Investment Strategy Overview

September saw the publication of the OECD's latest Interim Economic Assessment. Confirming the trend that has been evident for some months, the OECD noted the divergence in the rate of economic growth between the major advanced economies and their emerging counterparts. In recent months, the pace of economic growth has picked up in the US, UK and Japan, while the Euro-zone has exited recession. In contrast, growth has lost momentum in China, Russia, India and Brazil.

In the US, there have been some welcome improvements in the labour and housing markets. Retails sales have held up well and the auto sector continues to enjoy strong activity. However, financial conditions have tightened somewhat, with the sharp rise in mortgage rates being of particular concern. Also, while the decline in the headline unemployment rate is encouraging, broader measures of labour market conditions such as the labour force participation rate (defined as the percentage of the working age population that is either employed or officially unemployed) paint a picture of a less robust recovery.

Reports on the UK economy have remained broadly positive. A notable recent development was the news of a much stronger than expected turnaround in the construction industry. The Markit/CIPS construction purchasing managers index (PMI) recently rose to its highest level since September 2007. That and other positive developments have prompted further upgrades to forecasts for UK economic growth. For instance, the OECD raised its 2013 forecast from 0.8% to 1.5%.

In last Quarter's report, we contended that there was insufficient case for the US Federal Reserve Bank (Fed) to start reducing monetary stimulus at this point on the basis that the pace of economic growth remained insufficiently strong while inflationary pressures remained muted. Importantly, the OECD's Interim Economic Assessment also highlighted the fragility of the ongoing recovery in the developed economies. It stated that "while the improvement in growth momentum in OECD economies is welcome, a sustainable recovery is not yet firmly established and important risks remain. It is necessary to continue to support demand, including through unconventional monetary policies, in order to minimise the risk of the recovery being derailed." Arguably, an assessment of those risks played a key role in the decision by the Fed to leave its quantitative easing programme unchanged despite widespread expectations of a cut back in the pace of asset purchases (tapering).

Since the Fed's decision, political risks have become more prominent on investors' minds as intransigence in Washington has resulted in a partial shutdown of government offices. Obviously, from an economic standpoint, the impact of the government shutdown will depend on how long the stand-off lasts. Nevertheless, an economy that continues to operate with a substantial output gap and still growing at a below-trend pace four years into an economic expansion hardly needs another negative growth shock.

In the bigger scheme of things, the real concern is how Congress handles the requirement for an increase in the US debt ceiling later in October. Political miscalculation then could have severe consequences for both the global economy and financial markets. The calamitous nature of the potential consequences of a US government default should hopefully mean that moderate Republicans rein in their more radical Tea Party colleagues.

Needless to say, the decisions that will be made in Washington over the next few weeks will play a crucial role in determining the outlook for the US economy and global financial markets in the months ahead.

Summary of implications for investment strategy

Clearly, these developments have some important implications for investment strategy. In particular, we would expect the Fed's decision to delay tapering to underpin equity market performance while also providing support for government bonds in the short term.

However, the ongoing stand-off in Washington could undermine investor sentiment over the next few weeks. Consequently, we would expect equity volatility to remain elevated in the early part of the fourth quarter. Financial market experience during the last episode of a stand-off between Congress and the White House on the issue of raising the US debt ceiling may provide some guidance. That episode resulted in a brief period of sharp losses in equities and risk assets in general. Also, government bonds yields declined and the US Dollar rallied strongly as investors sought safe havens. That experience suggests that investors should err on the side of caution until these issues are resolved.

Abi Oladimeji
Head of Investment Strategy

TMI Asset Allocation Scorecard

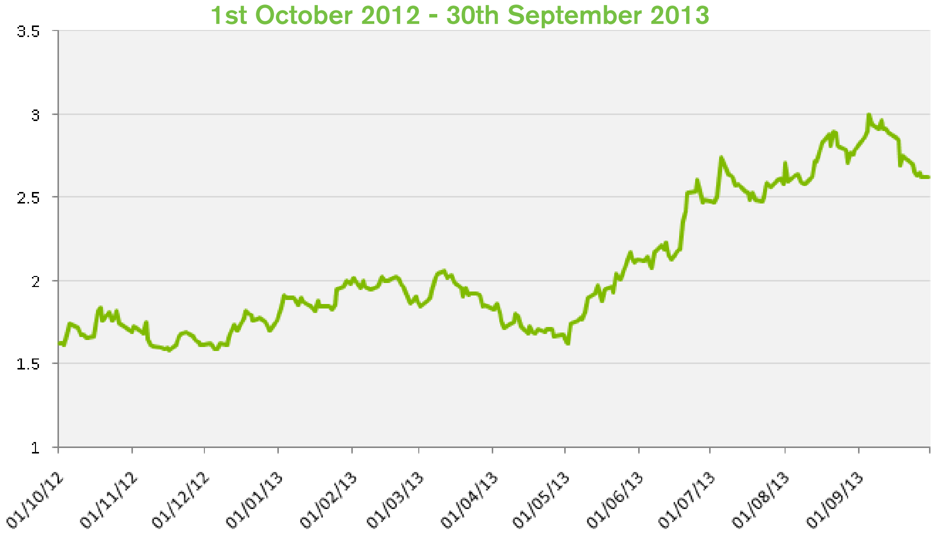
	United States	Euro-Zone ex Germany	Germany	United Kingdom	Japan	Emerging Markets
Equities (overall)			+			
Equity allocation by region	0 / +	+	0	0	0	0 / +
Bonds (overall)			0 / -			
Corporate bonds	0	0	0	0	0	0
High Yield bonds	0	0	0	0	0	
Govt guaranteed bonds	0	0	0	0	0	
Index-linked bonds	0	0	0	0	0	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

