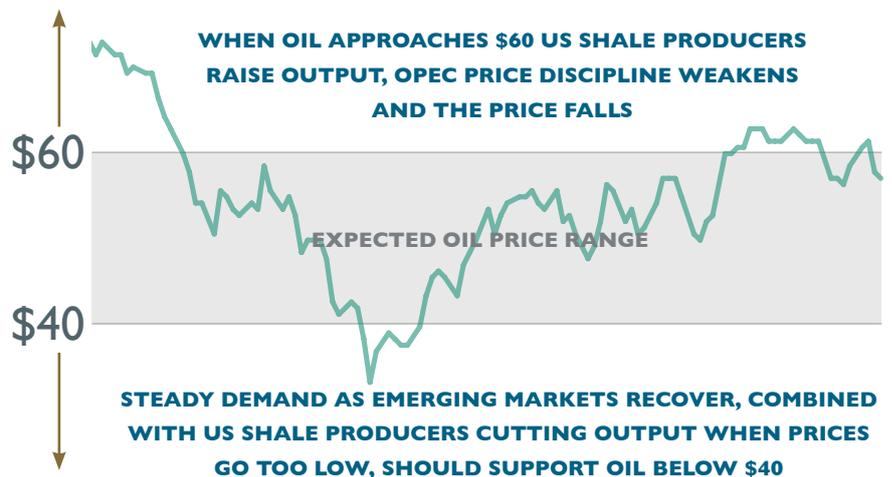
US INTEREST RATES ARE DRIFTING UP

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.



This presentation is a financial promotion for UK regulatory purposes. It is for illustration purposes only and is based on information we hold about you. It is not a recommendation to invest and is intended to assist in making a subsequent personal recommendation.

The value of investments, and the income from them, can go down as well as up, and you may not recover the amount of your original investment. Past performance should not be taken as a guide to future performance. Where an investment involves exposure to a foreign currency, changes in rates of exchange may cause the value of the investment, and the income from it, to go up or down. In the case of some investments, they may be illiquid and there may be no recognised market for them and it may therefore be difficult for you to deal in them or obtain reliable information about their value or the extent of the risks to which they are exposed.

Investments in emerging markets are subject to certain special risks, which include, for example, a certain degree of political instability, relatively unpredictable financial market trends and economic growth patterns, a financial market that is still in the development stage and a weak economy.

The information contained in this presentation is believed to be correct, but cannot be guaranteed. Opinions constitute our judgement as at the date of issue and are subject to change. The analysis contained in this presentation has been procured, and may have been acted upon, by Coutts & Co. (Coutts) and connected companies for their own purposes, and the results are being made available to you on this understanding. To the extent permitted by law and regulation, neither Coutts nor any connected company accepts responsibility for any direct or indirect or consequential loss suffered by you or any other person as a result of your acting, or deciding not to act, in reliance upon such information, opinions and analysis.

Full details of the fees and costs are set out in our Fee Tariff, available on request.

Not all products and services offered are available in all jurisdictions where The Royal Bank of Scotland Group operates. Certain aspects of the service may be performed through, or with the support of, different members of The Royal Bank of Scotland Group, of which Coutts is a member.

Coutts is a member of the Financial Services Compensation Scheme (FSCS) (the "Scheme"). Investment business undertaken with Coutts in the UK may be covered by the FSCS. In respect of investment business, the Scheme covers a claim up to a maximum of £50,000 per person. More details on the types of person and other entities who are or are not covered, and how eligible claims are calculated, can be found on the FSCS website www.fscs.org.uk.

Tax reliefs and other matters referred to are those available under current legislation, which may change, and their availability and value will depend on your individual circumstances.

Issued by Coutts, which is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Coutts is registered in England No. 36695. Financial Services Firm Reference Number 122287. Registered office: 440 Strand, London WC2R 0QS.

January 2017
