First State Investments

FIRST STATE DIVERSIFIED GROWTH FUND

Multi Asset
Q3 2019 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 3.5%[1] during the September 2019 quarter. During the period financial markets were affected by slowing global growth, policy easing by major central banks and an unstable geopolitical climate – particularly a potential escalation in the ongoing US-China trade conflict.

The Neutral Asset Allocation ('NAA') provided a favourable performance contribution, through exposure to equities and, to a lesser degree, fixed income and currency exposure. Dynamic Asset Allocation ('DAA') provided a larger contribution to total returns, primarily via fixed income and equity exposures. The RPI increased by 2.4% in the year ending 30 September 2019.

The Fund has delivered 3.9% p.a. (net of fees and taxes) since inception in June 2015, 1.3% p.a. above UK RPI, with a monthly volatility of 6.3%. For reference, over the same period the FTSE 100 Index delivered 6.1% p.a with a volatility of 10.5%.

Performance overview

Annual Performance (% in GBP) to 30 September 2019	12 months to 30/09/2019	12 months to 30/09/2018	12 months to 30/09/2017	12 months to 30/09/2016
First State Diversified Growth B GBP Acc	**10.18**	**-6.96**	**7.33**	**12.61**
UK Retail Price Index	2.40	3.00	3.49	1.60

Cummulative Performance (% in GBP) 30 September 2019	3 months	6 months	YTD	1 year	2 years	3 years	Since Inception 23/06/2015
First State Diversified Growth B GBP Acc	**3.54**	**6.77**	**12.78**	**10.18**	**2.51**	**10.03**	**17.57**
UK Retail Price Index	0.59	2.20	1.79	2.40	5.47	9.15	11.37
Real Return	2.95	4.57	10.99	7.78	-2.96	0.87	6.20

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 The First State Multi-Asset Strategy. This information is 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 for each Fund.

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

During the quarter global growth decelerated to the slowest pace since the Eurozone crisis of 2012. In response central banks in the US and Europe tried to buoy economic prospects by delivering further monetary easing.

Equity markets were mixed. Developed markets made modest gains, while emerging markets declined as the US-China trade dispute rumbled on. Government bond yields declined markedly over the quarter due to a combination of heightened risk aversion as US-China trade tensions escalated and evolving interest rate expectations worldwide.

Slowing GDP growth in China has persisted – the world's second largest economy grew 6.0% in the 12 months ending 30 September 2019, the lowest rate of growth in around 30 years. The manufacturing sector has felt the most pain; after averaging 7% annual growth since 2013, growth in industrial production fell to a record low of 4.4% in August 2019. Industrial output has slowed in other regions too. The US ISM Manufacturing Index deteriorated to 47.8 in September; now firmly in contractionary territory. Worse still, Germany, Europe's largest economy, may already be in recession given negative growth in the June quarter and weak expectations for the second half of 2019. Unsurprisingly, business sentiment in the Eurozone has fallen to its lowest level in six years, dragged down by ongoing uncertainty over how Brexit might affect European firms. The seemingly endless Brexit saga continues to cause uncertainty, with Prime Minister Johnson facing pressure to resign and the opposition Labour Party refusing a general election.

