

Fourth quarter 2016

Investment Committee Update

The Orchard Practice



Welcome

The Omnis Investment Committee oversees all aspects of the Omnis investment offering.

The Committee met recently to discuss the Omnis funds and the performance of the external fund managers. This bulletin summarises the principal discussion points from that meeting and is the latest in a series of regular updates from the Committee, which takes seriously its responsibility to ensure the funds are properly managed at all times.

Economic and Market Context

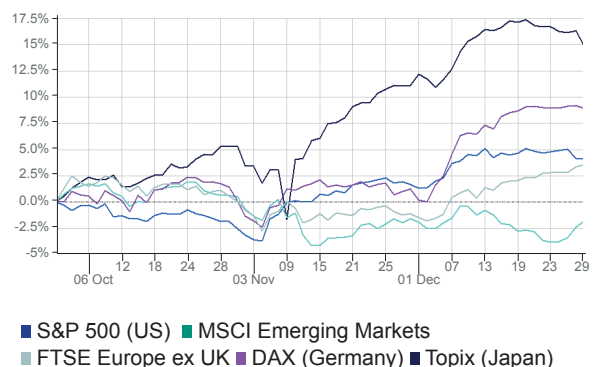
The last quarter of 2016 was dominated by geo-political events, principally the US election. Fears over the Chinese economy and data that suggested the US economic growth might not be as robust or as deep seated as many had hoped also weighed on investor sentiment. Markets saw-sawed between gains and losses going into the election as pollsters predicted varying outcomes from a solid Democratic win, to a Republican win, and back to a slim Democratic win. At the final count, Donald Trump was announced President-elect. The initial reaction saw markets plummet as Trump's protectionist policies were seen as damaging to global free trade and future growth. But since then they have begun to recover as his blend of deregulation, infrastructure spending and tax cuts could be just the fillip required to boost jobs and consumer demand. The lowering of corporation taxes is seen as particularly supportive of US stocks as it should encourage companies to repatriate the billions of profits they are holding in overseas accounts.

With the US Federal Reserve (the Fed) increasing interest rates for the first time in a year and starting to make it plain that interest rates are set to rise further, the dollar strengthened against all major currencies. This is seen as positive to exporters, particularly in Japan and Europe where weakened currencies provide a competitive advantage. Despite the recent recovery in commodity prices – albeit from their all-time lows – a strong dollar weighs heavily on emerging markets, particularly those with debt issued in US dollars. If the dollar continues its rapid ascent, the interest on these could become increasingly difficult to fund. In the UK, the economy seemed to shrug off the worst predictions of the doom-sayers and most economic data seem to point to a healthy and growing economy. In particular, recent data show that the British consumer remains positive about the future. The post-referendum fall in sterling has particularly

benefited larger companies as the majority of their earnings come from overseas. More domestically-oriented mid- and small-cap stocks did not benefit to the same degree. It remains to see whether the 'DIY recession' has been avoided or postponed as much remains uncertain about the shape of the British economy once it leaves the European Union. This has dampened business confidence and business investment remains subdued.

The Italian referendum – once seen as a potentially bigger threat to the European Union than the Brexit vote – has had less of an impact on the markets than many had feared.

FIGURE 1: QUARTER 4, A GAME OF TWO HALVES



Source: FE Analytics, 30th September 2016 to 31st December 2016. Index total returns in local currencies.

Looking forward to 2017, it is believed that Donald Trump will water down some of his rhetoric from the stumps – or be forced to concede on some of his more controversial promises – and he is being painted as a fiscal conservative in the mould of Ronald Reagan. Political risks remain, however. Although Prime Minister Matteo Renzi lost the vote, his resignation has not triggered a new election and he stayed on long enough to steer a bank rescue plan through parliament. But with elections in Germany and France later this year, and the fear of an Italian election still in the back of investor's minds, political uncertainty remains. The election of Donald Trump is the latest in a growing trend of populist reactions to what have become seen as political elites who are in the thrall of big corporations. This could embolden populist parties of both the left and the right in upcoming elections across Europe.

Whilst the Fed has started the process of moving interest rates back to their long-term norms, the pace and scale of that process remains unclear. Following its recent meetings it has repeatedly stressed that its decisions will be based on more than just the domestic economy but will also take

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into consideration the global economic backdrop. In Europe, the ECB has recently announced that it will extend its bond-buying programme (quantitative easing, QE) much as expected but it will also start to scale back the level of support by €20bn from €80bn a month to €60bn. Meanwhile, the Bank of Japan has said that it will use its QE programme to keep the yield on 10-year Japanese government bonds close to 0% even if this means overshooting its 2% inflation target.

