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VIEWPOINT

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Newsflash

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Table of Contents

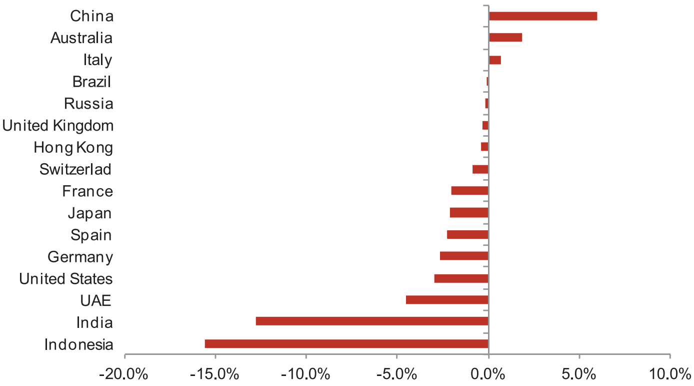
1. Market commentary 1 – 3
2. Market performance 4 – 5
3. Asset allocation dashboard 6
4. Important notes 7

Market commentary

After the strong performance in July, markets returned to a risk-off stance in August, leading to a sell-off in several asset classes, including equity, fixed income and property. Although investors' attention remained focused on the Federal Reserve's (Fed) tapering of Quantitative Easing (QE) and the timing of the initial move, progressively this shifted to the rapidly developing problems in emerging markets and, towards the end of the month, to the deteriorating situation in Syria, which posed the very serious risk of escalating into a much more damaging regional conflict drawing in the west.

The MSCI World index returned -2.1% in the month, taking its year-to-date performance to 11.7% in US dollar terms. Returns in individual countries were mixed, with the US underperforming Europe and the UK, both of which held up well during the month, buoyed by increasing signs of economic recovery. Once again, however, the big moves took place in the emerging markets, with the MSCI Global Emerging Markets index falling by 1.7%, leaving the index down 10.2% year-to-date, over 20% behind developed markets. Countries most susceptible to capital outflows, following the projected cuts to the Fed's asset purchases, were impacted the most, which helped contribute to the huge differences in returns seen within emerging markets over the month. Countries with weak current account positions, large fiscal deficits and relatively high dependencies on foreign borrowings suffered the sharpest falls in equity, bond and currency markets, with specific Asian markets, namely Indonesia (-15.6% in US dollar terms) and India (-12.8% in US dollar terms) underperforming.

Figure 1: Key equity market performance in US dollar terms for August

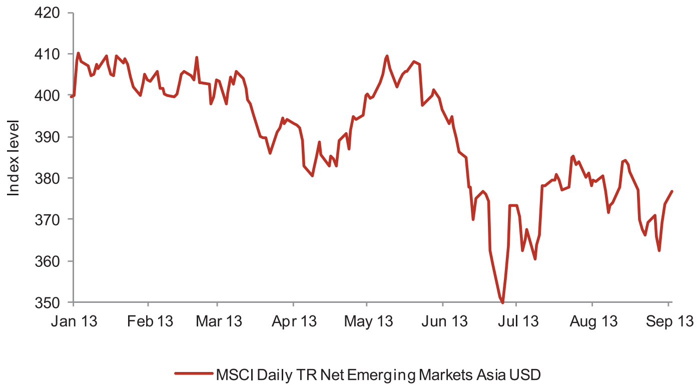


While there were mixed figures from the US on the state of the economy jobless claims fell more than expected, new home sales and durable goods orders disappointed and manufacturing was slightly softer than analysts' expectations the broad consensus remains for the Fed to begin cutting back on its monetary easing after its next meeting on 17 and 18 September. This led to a strengthening of the US dollar against most of its global counterparts and contributed to a further escalation in bond yields in the US and elsewhere.

Strong GDP figures for the second quarter supported the story of a gradually recovering developed world after the Eurozone returned to growth (+0.3%) after six consecutive quarters of shrinkage and the UK revised up its reading (+0.7%), in the three months to June. The biggest constituent economies of the Eurozone also fared well, with second quarter growth figures for Germany and France growing by 0.7% and 0.5% on the quarter respectively, whilst Italy and Spain, remained in mild recession but showing more encouraging signs. Eurozone Purchasing Manager Indices (PMIs) remained strong in August, with the flash composite index adding 1.2 points to 51.7, taking it to a 26 month high. There was also evidence of stabilisation in China, with PMIs moving back above the 50 point level for the first time in four months, and signs of a soft priming of the economy by the administration. This helped the Chinese equity market rally by 5.3% in the month, in contrast to the rest of Asia, and brought year-to-date returns to - 4.9% (both in local currency terms).