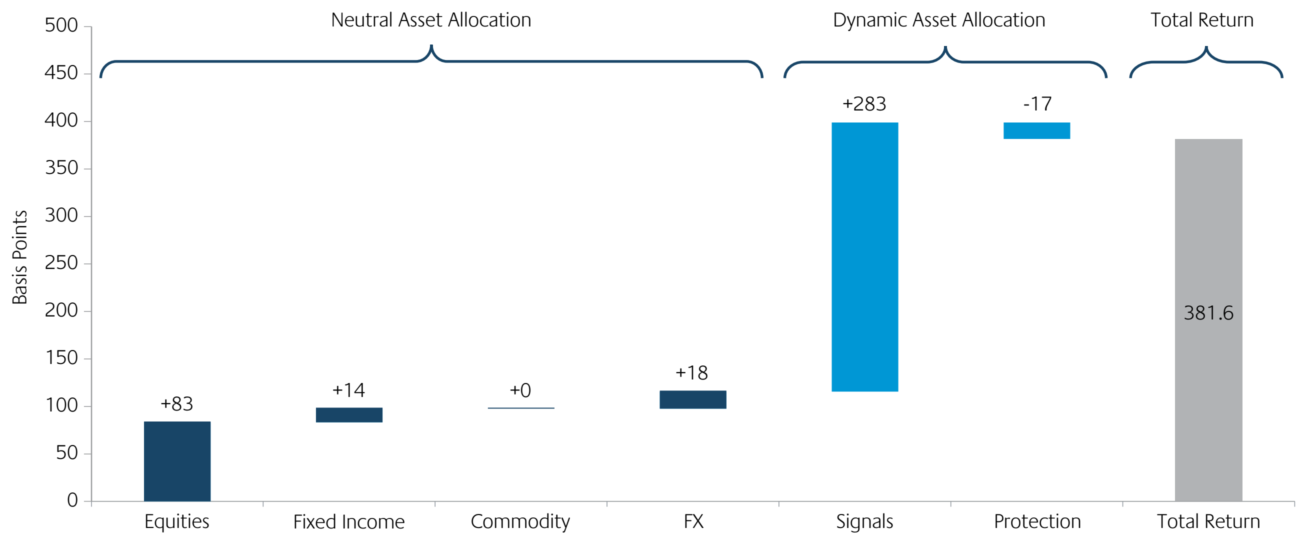
Portfolio performance and attribution

The NAA provided approximately a third of the total return. The allocation to equities provided the largest contribution, although fixed income and currency exposure were also positive, as shown in Figure 1. DAA positions were the main drivers of Fund performance for the quarter as our preferred exposures within fixed income and equities outperformed.

Key drivers of performance over the period:

- NAA positions added 1.2%, primarily driven by returns from US and Japanese equities
  - Equities, excluding the currency impact, added 0.8% over the quarter, as developed markets advanced
  - Fixed income exposure, including cash, contributed 0.1%
  - Currency exposure from the NAA added 0.2%, as sterling moved lower
- DAA positions added a further 2.7%, driven by our investment signals:
  - Bond positioning added 1.7%. Our preferred exposures to Italy, India, Mexico and New Zealand were the largest contributors. Countries in which the Fund held short positions: Germany, France and South Korea detracted, although to a lesser extent than contributions from the long positions, as yields fell globally.
  - Currency positions detracted 0.6%; mainly within developed markets. Our preference for the Norwegian krone vs the Swiss franc detracted as perceived 'safe haven' assets fared well.
  - Positions informed by our equity signals added 1.7%. Exposure to Japan, Italy and Netherlands were positive. The Fund held short positions in Taiwan and France, both of which were small detractors.
  - Protection strategies, in the form of put options on the S&P 500 Index, detracted from performance.

Figure 1: Quarter-end performance contribution to 30 September 2019



Source: First State Investments as of 30 September 2019. Gross performance contribution might differ from official performance, due to data source, pricing, and timing.

Portfolio positioning

Neutral Asset Allocation ('NAA') positioning

We undertook the most recent semi-annual NAA review in May 2019. Figure 2 shows the changes from the last NAA review.

The NAA maintained the 50% allocation to global equity markets. Equity investments are diversified across regions, with a quarter of the overall equity exposure held in domestic shares. Within fixed income, the Fund's allocation to corporate high yield credit was maintained at 10%, while the emerging market local currency bond holdings were removed with the proceeds reallocated into short-dated UK government bonds. As such, the NAA is currently positioned with the aim of protecting capital and, under this configuration, we expect a modest return of just over 3.0% p.a. We see return opportunities in various 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). We will be reviewing the NAA again in November 2019.