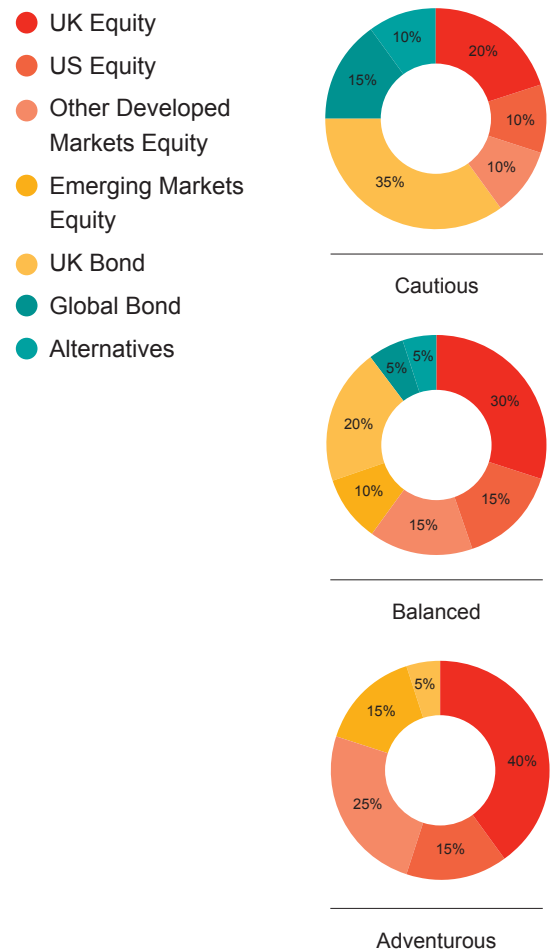
Uncertainty remains and markets are likely to be sensitive to any bad news and therefore volatile. In the next phase of the economic cycle, the gap between winners and losers is likely to widen and this presents opportunities for those who remain focused on the longer term. In this scenario, investors should remain focussed on the fundamental robustness, profitability and growth of the companies in which they invest.

The diversification inherent in the Graphene Model Portfolios should provide a welcome degree of ballast in such conditions. Nonetheless, investors should try and retain their focus on the longer term.

Openwork Graphene Model Portfolios

The Openwork Graphene Portfolios each offer a selection from the ten Omnis Portfolio Funds. These funds, discussed individually below, have been designed specifically to complement each other within the Openwork Graphene Portfolios, with allocations determined by the Openwork Investment Committee (see Figure 2).

FIGURE 2: STRATEGIC ASSET ALLOCATION OF THE MODEL PORTFOLIOS



Though the period since launch remains short of the recommended medium- to long-term holding period, the signs are that the Graphene Portfolios are still navigating challenging market conditions well. The past year has been marked by higher volatility which has seen four sell-offs in global equity markets. The fear of a sharp slowdown in China and the US drove markets lower in Q1; the Brexit referendum result saw markets fall at the start of Q3; renewed fears over the health of the US economy drove markets lower in late Q3; and the election of Donald Trump as the next President of the United States of America saw a knee-jerk fall in assets in November. However, markets have bounced back from each shock with the S&P500 and the FTSE All Share ending the year on their all-time highs. Given that the Adventurous portfolio has a higher exposure to equity markets it is not perhaps surprising that it has seen the greatest variance in returns over the year (see Figure 3). However, at the end of the twelve months, the three models have performed in line with expectations. Importantly, all portfolios have benefited from diversification – primarily through fixed income investments and international currency exposures – providing some shelter from the worst of the market turbulence.

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FIGURE 3: OPENWORK GRAPHENE MODEL PORTFOLIOS, 2016 TOTAL RETURN



- Graphene Adventurous Model Portfolio
- Graphene Balanced Model Portfolio
- Graphene Cautious Model Portfolio

Source: Omnis Investments, Financial Express Analytics, 28th February 2014 to 31st December 2016. Portfolios rebalanced each 31st August and 28th February.

The Key Investor Information Documents (KIIDs) and factsheets for the Omnis Portfolio Funds, of which the portfolios are composed, are available from the Omnis website at www.omnisinvestments.com.

Omnis Portfolio Funds

OMNIS UK EQUITY FUND, MANAGED BY SCHRODER INVESTMENT MANAGEMENT

The aim of the fund is to provide a return to investors from both capital appreciation and from a rising stream of income from a rising stream of dividends. The manager seeks to achieve this by finding mispriced opportunities and moments of change, such as changes to legislation, to competition, or to management change or restructuring. This rising stream of dividend earnings will become increasingly important as inflation starts to increase.

The main theme has been a rising dollar. And UK companies that have significant overseas earnings – largely large cap companies – have seen their share prices rise as investors seek to benefit from this income. Domestically, the managers do not think the picture is as gloomy as it has been painted. The companies they speak to are cautiously optimistic and still see opportunities for growth. The UK economy is displaying a level of dynamism that hasn't been seen for some time. For example, house builders – a very domestically-focused sector – are still positive. The challenge is in identifying the sectors and companies that have the potential to "win" in the coming environment. The managers remain confident that many opportunities will emerge across what is generally a reasonably-valued UK equity market as the much-discussed uncertainties of 2017 play out.