In other Asian emerging markets, attention focused on current account deficits, structural imbalances, weakening growth and foreign capital dependency. This led to the sharpest sell off in some Asian markets since 2008/09 and before that the Asian crisis of the late 1990s. Whilst comparisons began to be drawn with that Asian crisis, the region is in much better financial condition today, with lower debt, less dependency on foreign capital (especially short term flows) and stronger banking systems. This therefore looks like a squall, albeit a serious one, triggered by the prospect of reduced global dollar liquidity, rather than a severe dislocation.

Figure 2: Recent sell- off in Asian emerging markets: YTD and comparisons to 2008/09



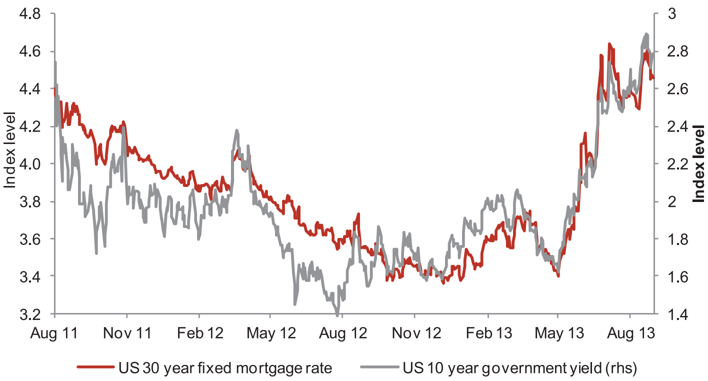
The immediate Syrian crisis, triggered by the regime's alleged use of chemical weapons, could yet lead to a punitive strike by the US, possibly backed by Arab league states. This prospect, with a serious risk of further escalation, pushed oil futures (+8.0%) and gold spot (+5.3%) prices higher and contributed to the strong performance of the international commodity index, which rose by 3.4% in US dollar terms. The consequences are clearly

Source: Bloomberg. Returns in US dollars unless otherwise stated. August 2013.

negative for global growth but the intention of the US and allies is punishment for use of chemical weapons, not to get involved in the civil war nor to instigate regime change. The reaction of Syria's allies, especially Russia and Iran will be critical, but there are hopes that the impact will be limited and markets will settle down after the 'shock' of further military engagement in the Middle East has been absorbed.

The issue which is likely to have by far the biggest impact on markets in the coming months remains the decision to be made at the Fed about when and by how much to reduce quantitative easing (QE). This in turn has led to the anxiety we are now seeing in emerging currency and equity markets. While the market continues to expect tapering to begin in September it is worth bearing in mind that the moves in markets since tapering talk by the Fed started in May has led to a very sharp rise in bond yields, which itself is an effective tightening of monetary policy, which can be seen, for example, in the spike in US mortgage rates to two year highs.

Figure 2: Fixed rate on US mortgages spike following yields on treasury bonds



It is worth bearing in mind that the Fed will initially taper, not stop, asset purchases, so policy will remain very loose for another year at least and that interest rates will not be raised for a further period, possibly as long as two years from now. Policy thus remains highly accommodating and monetary policy in the other major developed markets, such as Japan, Europe and UK, will remain ultra loose for a very long time yet.

Against this background, and with developed world economies gradually picking up, the environment for equities remains supportive. While the prospect of Fed tapering will keep investors nervous in the months ahead, and the risks surrounding emerging markets and the Middle East geopolitical situation have clearly deteriorated significantly in recent weeks, it is important to remember that the reason for tapering will be an improving economy, which is good for the corporate sector and growth assets generally. Recent market setbacks especially in Asia have brought valuation levels down to attractive territory and markets are expected to recover once the current squall has blown over.

Source: Bloomberg. Returns in US dollars unless otherwise stated. August 2013.