Figure 2: DGF Neutral Asset Allocation

DGRF NAA	Nov-18		May-19	Change
Liquid securities	5.0%	–	5.0%	0.0%
Short-dated gilts	27.0%	▲	35.0%	8.0%
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	8.0%	▼	0.0%	-8.0%
EM hard currency bonds	0.0%	–	0.0%	0.0%
UK Equities	12.5%	–	12.5%	0.0%
World (ex-UK) Equities	37.5%	–	37.5%	0.0%
Commodities	0.0%	–	0.0%	0.0%
Total	**100.0%**		**100.0%**	

Source: First State Investments

Dynamic Asset Allocation ('DAA') positioning

At the end of June, we had a preference to reduce the NAA equity weight by 7% and tilt the portfolio to fixed income exposure. During the September quarter, we increased the equity exposure to the NAA weight of 50% as bond yields fell. We added exposure to Canada and South Africa, while reducing exposure to India.

Within the fixed income component of the portfolio, the Fund began the period with a duration exposure of 2.1 years, but this was reduced by 1.0 years over the quarter. As yields fell, the relative attractiveness of fixed income markets diminished somewhat; especially within Japan and emerging markets.

In line with valuations, we continue to find emerging market currencies attractive. We added to the Fund's exposure during the quarter, with various European currencies currently most attractive (Russian ruble, Hungarian forint and Polish zloty).

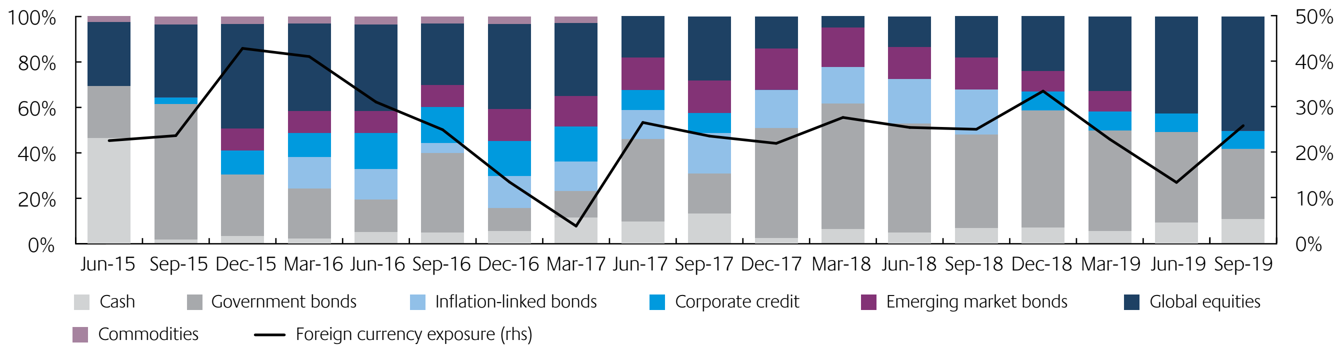
Combined NAA and DAA fund portfolio positioning

At 30 September 2019, the Fund had an equity exposure of 50%, with broad-based exposure globally. The duration (interest rate risk) of the Fund continues to be focused on emerging markets where we see the best opportunities. The foreign currency exposure of the Fund increased 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 to boost performance.

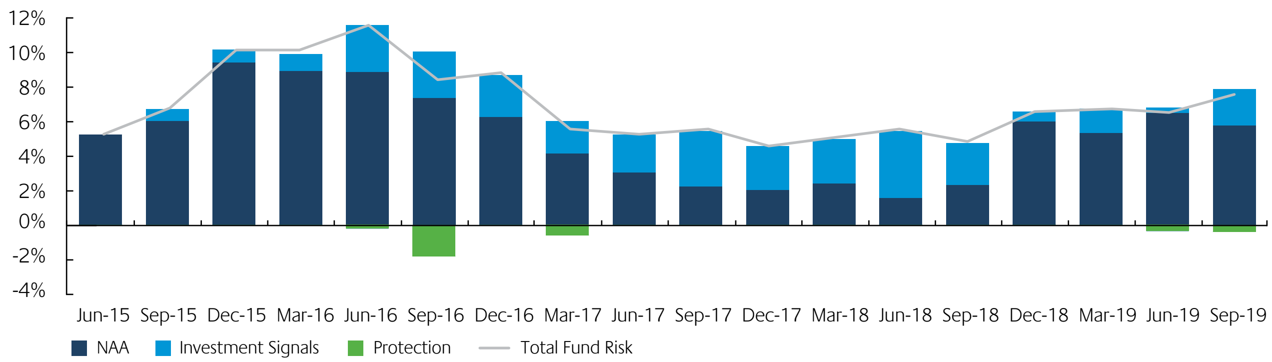
Figure 4 shows a breakdown of the Fund's ex-ante risk contribution since inception.