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

Market Overview

It was a decent, but not spectacular, quarter for markets, with equities rebounding following their mid-year sell-off and bonds recovering after sharp falls in August.

10yr US Treasury Yield
1st October 2012 - 30th September 2013



Source: Bloomberg

The best performing major market over the period was Europe, with a rise of 11% led by the 'peripheral' countries: Spain rose 17.6% and Italy 13.6%, closely followed by France with a 10.6% rise. The FT All Share managed 4.5%, led by small and mid-cap stocks (with the FTSE 250 up 7.4% and FTSE Smallcap up 10.5%, very similar to the mid and small cap returns in the US); large caps underperformed with a rise of 3.8%.

The US market lagged Europe, in a repeat of the second half of 2012. The S&P500 rose 5.3%, led by industrials (up 11%) and technology stocks (the Nasdaq up 11%). 'Bond proxy', or high yielding, stocks underperformed and the Dow Jones Utilities index fell 0.76%. Some confidence returned to emerging markets, with China up 10% and Brazil up 13%, though Mexico and India were flat.

Most of the gains occurred in July when markets recovered strongly following their setbacks in late May and June, with the major UK and US equity indices up over 6% in July, and investors confident that the world economy had more than enough momentum to withstand 'tapering', or the reduction the Federal Reserve's bond purchasing programme.

Further evidence of recovery emerged in August, with a series of indicators including consumer confidence, PMI surveys, GDP revisions and house price indicators all coming in significantly above expectations. The PMI Composite in the UK has risen to over 60, its highest level in 15 years, while the Eurozone PMI is above 50, indicating expansion. Rising interest rate expectations knocked stocks, and the UK and other major markets fell 3%.

Initially stocks performed well in September, recovering all their August losses. However, towards the end of September profit taking set in again as fears increased of a government 'shutdown' in the US and a breach of the country's debt ceiling. There are concerns of a repeat of August 2011, when inability to reach political agreement led to a short if sharp drop in equities and a downgrading of the United States' credit rating from AAA.

Bond market returns turned out better than expected, with the FT All Stocks government bond index returning 0.5%. This index was down -1.5% by mid September, as the sell off in US government bonds was mirrored in the UK – despite the best efforts of the Bank of England to use 'forward guidance' to manipulate bond yields through its linking of rates to certain macro variables like unemployment. The 10 year yield touched 3% in both the US and UK, and there was a danger of a full blown bear market developing in bonds.

But the tone in fixed interest markets changed radically when the Federal Open Market Committee decided not to taper on September 18th. The introduction of tapering had been regarded as a cast-iron certainty, and the only question was whether the reduction would be $10-$15bn per month or more. In the event, the current programme of $85bn of purchases per month was left intact, and the Fed reduced its expectations for the US economic growth by 0.3% in both 2013 and 2014. This was probably the biggest surprise given by the Fed in recent years, and led to an immediate 15 basis point rally in the US 10 year yield. There has been some follow through in fixed income markets since then, with the US government currently undergoing a 'shutdown' of non-essential services, and a potential debt default in the latter part of October, though we see this as highly unlikely.

James Penn
Senior Portfolio Manager

Historic Market Rates*

As at 30th September 2013

	Close	3 month % Change	6 month % Change	1 year % Change	3 years % Change
FX					
GBP/USD	1.6183	6.38%	-6.54%	0.10%	2.89%
EUR/GBP	0.8361	-2.23%	-0.94%	5.11%	-3.44%
EUR/USD	1.3532	4.01%	5.55%	5.23%	-0.65%
USD/JPY	98.2100	-0.94%	4.40%	25.97%	17.67%
USD/CNY	6.1209	-0.27%	-1.50%	-2.61%	-8.54%

