McLAREN CAPITAL
MANAGING WEALTH

Market Update

September 2016

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McLAREN CAPITAL Ltd | MANAGING WEALTH

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Introduction

Q3 2016 began with much of the economic and political world still in shock over the largely unexpected result from the UK's European referendum. With the UK voting to leave the union there was a general sense of uncertainty which led to fragile global investor sentiment and in turn the old investment adage of 'sell in May and go away' was anything but applicable for the summer of 2016.

However despite this monumental event, the markets appeared to quickly shrug off the initial concerns from the BREXIT vote and the quarter has on the whole seen positive returns from the majority of global indices. Central bank intervention both at home and abroad appears to have been viewed in a largely positive manner, whilst there is little doubt that significant swings in exchange rates has benefited investors across various geographic regions.

We have referred to the VIX index on previous updates but as a re-cap it measures the volatility within US stock markets and hence can be used as a relatively strong indicator of investor sentiment. During August the index dipped to its lowest level year to date which suggests that investor confidence has risen although the McLaren Capital investment committee urges our clients to remain wary of bouts of market fragility and the latter stages of the quarter have indeed seen a slight increase in global market volatility.

The world now turns its attention to the US presidential elections and the possible ramifications that this may have regardless of who wins. It would appear that most post polls have Hilary Clinton in the lead but these polls would also suggest that the Democrats may take the senate and the Republicans the house which could potentially lead to policymaking deadlock whoever is crowned the victor. Although as UK voters know all too well (from both the last general election and the EU referendum) the polls only tell the public so much and the opinion from those with their feet on the ground in the US would suggest that it may well be a much closer run race than currently predicted and the polls are indeed narrowing.

USA

As noted in the introduction it is hard not to concentrate on the upcoming Trump vs. Clinton battle for the US presidency but prior to this the US has had a relatively strong Q3 2016. The economic data released over Q3 has been steady rather than spectacular (such as the labour figures) but as noted consumer confidence has risen and this has, in part, led to the S&P reaching historic highs during the quarter.

Q3 also witnessed some important merger and acquisition events as Pfizer agreed to purchase bio-pharmaceutical Medivation in a deal worth $14 billion whilst mega cap giant Wal- Mart agreed a deal worth over $3 billion to buy online retailer Jet.com which amounts to one of the largest ever acquisitions of an e-commerce company.

From a macro perspective much of the focus has once again been on Janet Yellen and the FED over when they may introduce a further interest rate hike. Analysts are now predicting that December could be the month that rates are raised again but naturally the result of the presidential election will have to be factored into the FED's decision. Yellen and her team are all too aware of the global impact that US monetary policy can have and so are always treading a fine line in terms of their decisions.

Little has changed in our investment committee's general view of the US. We continue to see opportunities for our clients in the vast US markets but we also fully appreciate the fact that current market valuations are on the high side and alongside this the fact that the earnings season that concluded at the end of August was hardly inspiring.

The McLaren Capital investment committee therefore recommends that our clients continue to have broad US exposure via sector / geographic specific funds as well as global equity mandates that have greater flexibility in terms of where they can invest. Through the combined use of such strategies investors can maintain holdings in both domestically focused US stocks alongside US stocks that are huge global powerhouses.

UK

Events in the UK have naturally been dominated by the referendum and the subsequent political fallout. The country has of course now got a new prime minister, a new cabinet (some appointments raised eyebrows more than others) and has now started down the long road to leaving the EU, be it that nothing official has actually been invoked / signed. It is amazing to think that out of the 6 political party leaders who stood in the last general election only two now remain in place and they are the SNP and Plaid Cymru leaders.

The Bank of England Governor was one of the first to assure the global markets on the morning after the referendum result that the BOE had a number of options available to deal with BREXIT and as such during the quarter the BOE lowered interest rates to 0.25% alongside a £60 billion gilt and £10 billion corporate bond purchase programme.

