UK CAPITAL MARKET ASSUMPTIONS

April 2018

19 April 2018

Contents

1 INTRODUCTION

This note compares the underlying projected asset returns assumed in the April 2018 and January 2018 releases of the EValue financial planning tool and seeks to give a brief description for the reasons for any changes. The return file used is revised every quarter to ensure that it is fully up to date.

This UK capital market simulation is based on the following principles:

- It is designed to simulate a wide range of sensible and internally consistent set of plausible outcomes of future capital market performance that are consistent with FCA regulations. However, no attempt is made to forecast future values and the projected values should not be taken as implying that EValue expects any particular asset class to outperform any other.
- It reflects the capital market conditions prevailing at the starting date of the simulation. The transition from these initial conditions to assumed long-term levels is a significant factor underlying the simulation results.
- The long-term average, or normative, levels incorporate a blend of historical capital market data and future expectations.
- A variety of standard asset classes, the government yield curve, an investment-grade corporate yield curve, price inflation and wage inflation are included in the simulation. Each simulation is from a British pound perspective.

The simulation has been performed using EValue's stochastic asset model, which is built upon a cascade structure that coherently links the modelled variables to ensure the economic consistency of each individual trial. For further information on the methods or assumptions underlying this simulation, please contact your EValue contact.

2 ANALYSIS OF SIMULATED RETURNS

Each trial is the simulation progress from the economic conditions prevailing at the simulation start date.

2.1 Market conditions

Table 1 compares the key market prices at the start of the simulation.

Table 1: Initial conditions for economic variables (in per cent)

Economic Variable	January 2018	April 2018
15-year par yield	1.58	1.63
5-year par yield	0.77	1.06
6-month par yield	0.23	0.55
RPI	3.88	3.61
CPI	3.16	2.74
Equity dividend yield	4.02	4.08

2.2 Asset returns

Table 2 on the next page presents the average annual year risk over a 10-year time period for January 2018 with those for updated for April 2018. The average annual year risk is defined as the average over the 10-year time period of the standard deviations, which are calculated through all the scenarios for each individual year. Consequently, these results contain no compound effects like those displayed in Table 4 on page 8. This measure is similar to simple volatility measures.

Comparisons on the previous basis are available in the appendix.

All figures presented here are before tax and charges.

Table 2: Comparison of 10-year average annual risk (in per cent)

Asset Category	January 2018	April 2018
UK Equity	16.5	16.6
US Equity	19.7	19.8
Europe Equity	21.7	21.7
Japan Equity	23.4	23.4
Pacific Ex-Japan Equity	25.3	25.4
Emerging Markets Equity	28.0	28.1
Property	14.5	14.6
Government Bonds	10.1	10.4
Index Linked Bonds	9.1	9.1
Global Government Bonds	9.4	9.5
Corporate Bonds	12.2	12.4
EU High Yield	14.6	14.7
Money Markets	2.6	2.7
Cash Deposit	2.3	2.4
RPI	3.5	3.6
CPI	3.6	3.7

2.3 Commentary

Markets and Economy

In January, it looked like the Great Rotation might finally have begun. For more than a decade investors and market gurus have been on the lookout for the moment when the bull market in bonds would come to an end and equities would take off. Central banks were raising rates, inflation was overshooting in the UK and poking above the surface elsewhere, economic growth looked strong around the world and equity markets were booming.

At the end of the quarter, things look quite different. The FTSE has given up its gains of the last two years (or four in euro terms), the rate of inflation is falling again in the UK, and while rates still look like going up in the short term they don't look like climbing as far as they did at the beginning of the year.

It's not clear that an equity boom had far to go in any case but there is a lot that is not clear at the moment. At home the impact of Brexit is still very uncertain. Internationally, there is significant threat of war of both trade and shooting type, and in the background there is mixed news about economic growth.

Top-down global concerns have been mirrored by share prices. Interest rates seem in harmony with this very minor key picture. Expectations for short term rates keep edging up while long term rates held steady or even fell. We are not yet in inverted yield territory, a famous bad omen, but this pattern might suggest that an economic slowdown is closer than previously thought.