	Close	3 month Change	6 month Change	1 year Change	3 years Change
BOND YIELDS					
US 10 YR	2.610	0.124	0.761	0.977	0.100
UK 10 YR	2.721	0.278	0.953	0.994	-0.229
GERMANY 10 YR	1.779	0.051	0.490	0.337	-0.499
JAPAN 10 YR	0.686	-0.167	0.173	-0.092	-0.254
SWISS 10 YR	1.021	-0.006	0.305	0.480	-0.383

	Close	3 month % Change	6 month % Change	1 year % Change	3 years % Change
EQUITIES					
S&P 500	1,682	4.69%	7.16%	16.72%	47.35%
DOW JONES	15,130	1.48%	3.78%	12.60%	40.24%
NASDAQ	3,771	10.82%	15.42%	21.03%	59.23%
FTSE 100	6,462	3.97%	0.79%	12.54%	16.47%
FTSE ALL-SHARE	3,444	4.69%	1.87%	14.84%	20.10%
DAX	8,594	7.98%	10.25%	19.10%	37.97%
NIKKEI	14,456	5.69%	17.18%	62.97%	54.29%
HANG SENG	22,860	9.89%	2.51%	9.69%	2.24%
COMMODITIES					
GOLD	1,328.94	7.64%	-16.78%	-25.01%	1.57%
CRUDE OIL - WTI	102.33	5.98%	5.25%	11.00%	27.96%
S&P GS SOFT CMD	650.14	-3.39%	-8.54%	-21.00%	-1.64%
S&P GS IND METALS	1,371.68	4.43%	-5.87%	-15.49%	-22.54%

*Total Return from Capital and Income

Source: Bloomberg

Demography and Investing

While as an equity investor I am focused and make decisions based on a long term investment horizon (five to ten years), it can be informative to look at trends even further out. These can form a backdrop against which to take investment decisions.

One of those long term factors is that of demographic change. At its most basic, this is the simple fact that unless global fertility falls significantly, the world's population is set to grow markedly over the next decades.

According to the UN, the distribution of populations will also change such that by 2050, Africa will home 24% of the world's people (up from 14% in 2010).

In addition, the population will age dramatically – particularly in the developed world. These charts show how population age is forecast to change through to 2050. A growing and aging population brings profound economic and political challenges, too complex to air fully here.

As an investor though, several conclusions arise. I have picked out three from a long list.

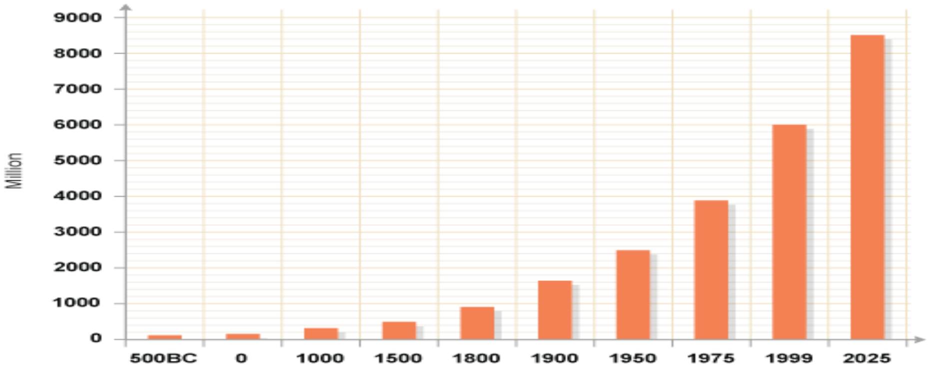
First, the shift in population from the developed to the less developed world will drive a GDP shift too. Long term, emerging markets will continue to increase their share of the world's GDP. Investment markets should benefit.

Second, aging rich populations will require different goods and services than a younger population. Demand patterns for the saving and investment, pharmaceutical, residential care and healthcare industries (to name but a few) will alter.

Third, demand for raw materials will drive commodity pricing up as supply lags, due either to exhaustion of reserves or to the increasing difficulties of extraction. While peak commodity theories have proved to be premature so far, they are likely to be tested again over the next few decades. As well as the direct effect on commodity prices, this should stimulate the development of new technologies that will either transform efficiency (e.g. the advances being made in agriculture through selective breeding and GM technology) or make the use of certain commodities obsolete.

