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REAL ASSETS INSIGHTS
Q3 2019

Investors' concerns in three main areas only intensified; namely Brexit, the US-China trade war and a slowdown in manufacturing globally. With no end in sight for any of these issues, investors are looking for central banks to act in support of the economy. During the quarter, both comments and actions from central banks showed that they share the same concerns. However, the muted equity market response and persistently low bond yields suggest that we may be reaching the limits to what monetary policy can achieve in this cycle, with little optimism that growth or inflation will rebound.

WHAT'S DRIVING MARKETS?

The backdrop of central bank easing and macroeconomic concerns boosted the already strong performance in government bonds this year. The scale of the rally in bonds is most clearly demonstrated by the fact that around $16 trillion of bonds now have negative yields. This hunt for safe haven investments has had a knock-on effect for other asset classes, notably gold, which rallied sharply over the quarter. With so many negative-yielding bonds guaranteeing investors a capital loss if they hold them to maturity, the lack of income from gold becomes less significant and gold is increasingly attractive as a long-term store of capital. Consequently, we are carrying a larger allocation to gold than has historically been the case, although we have trimmed it slightly following a strong run.

POSITIVE CONTRIBUTORS

Property assets

Property has been a strong performer over the quarter and has seen its relative value improve against the backdrop of falling bond yields. Performance has not been uniform across the sector. 'Alternative' sectors such as student accommodation and self-storage, outperformed traditional sectors, such as retail and offices. The retail sector has been particularly weak, struggling with both the cyclical pressures of falling tenant demand, as well as with structural change, as online shopping squeezes tenants' profitability. Alternative property asset classes have long been a feature of our property allocation, favoured for their defensive income and relatively stable capital values. Whilst historic returns have been excellent, prospective returns may be lower given less attractive valuations. We are aware that a soft Brexit outcome could result in a rotation out of these assets and into more economically sensitive and structurally challenged parts of the market.

NEGATIVE CONTRIBUTORS

Commodities

Oil fell sharply during the quarter as concerns grew that slowing economic growth would weigh on demand at a time when supply from OPEC has continued to expand. This impacted not just the oil price but had a spillover effect on midstream energy companies that own the pipelines and storage facilities necessary to process the commodity. This relationship between the oil price and midstream companies is consistent with other periods of energy price weakness over the past few years. But the key difference this time around is that the US Federal Reserve is cutting interest rates, so when the oil price stabilises these high yielding companies should find their shares in relatively higher demand.

PORTFOLIO CHANGES

During the quarter, we added a new position, the JPM Global Core Real Assets Fund. This is an investment trust that allocates to JP Morgan's institutional real asset strategies spanning US real estate, Asian real estate, shipping and infrastructure. The attraction is that it gives us access to a diversified portfolio of over 500 physical assets and, by using their in-house strategies, it is a cost effective way for us to access assets in the US and Asia that diversify our geographical exposure. This diversification is particularly attractive given the volatile political backdrop in the UK and Labour's threat of infrastructure nationalisation.

We sold the Pictet Timber Fund following a manager change which reduced our confidence that the fund will be able to continue delivering the good returns of the past. The search for a replacement fund that can give exposure to timber land is ongoing.

OUTLOOK

The strong rally this year across asset classes, despite a shaky economic backdrop, has seemingly been built on hopes of central bank intervention. Now this has arrived, it is difficult to see what will next drive markets, as it is likely to be some time before the looser monetary conditions feed through to the economy. Until we see a benign resolution on Brexit or the trade war or an improvement in economic activity, we favour a bias towards defensive assets that can diversify equity risk within a portfolio.

Central banks have responded to support the economy through lower interest rates, resumption of quantitative easing and promises for future support. However, there is the chance that they cannot prevent a more protracted slowdown that spreads from manufacturing into the services sector with a greater impact on GDP growth, consumption and jobs.

Identifying areas that can be resilient to a downturn while generating an attractive income is our focus for the portfolio. We believe that real assets combined with some truly defensive assets such as gold and inflation-linked bonds can achieve this. We are optimistic that the Architas Diversified Real Assets Fund can be a useful allocation if the economy doesn't bounce back from the current, weak trend.

LONGER-TERM PERFORMANCE

Cumulative return Total returns for the periods shown (%)	1m	3m	6m	YTD	Since inception (5 Aug 2014)
Architas Diversified Real Assets A Acc	0.00	1.90	4.30	8.04	23.60
FTSE AllSh TR GBP	2.95	1.27	4.57	14.41	38.99
Markit iBoxx GBP Gilts TR	0.50	6.55	8.04	11.85	38.98

Discrete yearly performance Total returns for the periods shown (%)	1 Oct 2018 to 30 Sep 2019	1 Oct 2017 to 30 Sep 2018	1 Oct 2016 to 30 Sep 2017	1 Oct 2015 to 30 Sep 2016	1 Oct 2014 to 30 Sep 2015
Architas Diversified Real Assets A Acc	4.48	1.11	2.90	9.12	2.86
FTSE AllSh TR GBP	2.68	5.87	11.94	16.82	-2.30
Markit iBoxx GBP Gilts TR	14.15	0.57	-3.71	13.15	8.57

Source: State Street and Morningstar, 30 September 2019. Performance as at 30 September 2019. Fund information is for the unit class A Net Acc. Total return figures are calculated on a single pricing basis and assume income is reinvested. Performance figures based on sterling unless otherwise stated. The fund performance figures take into account the annual management charge.

IMPORTANT **INFORMATION**

The Architas fund featured in this document can invest entirely in units of collective investment schemes. The value of the fund and the income from it can fall as well as rise purely as a result of exchange rate fluctuations. Clients can invest in the fund mentioned within this document through a number of financial products. This fund may not be appropriate for investors who plan to withdraw their money within five years. Past performance is not a guide to future performance. The value of your client's investment can go down as well as up and they may not get back what they originally invested. Some of the fund's portfolio is invested in non-mainstream assets, which during periods of stressed market conditions may be difficult to sell at a fair price, which may in turn cause prices to fluctuate more sharply than usual.

If you require further information on any of our funds, the Key Investor Information document (KIID) and the prospectus are both available free of charge on request from Architas Multi-Manager Limited. The KIID is designed to help investors make an informed decision before investing. You can view or download all our funds' KIIDs via our website at **architas.com** on the home page and the Literature Library.

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* *Monday to Friday 9.00am–5.00pm; calls may be recorded.*

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