Analysts as ever have disagreed over the timing of this monetary intervention and in part this has been due to some of the economic data released during Q3. Everyone remains fully aware of the size of the UK trade deficit but interestingly recent figures have shown that the gap has shrunk since the vote with a sizeable increase in exports and a reduction in imports, fuelled primarily by the decrease in value of the pound. Alongside this PMI figures in August were unexpectedly strong and this has increased debate over the timing of the BOE's intervention but we believe that the important question marks still remain over the true impact that BREXIT is likely to have.

Whilst focus is likely to temporarily switch to political events in the US there is no doubt that Theresa May and her team have highly complex negotiations ahead of them in securing the UK as strong an exit deal as possible from the EU and this will naturally affect the ongoing general economic picture in the UK.

Our investment committee's general view of the UK remains similar to previous updates. The UK is home to a vast number of high quality companies, some of whom are huge global players whilst others are more focused on domestic markets. As we remarked upon in our previous BREXIT update, it has been the smaller, more UK orientated companies that initially took more of a hit after the vote but it has been encouraging to see them rally in Q3 and such companies do tend to perform exceptionally well over the long term and as such investors with suitable investment timeframes are urged to be patient.

The McLaren investment committee continues to have faith in the UK markets but acknowledges that a tricky road lies ahead in terms of European negotiations. As such we retain our view that whilst diversity is key within our portfolios' UK holdings there should currently be a slight bias towards larger, more global facing UK companies within our clients' portfolios.

Europe

Unsurprisingly the result of the UK referendum also lowered investor sentiment across Europe. Amongst a host of issues one of the primary fears for those in Brussels is that other nations may now look to leave the Union and the likes of Holland, Italy and Hungary have all expressed a desire to hold their own referendums. That said, Europe, as with the global markets in general, recovered well after the initial slump in Q3, although currencies again played their part as the fluctuating value of the Euro (vs. the dollar) boosted the fortunes of exporters in particular.

As with the UK and Japan, investors have been keeping careful tabs on Mario Draghi and the ECB to see whether further stimulus will be injected into the EU. At the most recent meeting many investors were surprised to hear that the trillion Euros bond purchasing programme will not be extended past its current deadline of March 2017 and the markets did initially appear to share the disappointment.

Draghi stated that the programme has been effective and whilst the zone's released economic data over Q3 was hardly spectacular there were some encouraging signs. The August PMIs reached a 7 month high and France's individual PMI reached its highest level since October 2015. Alongside this a number of companies beat analyst predictions with their corporate earnings and so there is data to support Draghi's views that the current stimulus programme is working.

Our investment committee notes these 'successes' but is also well aware that the current programme has not boosted inflation in the manner in which it was planned and also acknowledges the challenges that BREXIT and potentially other nation exits will create for the EU.

That said there are still plenty of quality companies within the region and therefore with the help of our experienced European Equity managers the McLaren Capital investment committee continue to see potential for the region going forward although we anticipate that volatility will remain in the sector for the foreseeable future.

Japan

Japan remains a very difficult economy to analyse; the country has now been subjected to a significant period of 'Abenomics' but results have not yet realised what the key players have wanted. The Japanese markets (like most others) have generally had a strong quarter but as with many global indices part of this success can be attributed to the large currency swings that Q3 has witnessed. Closer scrutiny of the returns points to resurgence in the performance of Japanese exporters although the flip side was weaker domestic returns.

Q2 GDP grew at an annualised 0.20% but crucially inflation remains well short of the Bank of Japan's 2% target and just as global investors are keeping a very careful eye on the US FED they have also been waiting to see what the Bank of Japan has up its sleeve at its end of Q3 meeting, as most analysts have suggested that the Japanese economy requires further stimulus.

At the meeting the BOJ have indeed decided to make changes to their stimulus programme. They have decided to maintain interest rates at their current level but are now aiming to keep yields on 10 year government bonds at around 0% and will continue to buy bonds at a rate of 80 trillion yen a year. The idea behind the 10 year government target is that it may help protect the long term interest rate from creeping below 0% even if it does in the short term and in theory this should

help investors and businesses earn a better return. Naturally the effectiveness of this latest attempt to kick start the economy will only be known further down the line.

