THOMAS
MILLER
INVESTMENT

IQ1

Global market intelligence, critical analysis and investor briefing

Investment Quarterly **APRIL 2014**

A NOTE FROM THE CHIEF EXECUTIVE

Thomas Miller Investment is a business with bold ambitions; we aim to grow assets under management significantly by being recognised as a firm that provides excellent long term investment performance and outstanding levels of service to our clients.

- We have an enviable performance track record in place, with some strong out-performance across our client base when compared to their tailor-made benchmarks.
- We believe a key part of service is clear communication. So, we have redesigned a number of our documents, to ensure our clients get the information they need in a clear and efficient manner.

These excellent developments are paying off. At the start of the year we were shortlisted for Professional Adviser's Discretionary Fund Manager of the year Award, and towards the end of Q1 we won a significant new offshore investment mandate.

We are genuinely excited about the future, and I look forward to updating you on more successes from TMI.

Mike Balfour, CEO

INVESTMENT STRATEGY OVERVIEW

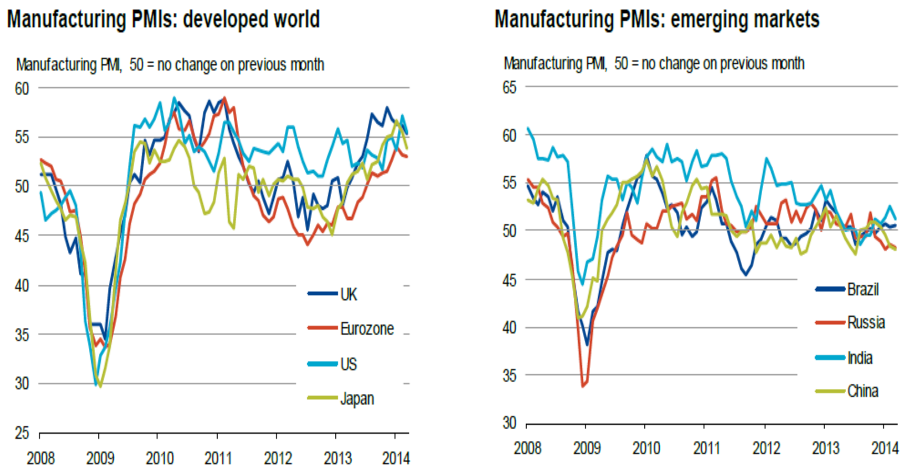
Despite mixed data, leading indicators continue to flag ongoing growth.

In contrast to widespread expectations for a rise in the momentum of global economic growth, the pace of growth since the turn of the year has been notably weaker than expected.

From a global standpoint, the bulk of the softness in the data has been driven by weakness in the emerging markets (EM). The underperformance of the EM has been down to a combination of structural imbalances and the impact of substantial fund outflows which were triggered by monetary policy adjustments in the US.

Confirming the weakness in the emerging markets, in March, HSBC's composite Emerging Markets Index declined for the fourth consecutive month. The index fell from 51.1 in February to 50.3 in March—barely above 50, the dividing line between expansion and contraction. The divergence in the pace of economic activity between the developed markets (DM) and the EM is highlighted in the chart below which shows Purchasing Managers Indices (PMIs; a forward-looking gauge of business conditions) across various countries.

Chart 1 – A two-track world: PMIs show ongoing divergence in economic fortunes between Developed and Emerging markets.



Source: Markit, April 2014

To keep things in perspective, it should be noted that while the EM are experiencing declines in the pace of growth, their rates of growth remain positive and, perhaps more importantly, their longer term prospects remain strong.

In contrast to the EM, the outlook for the major DM continues to improve—albeit slowly. In the US, severe winter weather has meant that recent data have not provided a reliable reflection of underlying economic realities. However, while the data has been mixed, key leading indicators continue to flag ongoing growth.

In the UK, recent data showed that the services sector expanded for the 14th consecutive month in February. That run has helped to increase employment levels while boosting business and consumer confidence. Importantly, the strength of the UK economic recovery is not currently feeding into higher inflation or inflation expectations. This should ensure that the Bank of England maintains the current level of monetary stimulus for a while longer.

