First State Investments

FIRST STATE DIVERSIFIED GROWTH FUND

Multi Asset
Q1 2020 Review

The First State Diversified Growth Fund ('the Fund' or 'DGF') aims to protect against UK inflation and provide capital growth by achieving a positive return (gross of fees and charges) of 4% in excess of UK Retail Price Index (RPI) over rolling five-year periods.

The Fund returned -1.84%[1] during the March quarter. Financial markets experienced distress as the COVID-19 outbreak prompted widespread selloffs for both risk and defensive assets. Volatility also rose substantially as lockdown measures generated uncertainty for the future of business activity and economic growth.

The Neutral Asset Allocation ('NAA') detracted from performance, particularly through equities. Dynamic Asset Allocation ('DAA') provided a material offset to these falls, primarily via protection strategies. The RPI increased by 2.5% in the year ending 31 March 2020.

The Fund has delivered 3.6% p.a. (net of fees and taxes) since inception in June 2015, 1.25% p.a. above UK RPI, with a monthly volatility of 6.2%. For reference, over the same period the FTSE 100 Index delivered 0.2% p.a. with a volatility of 12.7%.

Performance overview

Annual Performance (% in GBP) to 31 March 2020	12 months to 31/03/2020	12 months to 31/03/2019	12 months to 31/03/2018	12 months to 31/03/2017
First State Diversified Growth B GBP Acc	**0.08**	**-4.50**	**1.45**	**14.36**
UK Retail Price Index	2.26	2.21	3.51	2.73
Bloomberg Barclays Global Aggregate Co	6.42	9.03	-5.08	16.43
FTSE 100 TR	-18.39	7.69	0.22	23.34
FTSE All-Share TR	-18.45	6.36	1.25	21.95
S&P 500 TR GBP	-2.24	17.88	1.61	34.68

Cumulative Performance (% in GBP) to 31 March 2020	3 months	6 months	YTD	1 year	2 years	3 years	Since Inception 23/06/2015
First State Diversified Growth B GBP Acc	**-8.62**	**-6.26**	**-8.62**	**0.08**	**-4.42**	**-3.04**	**10.17**
UK Retail Price Index	0.06	0.06	0.06	2.26	4.52	8.19	11.44
Real Return	-8.68	-6.32	-8.68	-2.18	-8.94	-11.23	-1.27

Source: Lipper IM / First State Investments (UK) Limited.

These figures refer to the past. Past performance is not a reliable indicator of future results. For investors based in countries with currencies other than the share class currency, the return may increase or decrease as a result of currency fluctuations.

Performance figures have been calculated since the launch date. Performance data is calculated on a net basis by deducting fees incurred at fund level (e.g. the management and administration fee) and other costs charged to the fund (e.g. transaction and custody costs), save that it does not take account of initial charges or switching fees (if any). Income reinvested is included on a net of tax basis. Source: Lipper IM / First State Investments (UK) Limited.

RISK FACTORS

This document is a financial promotion for First State Diversified Growth Fund for professional clients only in the EEA and elsewhere where lawful. Investing involves certain risks including:

- **The value of investments and any income from them may go down as well as up and are not guaranteed. Investors may get back significantly less than the original amount invested.**
- **Currency risk:** changes in exchange rates will affect the value of assets which are denominated in other currencies.
- **Emerging market risk:** emerging markets may not provide the same level of investor protection as a developed market; they may involve a higher risk than investing in developed markets.
- **Derivative risk:** the use of derivatives may result in large price fluctuations and gains or losses that are greater than an investment in the underlying asset.
- **Credit risk:** the issuers of bonds or similar investments may not pay income or repay capital when due.
- **Interest rate risk:** interest rates affect the value of investments; if rates go up, the value of investments fall and vice versa.

Reference to specific securities or companies (if any) are included to explain the investment strategy and should not be construed as investment advice, or a recommendation to invest in any of those companies.

For a full description of the terms of investment and the risks please see the Prospectus and Key Investor Information Document.

If you are in any doubt as to the suitability of our funds for your investment needs, please seek investment advice.

[1] Net of fees and tax for the B GBP Accumulation share class

Investment process

The investment process comprises two building blocks. The first, which we call Neutral Asset Allocation (NAA), sets longer-term, beta allocations on a long-only basis. The second part, which we call Dynamic Asset Allocation (DAA), allows us to exploit shorter-term alpha opportunities through proprietary strategies that aim to be uncorrelated to broader markets. Further, DAA strategies aim to help manage risk through protection strategies. We review the DAA on a weekly basis.