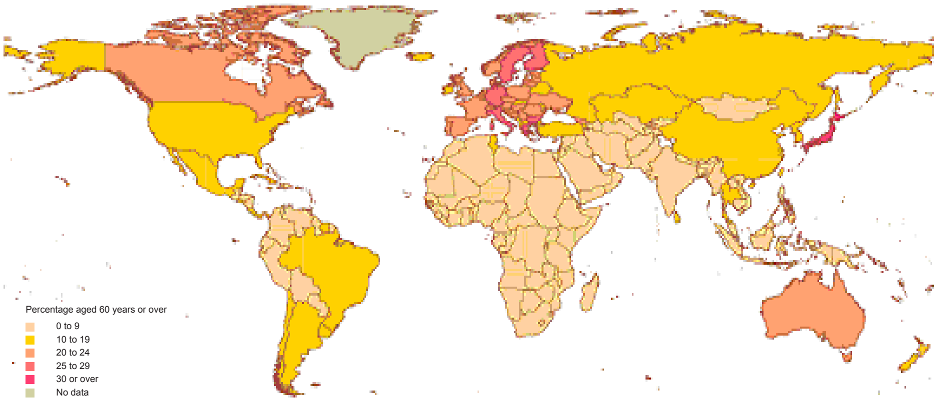
This powerful demographic force provides a background to our work and is one input into our investment decision making. While the economic cycle will still be the dominant force driving markets, awareness of these longer term trends can help us as investors from getting carried away in either greed or fear. Hence, understanding the long term means that despite their current unpopularity with some investors, commodity and consumer goods stocks retain their long term attractions.

World Population
(in Millions)

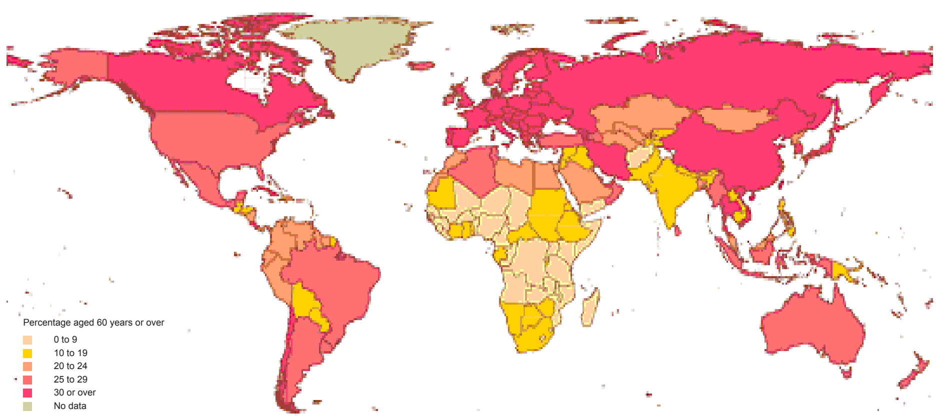


Population Age Forecast: 2012 to 2050

2012



2050



Andrew Herberts
Deputy Head of Private Investment Management (UK)

Source: United Nations Department of Economic and Social Affairs – Population Division

Thomas Miller Investment - Looking to the Future

Our longest standing client relationship is 125 years old this year. We are very proud of that achievement. That relationship is one where the client outsourced the investment management to a trusted expert in Thomas Miller, enabling the client to dedicate their time to their particular area of excellence.

To become that trusted adviser to this client and many more over the years, we have had to work diligently to understand our clients' objectives and the difficulties they face, whilst navigating through the myriad of changes and events we have faced in our industry.

Fortitude through extreme market conditions has kept our portfolios true to their objectives. Reacting to revolutions in technology and evolutions of the regulatory backdrop has allowed us to service our clients well.

One of the most recent regulatory changes has been the Retail Distribution Review (RDR). This change has had a material effect on the financial advice and investment industries. Over £2.2trn is controlled by investment managers, banks and financial advisers, with financial advisers directly influencing over £600bn of those assets.

RDR has been a catalyst; influencing more advisers than ever before to look for firms they can outsource their clients' investment management requirements to, so that they can focus on their area of expertise.

We are well placed to benefit from this shift. Why? We have a history of doing two things very well; client service and investment management,

- Great service is hard to define; good service means different things to different clients. So, we listen to clients, and react to their needs. The service is tailored to each client.

- To us investment performance isn't just about beating industry benchmarks. There are far more important things at stake, not least our clients' objectives – their current and future needs and liabilities. So, we work with clients to understand their requirements, objectives and aspirations, and we tailor portfolios to target those goals. We aim to grow their assets in real terms, helping clients get where they need to be.

Many clients of Thomas Miller Investment will only know us in their particular sector; so it is worth highlighting that Thomas Miller Investment manages money for institutions, pension funds, charities and private clients, both onshore and offshore.

From the stable foundations of time and experience, and with the support of the Thomas Miller Group we are now looking to grow Thomas Miller Investment. We are expanding the teams across our offices, hiring highly regarded experts to enhance our proposition whilst keeping us true to our two tenets of great service and tailored investment management.

Our newest clients look just like our longstanding clients; they are investors who want to work with a trusted expert, one who is focused on their unique objectives, capable of navigating their portfolios through the times that lie ahead and responsive to their needs. We are working hard to find those clients and forge new relationships with them.

Matt Lonsdale
Head of Intermediary Business Development

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