Financial markets and investment strategy

In contrast to their respective bond markets, US and UK equity markets have struggled since the start of the year. For the year so far, the best returns across both asset classes have come from the periphery of the Eurozone. As investors increasingly buy into the Eurozone recovery story, they have demanded a lower premium for holding assets within the periphery economies. Moreover, these assets continue to benefit from the growing expectation among investors that the European Central Bank may eventually have to embark on further monetary stimulus in an attempt to avert deflation.

In contrast to their respective bond markets, US and UK equity markets have struggled since the start of the year.

Over the next quarter, uncertainties surrounding the outlook for the EM should ensure that government bond markets in the major DM continue to enjoy safe-haven demand. Moreover, concerns about the US economy will linger until the weather effect is no longer evident in the data. Finally, any escalation of the geo-political crisis in the Crimea region will undermine financial markets. Taken together, all these should mean that financial markets continue to be very volatile. In particular, equities remain vulnerable to short term setbacks.

From an asset allocation perspective, fundamentals still favour equities over bonds. But simply asserting that equities offer better value than bonds is not, in itself, particularly helpful because neither asset class is ‘cheap’ in absolute terms. Following the gains seen over the past year, the valuation argument for equities (particularly in DM) is somewhat diminished. While the longer-term outlook for government bonds remains unattractive given current valuations, our expectations that the pace of economic growth will remain modest in the year ahead while inflation will remain benign, suggest that a protracted sell off is unlikely in the near term. Importantly, unlike in 2013, returns from risk assets in 2014 are likely to be notably lower and volatility notably higher.

Overall, we believe that the long term outlook for equities remains attractive. We also continue to favour selected alternative investments. In the fixed income markets, we still prefer corporate bonds to government bonds and we have now cut back on exposure to high-yield bonds. For now, we retain a neutral positioning on the major currency pairs and await better entry points for positions in favour of the US Dollar.

Abi Oladimeji
Head of Investment Strategy

ASSET ALLOCATION

TMI ASSET ALLOCATION SCORECARD

	United States	Euro-Zone ex Germany	Germany	United Kingdom	Japan	Emerging Markets
Equities (overall)			0/+			
Equity allocation by region	0	0	+	+	+	0
Bonds (overall)			0/+			
Corporate bonds	+	+	+	+	+	+
High Yield bonds	0	0	0	0	0	0
Govt guaranteed bonds	+	0	0	+	0	0
Index-linked bonds	0	0	0	0	0	0
Alternatives			0			

The scorecard above represents our current tactical asset allocation position relative to portfolio benchmark. 0 =neutral, + =overweight, - =underweight.

A dull start to the year...

It was a somewhat dull start to 2014, with major world stock markets making little headway after the strong gains seen in 2013.

In equity markets, the best performing region was Europe where recovery showed continued momentum, with the Eurostoxx 50 index up 1.7% over the quarter. This disguised significant disparities, however, and the German DAX and Dutch AEX were flat. In contrast, 'peripheral' markets had a strong start to the year, reversing some of their recent underperformance, to be the best performing world markets.

Italy rose 14%, while Greece was up 15%, Portugal 15%, and Ireland 10%. US investors continue to invest in the region. The Spanish market was more muted, up 4.3%, while 'semi-core' countries, such as France and Belgium, were up 2.2% and 7% respectively.

In contrast, the UK had a rather poor start to the year, with the FTSE 100 index falling 2.2%. Mid-caps did better, and a rise of 2.1% in the Mid-250 index meant that the decline in the FTSE All Share index was limited to 1.5%. The worst sector was mobile telecoms led by Vodafone, which fell 10.3%, with banks close behind at -8.8%. Strong performances came from the real estate and electricity sectors, both up 5%, water (+3%), pharmaceuticals (+2.5%), and industrial engineers (+2.4%). Miners rose 1.4%, while life insurers fell 1.9% after the Budget abolished the requirement to purchase retirement annuities.

There was a theme of underperformance from last year's outperformers: thus, Japan has been one of the world's worst performing markets so far this year. The Nikkei 225 index dropped 9%, while the market cap weighted Topix fell 7.8%. The US has also been dull, and the S&P 500 is up only 1.1% year to date. Large caps underperformed, mirroring the UK, and the S&P 100 was up only 0.4%, while the Dow Jones Industrial index actually fell. The Utilities index was the best performing sector, reflecting the strength of long bonds, up 8%.