Bottom-up projections, however, are not yet so concerned. In particular, the FTSE suffered more than other markets but that is not yet reflected in the fundamental outlook.

Effect on projections

This wasn't a great quarter for investors but higher interest rates and cheaper shares make for some kind of silver lining.

Prospects look brighter across almost all asset classes and the effect is quite significant in the short term. Even so, the scale of changes is rather underwhelming given the dramatic news coming out the market and elsewhere, and what excitement there is peters out over the long term.

The only asset class to miss out is property where valuations may be lagging the news from interest rates and other markets.

Other than that, there is little sign of any asset class making a break from the rest in either direction.

3 APPENDIX: DESCRIPTION OF ASSET CLASSES

EValue's asset models are intended to represent the possible joint behaviour of broad asset class types as typically found in retail collective investments.

The models do not simply replay the average of recent history but instead reflect a broader range of economic conditions, for example current interest rate levels.

The table below provides a list of the main asset classes and what they are intended to represent.

Table 3: Description of asset classes

Name	What it represents
UK Equity	A diversified portfolio of UK equities.
US Equity	A diversified portfolio of US equities.
Europe Equity	A diversified portfolio of Eurozone equities.
Japan Equity	A diversified portfolio of Japanese equities.
Pacific Ex-Japan Equity	A diversified portfolio of equities from established markets on the Pacific Rim excluding Japan.
Emerging Markets Equity	A diversified portfolio of equities from global emerging markets.
Property	A diversified portfolio of UK commercial property.
Government Bonds	A portfolio of conventional UK government bonds with a broad range of maturities.
Index Linked Bonds	A portfolio of index linked UK Government bonds with a broad range of maturities.
Global Government Bonds	A portfolio of developed economies' sovereign bonds.
Corporate Bonds	A managed portfolio of UK corporate bonds with an average credit rating of "A".
EU High Yield	A managed portfolio of euro-denominated non-investment grade corporate bonds.
Money Markets	A portfolio of cash and equivalents with characteristics and average terms typical of money market funds.
Cash Deposit	A rolling cash deposit earning interest at the yield of short-term UK government debt (subject of a floor of zero).
RPI	Retail price inflation in the UK as measured by the Retail Prices Index (RPI).
CPI	Consumer price inflation in the UK as measured by the Consumer Prices Index (CPI).

4 APPENDIX: ANNUALISED RETURNS STATISTICS

Table 4 compares the 10-year annualised compound returns for January 2018 with those for updated for April 2018. Annualised compound return is the constant annual rate at which the original investment would have had to grow to achieve a given final value at the end of the investment period. The average and standard deviation of annualised compound return across the set of simulations summarise the expected return and uncertainty or risk characteristics of each asset.

Table 4: Comparison of 10-year annualised compound returns (in per cent)

	January 2018			April 2018		
Asset Category	Mean	Median	SD	Mean	Median	SD
UK Equity	4.7	4.6	5.5	5.0	5.0	5.6
US Equity	5.0	4.7	6.2	5.2	4.9	6.2
Europe Equity	4.4	4.2	7.0	4.8	4.5	7.0
Japan Equity	5.6	5.4	7.3	5.8	5.7	7.3
Pacific Ex-Japan Equity	4.2	4.1	7.7	4.4	4.3	7.7
Emerging Markets Equity	4.5	4.1	8.2	5.0	4.5	8.3
Property	1.7	1.6	5.1	1.6	1.4	5.1
Government Bonds	1.2	1.5	1.8	1.4	1.6	1.8
Index Linked Bonds	1.2	1.1	3.4	1.4	1.3	3.4
Global Government Bonds	2.2	2.2	2.9	2.4	2.3	3.0
Corporate Bonds	2.4	2.4	2.8	2.6	2.6	2.8
EU High Yield	2.7	2.6	5.2	2.9	2.8	5.2
Money Markets	1.2	0.7	1.9	1.4	1.0	1.9
Cash Deposit	1.6	1.1	1.6	1.8	1.3	1.7
RPI	5.0	4.7	2.5	5.2	4.9	2.6
CPI	3.9	3.6	2.6	4.1	3.8	2.6