For a comprehensive description of the investment process, click **here**

Market review

The first quarter of 2020 threw quite the curveball after a promising start; trade talks between the US and China were finally making ground and uncertainty surrounding the UK's exit of the European Union was finally under control, with Brexit officially taking place at the end of January. Equities were continuing to rise in the longest economic cycle in history but as the Lunar New Year holidays approached, financial markets were thrown off their course as the COVID-19 virus, which initially appeared isolated to China's Hubei province, began its world tour. Lockdown restrictions have been instated in many countries as governments try to curb the spread of the virus. Many central banks have also come to the rescue, lowering interest rates and restarting quantitative easing.

Global equities had performed tremendously as the economic cycle continued – perhaps on borrowed time – until the COVID-19 outbreak proved a surprising enough event to send world equity markets on a downward trajectory. It is almost hard to remember that the S&P 500 delivered returns of 30.5% over the 2019 year but over the last three months reduced by 19.6%. The UK FTSE All-Share contracted by 25.1% and MSCI Europe ex-UK down by 20.9%.

As central banks cut interest rates and restarted quantitative easing, government bonds performed well with US 10-year Treasury note gaining 8.2% for the quarter. The benchmark ten-year yields closed 46 bps and 28 bps lower in the UK and Germany, respectively. While a recession is less of a question and more an expectation for many markets, only time can unveil the length and severity of it.

While investors flocked toward more perceivably defensive assets, riskier fixed income assets like corporate bonds faced large redemptions, which exerted downward pressure on valuations in the thinly traded market. The Bloomberg Barclays Global Aggregate Corporate Index saw credit spreads widen as far as 2.75% by month end and delivered -0.3% in returns.

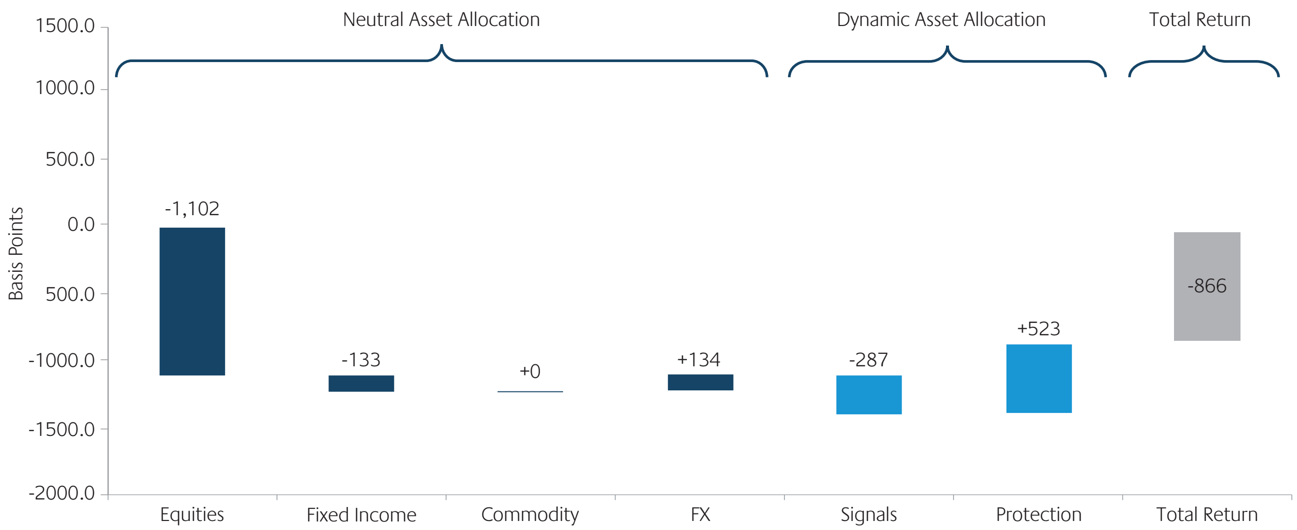
Portfolio performance and attribution

NAA was the main driver of performance during the period, as shown in Figure 1. This was primarily a result of equity exposures, though credit exposures within fixed income, also detracted slightly. DAA positions provided positive returns through the significant protection strategies implemented over the period.

Key drivers of performance over the period:

- NAA positions detracted 11.0%, primarily driven by returns from US and UK equities
  - Equities, excluding the currency impact, detracted 11.0% over the quarter, as global markets retreated
  - Fixed income, which includes government and corporate bonds, detracted 1.3%
  - Currency exposure from the NAA added 1.3%, as sterling moved lower
- DAA positions added a further 2.4%, driven by our qualitative views:
  - Bond positioning detracted 0.2%; the bulk coming from emerging markets. Long positions in South Africa and Poland were the largest contributors.
  - Currency positions detracted 1.2% to performance. Long position in the Brazilian real was the largest contributor
  - Positions informed by our equity signals detracted 1.5%. Long positions in Spain and Canada were the largest contributors
  - Protection strategies added to performance over the quarter

Figure 1: Quarter-end performance contribution to 31 March 2020



Source: First State Investments as of 31 March 2020. Gross performance contribution might differ from official performance, due to data source, pricing, and timing.