Q1 2014 Highlights:

- **Recovery in Europe showed continued momentum.**
- **The FTSE 100 index fell 2.2% over the quarter.**
- **Japan has been one of the world's worst performing markets in 2014.**
- **Bonds outperformed equities in the first quarter.**
- **Evidence mounts that the US Federal Reserve is committed to reducing its extraordinary monetary stimulus.**

In defiance of most predictions at the end of last year, bonds outperformed equities in the first quarter, perhaps symptomatic of excessively positive sentiment towards stocks and negative sentiment towards bonds. The margin of difference was not huge, with UK Gilts up 2.1% and US Treasuries up 1.78%, but it does underline how excesses in sentiment can sometimes be a useful predictor of future returns.

The worst affected stock markets have been Emerging Markets, which experienced a significant sell-off in mid-January. The catalyst was further hikes in interest rates in several Emerging economies, provoked by sustained current account imbalances and falls in the value of currency.

Brazil raised its benchmark Selic rate with hikes in January, February and April to 11%, 3.5% above the rate a year ago. Turkey was forced nearly to double rates overnight in January to stop the lira collapsing, with the lending rate increasing from 7.75% to 12%.

India's central bank raised the core repo rate to 8% in January while in the same month South Africa's central bank increased rates for the first time in over five years to 5.5%. The above are all members of the 'fragile five' and face significant inflation problems, with India's Consumer Price Index at 10%, Turkey's at 7.4%, and Brazil's at over 6%. One would have thought the hiking cycle in Brazil at least is near its peak.

Elsewhere, evidence mounts that the US Federal Reserve is committed to reducing its extraordinary monetary stimulus, with further cuts of $10bn in January and March to its asset purchase scheme. The monthly rate of purchases is now $55bn. This has had little impact on the domestic bond market, though it has had a secondary impact on emerging market bond markets as noted above.

Until mid-March the best performing asset class was gold, in a partial reversal of its 20% fall in 2013. Rising geo-political concerns in the Ukraine, together with extremely bearish investor sentiment and a highly oversold position, saw the yellow metal rally $150 to $1350, although towards the end of March it lost some of these gains.

MSCI Emerging Market Equity Index

Source: Bloomberg

James Penn
Senior Portfolio Manager

UK Budget Update

In recent years, the UK Budget has been losing its occasional sense of excitement and occasion. Bi-annual Budgets and the deliberate leaking or pre-announcement of major measures has largely taken the steam out of the day.

This year, however, the Chancellor caused a stir, particularly with two announcements with significant impact for UK investors and savers.

First was the removal of the distinction between Cash ISAs and Stocks and Shares ISAs, and the 30% increase in the allowance to £15,000 effective from July (until then the limit is increased to £11,880, with a maximum of £5,490 in a Cash ISA). The post-July product will be known as the New ISA or NISA, and represents a considerable boost for UK investors.

Second was the announcement on pension funding, trailing the removal of most restrictions on how to access pension savings on retirement. The removal of any requirement to purchase an annuity dominated the headlines, and shares in the annuity providers were hit hard. In contrast, asset management share prices rose. More detail from the Treasury is needed to complete the picture. However the extra freedom in how we deal with our pension funds brings complexity. It does not necessarily signal the death of the annuity (which remains a useful way to transfer risk away from an individual) but it makes the seeking of sound, trusted advice from a reliable source even more important. For example, the ability to access all the pension capital from April 2015 brings risk as well as opportunity. Thomas Miller Investment knows a number of advisory firms who can help our clients in this regard.

Andrew Herberts
Deputy Head of Private Investment Management (UK)

POLITICS

UK Politics

The UK political scene is rather lively at the moment, and there is a risk that events could impact on market performance and on how the UK is seen by international investors.

First, there is the September 18 Referendum on Scottish independence, with the media being full of assertion and counter-assertion about the impact on Sterling (would Scotland be allowed to keep the pound?) and on economic stability. Here, our Scottish-based clients should note that their securities and cash balances are held to our order by London-based and English-registered custodians. In addition, our investment management businesses are registered in London and the Isle of Man.