Market performance

Asset Class/Region	Index	Currency	Month	Year to date
		To 30 August 2013		
Equities				
UK - All Cap		GBP	-2.2%	13.3%
UK - Large Cap		GBP	-2.4%	11.9%
UK - Mid Cap		GBP	-1.4%	20.5%
UK - Small Cap		GBP	1.2%	21.8%
United States	S&P 500 NR	USD	-3.0%	15.7%
Continental Europe	MSCI Europe ex UK NR	EUR	-1.0%	9.3%
Japan	Topix TR	JPY	-2.2%	30.1%*
Asia Pacific (ex Japan)	MSCI Pacific ex Japan TR	USD	0.0%	-1.5%
Global developed markets	MSCI World NR	GBP	-4.0%	17.2%
Global emerging markets	MSCI EM (Emerging Markets) NR	GBP	-3.6%	-5.6%
Bonds				
Gilts - All	BofA Merrill Lynch Gilts TR	GBP	-1.1%	-3.6%
Gilts - Under 5 years	BofA Merrill Lynch Gilts TR under 5 years	GBP	-0.5%	-0.4%
Gilts - 5 to 15 years	BofA Merrill Lynch Gilts TR 5 to 15 years	GBP	-1.7%	-4.0%
Gilts - Over 15 years	BofA Merrill Lynch Gilts TR over 15 years	GBP	-1.1%	-5.7%
Index Linked Gilts - All	BofA Merrill Lynch Inflation-Linked Gilts TR	GBP	-0.4%	0.4%
Index Linked Gilts - 5 to 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR 5 to 15 years	GBP	-1.6%	-2.0%
Index Linked Gilts - Over 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR over 15 years	GBP	0.2%	1.5%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	-0.7%	-0.1%
US Treasuries	JP Morgan United States Government Bond Index TR	USD	-0.5%	-3.2%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	-0.7%	-3.3%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	-0.6%	2.7%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	-0.5%	0.3%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	-0.2%	0.7%
Euro High Yield	BofA Merrill Lynch Euro High YieldConstrained TR	EUR	-0.3%	4.7%
Global Government Bonds	JP Morgan Global GBI	GBP	-2.3%	-0.3%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	GBP	-2.4%	1.1%
Global Convertible Bonds	UBS Global Convertible Bond	GBP	-2.8%	13.7%
Emerging Market Bonds	JP Morgan EMBI+	GBP	-4.8%	-7.1%

* estimate

Source: Bloomberg. August 2013.

Market performance

			To 30 August 2013	
Asset Class/Region	**Index**	**Currency**	**Month**	**Year to date**
Property				
UK Direct Property	UK IPD All Property TR	**GBP**	0.0%*	3.8%*
UK Property Securities		**GBP**	-5.8%	11.5%
Global Property Securities		**GBP**	-6.2%	4.1%
Currencies				
Euro		**GBP**	-2.5%	5.0%
US Dollar		**GBP**	-1.9%	4.8%
Japanese Yen		**GBP**	-2.2%	-7.4%
Commodities & Alternatives				
Commodities	RICI TR	**GBP**	1.4%	4.1%
Agricultural Commodities	RICI Agriculture TR	**GBP**	-0.5%	-2.8%
Oil	ICE Crude Oil CR	**GBP**	5.9%	9.9%
Gold	Gold Spot	**GBP**	3.2%	-12.5%
Interest Rates			**Current rate**	**Change at meeting**
United Kingdom	1 August 2013	**USD**	0.25%	-
United States	31 July 2013	**GBP**	0.50%	-
Eurozone	1 August 2013	**EUR**	0.50%	-
Japan	8 August 2013	**JPY**	0.10%	-

* estimate

Source: Bloomberg. August 2013.

Asset allocation dashboard

● Positive (green)	● Neutral (yellow)	● Negative (red)

Asset class	View
Equities	
Developed equities	Neutral
UK equities (relative to developed)	Positive
European developed equities (relative to global developed)	Neutral
US equities (relative to developed)	Negative
Japan equities (relative to developed)	Neutral
Emerging market equities	Positive
Fixed Income	
Government	Negative
Index-linked (relative to government)	Negative
Investment grade (relative to government)	Positive
High yield	Neutral
Loans	Positive
Emerging market debt	Neutral
Convertible bonds	Neutral
Alternatives	
Commodities	Neutral
Hedge funds	Neutral
Property (UK)	Neutral
Currencies	
Dollar	Neutral
Euro	Negative
Yen	Negative

Source: Momentum Global Investment Management June 2013

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