Portfolio positioning

Neutral Asset Allocation ('NAA') positioning

We undertook our semi-annual NAA review in November 2019. Figure 2 shows the changes from the last NAA review.

The NAA maintained the 50% allocation to global equity markets. Global equities now account for a 40% allocation in the NAA while UK equities has been reduced to 10%. Within fixed income, we maintained the allocation to corporate credit at 10% and short-maturity UK gilts. As such, the NAA is currently positioned with the aim of protecting capital and, under this configuration, we expect a modest return of just under 3.0%. We see return opportunity in our alpha signals and are therefore allocating about half of the Fund's risk to DAA in order to maximise the potential of meeting the Fund's rolling five-year performance objective of RPI +4% (gross of fees and charges). The next scheduled review will be in April 2020.

Figure 2: DGF Neutral Asset Allocation

DGRF NAA	Apr-19		Nov-19	Change
Liquid securities	5.0%	–	5.0%	0.0%
Short-dated gilts	35.0%	–	35.0%	0.0%
Long-dated gilts	0.0%	–	0.0%	0.0%
Global government bonds	0.0%	–	0.0%	0.0%
High yield	10.0%	–	10.0%	0.0%
EM local currency bonds	0.0%	–	0.0%	0.0%
EM hard currency bonds	0.0%	–	0.0%	0.0%
UK Equities	12.5%	▼	10.0%	-2.5%
World (ex-UK) Equities	37.5%	▲	40.0%	2.5%
Commodities	0.0%	–	0.0%	0.0%
Total	**100.0%**		**100.0%**	

Source: First State Investments

Dynamic Asset Allocation ('DAA') positioning

Over the Mach quarter we were underweight to equities as an asset class by 9%. Within equities, we were underweight Japanese and French equities.

Within the fixed income component of the portfolio, duration reduced from 1.0 to 0.8 years over the quarter. Positions remained consistent, with the largest duration contributions coming from other developed markets via New Zealand, while holding short positions in the Eurozone and emerging markets.

Over the quarter we reduced our exposure to foreign currencies, particularly to emerging market currencies. We continue to find emerging market currencies attractive, especially the Thai Baht and Chilean Peso.

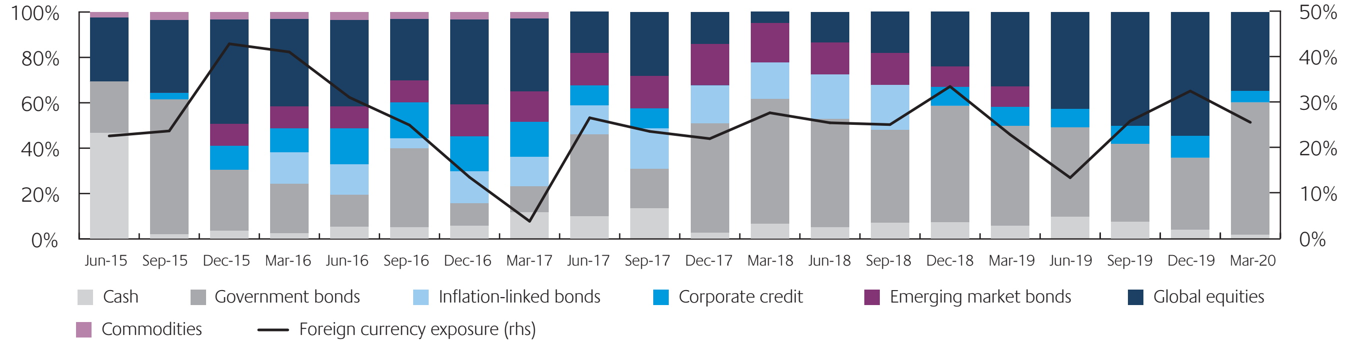
Combined NAA and DAA Fund portfolio positioning

At 31 March 2020 the Fund had an equity exposure of 35%, with broad based exposure globally. The duration (interest rate risk) of the Fund is focused on Japan where we see the most attractive opportunities. The foreign currency exposure of the Fund decreased over the quarter, to 26%.

Given current equity and bond valuations, NAA alone appears unlikely to be able to deliver the required return to meet the Fund's performance objective of RPI + 4%pa over rolling five-year periods. To bridge this shortfall, we use DAA with the aim of boosting performance.