It is easy to dismiss 'Abenomics' as a failed experiment but as we have previously commented on corporate governance (amongst other things) has improved and hence we are starting to see a 'new Japan' emerge away from the archaic manner in which businesses used to be run in the country. The 'new Japan' is very much an ongoing project but our investment committee believes that this does give the Japanese markets some hope and hence we feel that investors with a suitable risk appetite should retain their exposure via their multi region global funds but as ever must be aware that it is likely to be a volatile and should only be seen as a long term investment.

Asia and Emerging Markets

China continues to dominate these sectors but worries over a hard landing in China appear to have subsided slightly as both sectors on the whole have had an encouraging quarter and many of the sectors' constituents have in fact beaten their developed market counterparts.

China's GDP figures came in at an annualised rate of 6.7% (the highest for 3 quarters) whilst the August PMIs were ahead of analyst expectations, although against this private investment growth eased further which has caused some concern.

Looking at other countries within the sectors, Brazil staged a largely successful Olympics and took a very important political step in removing Djilma Rousseff from office. The latter point is very important as if Brazil is to continue with its economic recovery then the politicians must make further steps in ridding the system of the huge levels of corruption that it has become famous for.

Other highlights for the quarter included highly impressive performance from the Thailand markets (where a referendum boosted public confidence in the Thai political system) whilst important legislation (the Goods and Services Tax) was passed in India. The sectors as a whole have had a strong run but valuations vs. developed markets continue to look relatively attractive and so value appears to remain.

The concerns for both sectors continue (as ever) to revolve around the data coming out of China as well as US monetary policy, the commodity recovery and a stable oil price. At the time of writing most of these factors appear to be in these sectors' favour but as recent economic conditions have proven things can change very quickly and hence investors should expect further volatility within these vast geographic regions.

It will also be interesting to see which nations drive the general economic recovery across these sectors as whilst China has released stronger than expected data across Q3 2016 analysts are suggesting that a resurgent Russia alongside Brazil and India could be the driving forces as we head into 2017.

Our investment committee continues to believe that both of these huge sectors remain worthy of our clients' attention as crucially the long term story remains compelling in both sectors and it should not be underestimated how significantly these regions contribute to global GDP. However, as has already been alluded to, the regions require certain economic / political conditions to prosper and given that the situation can change quickly so there is likely to be significant ongoing

volatility in both Asia and Emerging Markets. As with Japan we therefore believe that any investment in both sectors needs to be viewed as a long time call rather than a short term opportunity.

Fixed Income

Fixed income in general has once again had a solid quarter although as ever there are significant differences between the various sub sectors that exist in the marketplace.

The lowering of interest rates in the UK and the decision to hold rates in the US has however once again reinforced the general view that bond yields in general are unlikely to increase anytime soon which in turn does highlight the lack of yield that is currently on offer.

That said, we have been in this macro environment for some time now and it would appear that debt as an asset class does continue to play an important role in the formation of diversified investment portfolios. Our investment committee does remain concerned over the potential fragility of fixed income but as we have said numerous time before there is such a huge market for these instruments now that it does change the playing field in which they are traded.

The investment committee does not necessarily share the same enthusiasm for current opportunities that a lot of bond managers do but we retain faith in the managers who we utilise in our portfolios (be they pure fixed income or multi asset managers) and believe that debt is therefore still worthy of our clients' attention.

Property

As we reported on in our BREXIT update UK Commercial property has been one of the sectors that has been hit hardest by the referendum result as investors became concerned over the illiquidity of the asset class and future investment / business prospects within the UK.

We noted at the time that the subsequent run on certain open ended property vehicles was largely guided by panic and events over the remainder of Q3 support this view. As our previous update explained a number of property managers felt they had to implement either trading suspensions or' fair value adjustments' (FVAs) in an attempt to stop a fire sale across the UK commercial property market.