Next, there is the rise in support for the UK Independence Party and for its policy of withdrawal from the European Union. How would markets react to the UK adopting a more "detached" policy towards Europe? Finally, there is the increasing imminence of the May 2015 General Election, with the Labour party moving somewhat to the Left and perhaps being less business-friendly than the Coalition Government.

The Pound has been surprisingly strong, and the UK has been seen as a haven for international investors. This is best shown by the remarkable rise in London property prices. We are not saying that this is all set to end. However, we do think that as well as focusing on the macro-economic and stock-specific factors, investors need to keep a close eye on political developments and be ready to take action if necessary. The next year is set to be very interesting from a political perspective.

Harry Morgan
Head of Private Investment Management (UK)

Private Funds

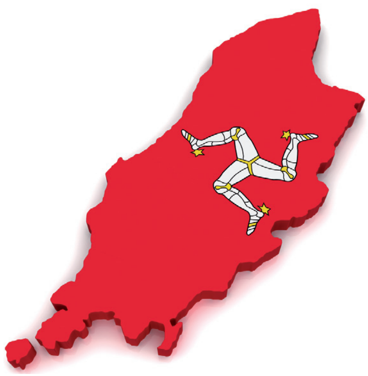
The Isle of Man Exempt Scheme has received keen interest from local and international investors. It is a flexible, cost-effective structure that is particularly beneficial for use by High Net Worth Individuals and Family Offices. There were over 170 of these schemes in operation during 2013, with a total net asset value of around $5.45bn*.

There are three categories of collective investment schemes in the Isle of Man - regulated (Authorised Funds, Regulated Funds and Recognised Funds), registered (Specialist Funds and Qualifying Funds) and unregulated (Exempt Schemes).

Exempt Schemes are private arrangements, which cannot be marketed to the general public and are restricted to having no more than forty nine investors. There are no specific requirements as to the permitted investors, permitted underlying investments, composition of financial statements or functionaries, making the structure very flexible in its application and day to day operation where tax advice and total expense ratio support their existence.

The most appropriate corporate vehicle for any new exempt scheme is selected after specific tax advice, asset management and investor requirements are taken into consideration. The vehicle can range from a traditional 1931 Act company, a 2006 Act company, through to a protected cell company (PCC) or a Limited partnership or unit trust arrangement. The benefit of holding assets through a recognised Isle of Man domiciled legal structure is often advantageous, not least for those seeking leverage or borrowing from financial institutions. Furthermore, assets can be segregated within an Exempt Scheme, through the use of separate sub-funds, thus providing a simple and cost effective structure for housing family assets or different investment strategies.

Whilst there is no requirement to appoint appropriately licensed functionaries to the exempt scheme, the use of an Isle of Man corporate vehicle will require an Isle of Man fiduciary service provider to deliver formation and ongoing compliance services. In addition, a fund administrator will add significant value to the process of ongoing valuation of assets, the provision of accounting services, administration of other functionary agreements and in providing the comfort and transparency of additional party oversight. There are no specific obligations in respect of the composition of the board of directors of an Exempt Scheme.



The benefit of holding assets through a recognised Isle of Man domiciled legal structure is often advantageous, not least for those seeking leverage or borrowing from financial institutions.

Pre-approval does not need to be sought from the Financial Supervision Commission or any other body to launch an exempt scheme, nor are there any prescribed parameters as to the preparation or content of any offering document, investor certifications or minimum subscription levels. Related to this, there are no initial or ongoing fees in the Isle of Man for the establishment or the operation of an Exempt Scheme, aside from the normal incorporation fee and annual corporate charge that are payable in relation to the use of an Isle of Man corporate vehicle. These factors contribute to making the Exempt Scheme a lower cost solution that is quick to establish and administer thereafter for its appropriate user base. Added to this is the benefit of the Island's zero rate company tax regime.

There are no restrictions on the asset classes that can be used and held within the Exempt Scheme or around strategies of borrowing or leverage, making for a highly flexible arrangement. The Exempt Scheme is suitable for a wide range of investment strategies, from long only traditional asset classes to hedging and speculative strategies, private equity or property. An Exempt Scheme can also hold non-financial assets, examples of which might include yachts, aircraft, art and antiques and intellectual property. The Scheme may contain one holding or many and it can obtain investment advice from any source. It is also flexible in that additional sub-funds can be added to accommodate different investment objectives or strategies or to segregate particular assets as was mentioned above.