Figure 3: Overall asset allocation as at 30 September 2019



Source: First State Investments, as at 30 September 2019

Figure 4: Portfolio ex-ante risk



Source: First State Investments, as at 30 September 2019

Market outlook

Market participants are increasingly considering the prospect of recession in key regions. With bond yields plunging globally and with talk of further easing by central banks with conventional options still available (i.e. positive cash rates), expectations of more unconventional policy measures and fiscal intervention are mounting. While diversification is always of critical importance, we continue to look for ways to participate in this late cycle, while ensuring enough defensiveness should the cycle finally roll over.

It appears that the adverse effects of the US-China trade conflict are beginning to spread beyond China and sentiment is falling globally, particularly in the broader Asia Pacific region. While these developments are constantly being scrutinised, we expect that tensions will be a lingering headwind regardless of any near-term progress. In addition to the trade tensions, there have been suggestions that Chinese policy makers could look to ease policy settings later this year to help support the slowing economy. This will be important for the global economic outlook given China's influence on the broader Asian region and, indeed, on global growth. It seems likely we will see further stimulatory moves from global central banks in the months ahead in an attempt to underpin economic activity levels. In the US, markets are suggesting there is a c.90% probability that the Federal Funds rate is lowered again during October and further rate cuts are expected thereafter. Consensus expectations suggest US officials could cut cash rates two or three times over the next 12 months to help prolong the economic expansion. With the next US presidential election little over a year away, there is likely to be increasing political pressure for them to do so as Trump seeks re-election.

In Europe, the markets have been awaiting the 'package' of measures indicated in mid-year. The widely anticipated asset purchase program has since been announced, for resumption sometime in November. The Bank of England is also expected to lower UK interest rates in the next few months, particularly if a destabilising 'no deal' Brexit results in a deterioration in economic activity.

The big question is how these policy measures might affect bond markets. Yields have moved a very long way in a relatively short amount of time and a period of relative stability seems plausible. In the near term, new monetary policy and fiscal stimulus may support the global economy, but it is unlikely that this will be able to offset the negative effects of lower global trade and associated economic slowdown. Given our flexible and dynamic approach to investing, we will continue to monitor developments closely and adjust portfolio positioning based on our analysis of evolving market developments.

Figure 5 provides a decomposition of ex-ante risk, as well as return contributions from each asset category for the September 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	1.22	0.20	1.53
World (ex UK) equities	4.00	1.24	4.06
Government bonds and cash	0.04	-0.02	0.38
Inflation-linked bonds	0.00	0.00	0.28
Emerging market bonds (HC)	0.00	0.00	-0.09
Emerging market bonds (LC)	0.00	0.00	0.32
Corporate bonds	0.17	0.33	1.05
Commodities	0.00	0.00	0.00
Currency hedging	-0.80	-0.59	-1.91
Protection strategies	-0.40	-0.17	-0.46
Other	0.00	0.00	0.00
Investment Signals			
Equities	0.26	1.71	1.85
Bonds	1.91	1.71	4.60
Currencies	1.01	-0.59	0.40
	7.40	**3.82**	**12.01**

Source: First State Investments as at 30 September 2019. Gross performance contribution might differ from official performance, due to data source, pricing, and timing.

For further institutional enquiries contact institutionalenquiries@firststate.co.uk

For wholesale enquiries contact enquiries@firststate.co.uk

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