During this period the investment committee has had extensive ongoing communication with property analysts and property managers who were typically in agreement over the true cause of the property market wobbles. The team at M&G (whose services we do not currently utilise) gave an excellent update on the sector a few weeks after BREXIT and informed us that they had countless offers on a number of their properties which pours cold water over the idea that foreign investors were no longer interested in the UK market.

We can now report that a number (although not all) of the managers who imposed either suspensions or FVAs have now either lifted these sanctions or reduced them and therefore most property funds have seen their values rise in the latter stages of Q3.

We mentioned the strength of recent UK economic data in an earlier section of this report and we believe that this helps the attraction of businesses investing in the UK. The UK commercial property market had (pre-BREXIT) gone on a very strong run and as we previously noted this could not go on indefinitely. However

given ongoing issues in the fixed income markets we still see value in property as an asset diversifier and whilst investors should not expect pre-referendum returns the asset class does still have the potential to generate gains through the combination of capital growth and income yield.

Absolute Return

As we have commented on before the Absolute / Targeted Return sector contains all manner of different investment strategies which take varying degrees of risk and given these huge variations it is therefore unsurprising that some strategies suit certain market conditions better than others and 2016 as a whole has proven to be a difficult year in which to manage these types of investments.

The different funds' management teams typically attempt to make various domestic or global plays within their strategies but various economic and political events during the calendar year have made this task significantly harder and this has affected the performance of funds like Standard Life GARS and Kames UK Equity Absolute Return. Our investment committee meets with the teams of these funds on a regular basis to understand why they have performed in the manner that they have and post our most recent meetings we continue to have faith in the managers' abilities.

The McLaren Capital investment committee therefore still believes that some of these lower risk strategies continue to offer strong diversification benefits within our clients' portfolios and hence we are happy to retain our current exposure to the absolute / targeted return funds in the McLaren Capital portfolios.

Commodities

As has now become the norm the global commodity markets continue to have an over reliance on the Chinese economy and this has naturally had a direct impact on raw material prices. With China releasing better than expected data Q3 2016 has been something of a welcome relief for commodity exporters and this has been reflected in market prices.

Mining companies in particular have had to make big corporate adjustments in recent years in their attempt to manage their way through the global commodity slump and it is interesting to note that Australia's terms of trade (export prices relative to import prices) have improved for the first time since the end of 2013.

If we look at some of the raw materials that tend to get mentioned less in our regular market updates coking coal has (at time of writing) risen by around 30% this calendar year whilst iron ore has risen by around 35% in the same time period although this may be short lived given new supply channels that will shortly be operational. However against this copper, which is often seen as a good indicator of industrial health, is not doing so well and so there is no guarantee that the rally on the other materials will continue.

Gold has had a steady quarter, in part due to post UK referendum concerns whilst oil has once again been volatile although is slightly up as we near the end of the quarter.

As before the investment committee believes that the commodity sector is still currently too risky to expose our clients to directly (via a pure commodity / natural resources fund). That said there is nothing stopping our multi asset and multi region managers from investing in either precious metals and / or natural raw materials

and as an example of this we can see that Troy Trojan (which is in all of our 6 core portfolios) currently has around 12% of the fund invested in a combination of gold and oil stocks / ETFs.

Conclusion

Given the shock result of the UK referendum market performance across Q3 2016 has been generally impressive. As the report has mentioned large currency swings have played their part in the subsequent rally but given the enormity of the result the global markets have proven to be resilient and this has been backed up by various central banks' intervention.

We have witnessed a period during which developing markets have continued to perform well versus their developed peers and in direct correlation commodities (in general) have also made steady progress. As mentioned, various important factors have recently been in the developing world's favour though and so ongoing performance may well be reliant on the continuation of the economic / political status quo.

The upcoming US election has the potential to create further periods of market volatility and hence this, alongside ongoing monetary policy decisions from the major economic powerhouses, is likely to shape the direction that global markets take over the remainder of 2016.

In line with these observations McLaren Capital will, as ever, continue to monitor global economic developments carefully to ensure that our clients' portfolios remain invested in suitable fund selections and asset allocations that match both their investment objectives and their attitudes to investment risk.

IMPORTANT NOTES

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