An Exempt Scheme is not required to appoint a custodian and the fund is free to implement whatever arrangements are appropriate for holding its assets, whether through the use of a third party, direct ownership or special purpose vehicles. Many investors appreciate the confidentiality provided by an Exempt Scheme arrangement.

There are no mandatory requirements relating to the audit of the financial statements of an Exempt Scheme. However, the scheme can still take advantage of the availability of local accountancy and audit practices should an audit be regarded as appropriate or necessary requirement of its investor base.

As an Exempt Scheme grows, there may be good reasons why it would become appropriate to make arrangements for public offerings or to exceed the investor limit. In these cases, there is a process that would allow the Exempt Scheme to convert into a regulated or recognised category of Scheme.

Because investments in an Exempt Scheme may not be offered to the public and may only be accepted on a private basis, they tend to represent a 'friends and family' arrangement. The nature of this private arrangement provides many benefits to high net worth individuals and private family offices who are seeking alternative structures for their assets in a recognised and highly regarded jurisdiction such as the Isle of Man.

Carolyn Gelling
Head of Collective Investment Funds

*Source: www.gov.im/fsc as at 30th September 2013.

Historic Market Rates

As at 31st March 2014

	Close	1 month % change	6 months % change	1 year % change	3 years % change
FX					
GBP/USD	1.6681	-0.38	3.08	9.82	3.83
EUR/GBP	0.8257	0.16	-1.25	-2.18	-6.53
EUR/USD	1.3772	-0.22	1.77	7.42	-2.95
USD/JPY	103.070	1.25	4.95	9.57	24.44
USD/CNY	6.2171	1.17	1.57	0.05	-5.06
BOND YIELDS					
US 10 yr	2.718	0.070	0.108	0.869	-0.752
UK 10 yr	2.736	0.017	0.015	0.968	-0.953
Germany 10 yr	1.566	-0.058	-0.213	0.277	-1.788
Japan 10 yr	0.642	0.056	-0.044	0.129	-0.618
Swiss 10 yr	0.952	-0.049	-0.069	0.236	-1.005

Source: Bloomberg

	Close	1 month % change	6 months % change	1 year % change	3 years % change
EQUITIES					
S&P 500	1,872	0.84	12.50	21.85	50.70
Dow Jones	16,458	0.93	10.05	15.66	44.47
NASDAQ	4,199	-2.45	12.06	30.24	57.18
FTSE 100	6,598	-2.57	3.94	6.99	26.04
FTSE all-share	3,556	-2.56	4.95	9.13	30.17
DAX	9,556	-1.40	11.19	22.59	35.71
NIKKEI	14,828	0.56	3.43	22.08	60.87
Hang Seng	22,151	-2.64	-2.45	2.97	4.56
COMMODITIES					
Gold	1284.01	-3.20	-3.38	-19.59	-10.35
Crude oil – WTI	101.58	-0.98	-0.73	4.47	-4.82
S&P GS soft cmd	703.12	7.47	8.15	-1.08	-18.14
S&P GS ind metals	1293.72	-2.37	-5.68	-11.22	-35.93

THE WRITERS

Abi Oladimeji
Head of Investment Strategy

James Penn
Senior Portfolio Manager

Harry Morgan
Head of Private Investment Management (UK)

Andrew Herberts
Deputy Head of Private Investment Management (UK)

Carolyn Gelling
Head of Collective Investment Funds

CONTACT US

For more information on Thomas Miller Investment, our Funds and services please contact in the first instance:
Laura Bellwood, Marketing Manager, on +44 (0) 1624 645200

Thomas Miller Investment Ltd
90 Fenchurch Street,
London, EC3M 4ST
Tel +44 (0) 20 7204 2200
Fax +44 (0) 20 7204 2737

Thomas Miller Investment Ltd
46 Charlotte Square,
Edinburgh, EH2 4HQ
Tel +44 (0) 13 1220 9310
Fax +44 (0) 13 1220 9310

Thomas Miller Investment (Isle of Man) Ltd
Level 2 Samuel Harris House,
5-11 St Georges Street, Douglas,
Isle of Man, IM1 1AJ
Tel +44 (0) 1624 645200
Fax +44 (0) 1624 645220

tminvestment.com