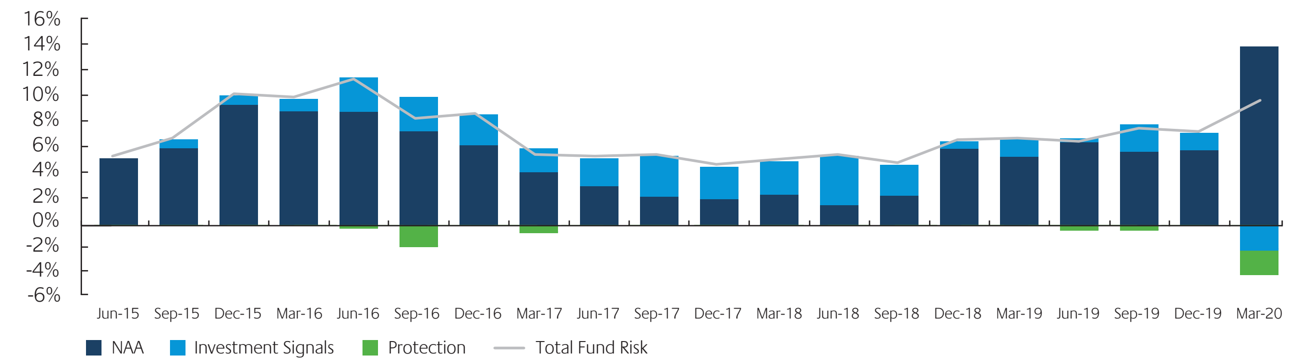
Figure 4 shows a breakdown of the Fund's ex-ante risk contribution since inception.

Figure 3: Overall asset allocation as at 31 March 2020



Source: First State Investments

Figure 4: Portfolio ex-ante risk



Source: First State Investments

Market outlook

Our near-term outlook for investment markets is rapidly changing as conditions across the world lose stability. Correlations between assets may be beginning to normalise after a tremendously volatile start to the year, however, we believe it is far too early to claim victory over the virus and ring the bell that the bottom in equity markets is in place. Fear has caused great paralysis in markets, prompting liquidity to dissipate. Growth forecasts have plummeted as several sectors enter an extreme slowdown in activity and economic indicators move from bad to worse.

The COVID-19 outbreak – now officially classified as a pandemic – is still in the initial phase for many countries and the world is still coming to grips with the real-world global implications. The unprecedented steps taken in terms of monetary and fiscal policies can do a lot to support the economy and ensure the economic and corporate structures remain in place for the next few months. As the approaches from various governments vary, the outcome from these measures could differ and time will tell which methods were superior. That said, this crisis is primarily a health crisis, hence without a real cure the situation can still get worse before it gets better. Until we are on the other side, we are unlikely to see any meaningful rebound in activity levels. Where asset valuations will be by then is unpredictable, but prices will be determined by the anticipated length and severity of the downturn. Global interest rates are expected to remain at record lows for quite some time and corporate profitability will face hardship.

Similar to previous crises faced by financial markets, support levels will eventually be found as investors manage to look ahead of the uncertainty and reset their long-term assumptions. While the crisis may be far from over, the moderation in volatility and improvement in market liquidity towards the end of March could appear an encouraging sign.

The Multi-Asset Solutions team strongly believes that risk management is key in such volatile times, and within our disciplined investment process we are still able to make qualitative overlays to manage our portfolios towards their respective investment objectives in a risk-controlled manner. Nobody can predict what the world will look like after the COVID-19 spread has passed, however, we are currently reviewing our longer-term economic outlook, and updating the data to reflect the latest policy measures taken by the central banks and governments. We will continue to monitor developments very closely with a view of managing the portfolio in a flexible and dynamic fashion with the intention of protecting capital and seeking out emerging opportunities from these market dislocations.

Figure 5 provides a decomposition of ex-ante risk, as well as return contributions from each asset category for the March quarter and the last year. Please note that currency exposure is included in the asset breakdown and hedging is included as an independent category.

Figure 5: DGF return contribution

	Risk Contribution (%)	Contribution to 3m return (%)	Contribution to 1 yr return (%)
UK equities	2.62	-2.61	-1.64
World (ex UK) equities	8.86	-6.30	-2.32
Government bonds and cash	-0.49	-0.20	-0.51
Inflation-linked bonds	0.00	0.00	0.00
Emerging market bonds (HC)	0.00	0.00	0.00
Emerging market bonds (LC)	0.00	0.00	0.02
Corporate bonds	0.52	-0.65	-0.44
Commodities	0.00	0.00	0.00
Currency hedging	3.51	-1.74	-0.45
Protection strategies	-2.10	5.70	5.97
Other	-0.01	0.01	-0.01
Investment Signals			
Equities	-3.41	-1.49	-0.75
Bonds	0.79	-0.22	2.46
Currencies	-0.72	-1.16	-1.24
	9.57	**-8.66**	**1.09**

Source: First State Investments. Gross performance contribution might differ from official performance, due to data source, pricing, and timing.

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