OMNIS INCOME & GROWTH FUND, MANAGED BY WOODFORD INVESTMENTS

The final quarter of 2016 marked the end of a difficult first year for the fund. Market leadership has been narrowly

concentrated in sectors to which the portfolio has no exposure. In particular, resource-related stocks have rallied in the aftermath of the US election, fuelled by optimism about what President Trump may mean for economic growth. In our view such optimism is misplaced. Outside of resources, returns have been more modest.

Within the portfolio, there have been one or two disappointments but, overall, we are satisfied with how the companies we hold are implementing their respective strategies. Much of this progress, however, has yet to be reflected in share prices.

Indeed, much of what we have seen in 2016 does not appear to be grounded in company fundamentals at all. In the long run, fundamentals are all that matter for share prices, but over shorter periods they can be overtaken by other factors, such as momentum (the belief that a security that has performed well can continue to outperform).

The manager believes that when this happens, it is important that as investors they stick to their disciplines: revisit their basic assumptions, and if they continue to hold true, maintain conviction in the strategy. The manager remains confident that the fund is appropriately positioned to deliver attractive long-term returns as and when fundamentals reassert themselves.

OMNIS US EQUITY FUND, MANAGED BY THE BOSTON COMPANY ASSET MANAGEMENT

US markets rallied in the fourth quarter in the wake of higher inflation expectations following the election. Holdings in consumer finance and capital markets segments drove performance. An investment in Synchrony Financial pushed returns higher following the release of solid quarterly earnings. Holdings in metals and mining companies and in construction materials providers also helped; as did a lack of exposure to containers and packaging.

Performance detractors came from IT services and software. In IT services, Visa declined despite solid fundamentals as many investors had held it for financial exposure, pushing the stock to relatively high valuations. With interest rates rising, these investors are switching to more direct exposure to financials. In consumer discretionary, Amazon.com declined despite solid quarterly earnings on investor uncertainty around the company's recent investments in new fulfilment centres. A lack of exposure to the hotels, restaurants and leisure sector also hurt performance.

The correlations between stocks – the degree to which they move in parallel with one another – have declined sharply over recent months, and this bodes well for active management. A higher spread between winners and losers appears likely. As interest rates rise, access to funding and the cost of that funding can become more challenging for companies. Also, if the US dollar continues to rise, this could put pressure on corporate profits, especially for commodities-related industries. In this environment, stock selection will be critical in identifying those companies poised to benefit from strong underlying fundamentals and/or the effect of Trump's policies in 2017.

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OMNIS DEVELOPED MARKETS (EX UK, EX US) EQUITY FUND, MANAGED BY THOMAS WHITE INTERNATIONAL

The mandate of the Omnis Developed Markets (Ex UK, Ex US) Equity Fund is dominated by the equity markets of Japan and continental Europe. The fourth quarter of 2016 was marked by a positive shift in investor sentiment, triggered by the unexpected US presidential election result. The prospect of increased public spending and less restrictive regulatory policies have boosted the short term outlook for US growth, and investors are increasingly confident that governments in Europe, Japan and other developed countries could soon follow the same path. Politicians with similar pro-business policies are receiving more popular support in select European countries where elections are scheduled in the near future. Accordingly, government bond yields in Europe and Japan have risen and are turning positive, as their central banks are now less likely to expand their quantitative easing measures (bond buying) further.

The improved economic growth outlook encouraged the manager to reduce the fund's exposure to defensive sectors such as consumer staples, telecom and healthcare. The recovery in energy and industrial commodities appear more sustainable, especially after the decision by a group of oil producers to control output. Reflecting this, the fund is now overweight energy and materials companies. We expect higher bond yields and the likely recovery in credit demand to help the banking industry, and the fund has increased its exposure to the financial sector.

OMNIS EUROPEAN EQUITY FUND, MANAGED BY JUPITER ASSET MANAGEMENT

Heading into 2017 the strategy will avoid making macro bets based on economic predictions. This is because the economic environment in Europe is not in itself a driver of success or failure for European companies. In recent years we have seen a trend of analysts forecasting double-digit earnings growth which have failed to materialise with earnings being largely flat.

Instead, the manager is looking for companies that are capable of exploiting their unique propositions or what have been called megatrends. These are large scale changes in society or trends in business practice – usually global in nature – such as demographics, outsourcing, climate change, and digitalisation. A good example of this is industrial laundry outsourcing. Whilst this is not the most exciting business to be in, industrial laundering is definitely non-core for a number of large scale institutions, such as hospitals. In France alone, the manager believes this represents an opportunity worth some €500 million.

Alongside their thematic focus, the manager retains a price discipline. Since the summer there has been a re-assessment of financial companies. This has seen valuations increase substantially across the board even though 57% of bad loans are held by Italian, Spanish, Portuguese and Irish banks.

OMNIS ASIAN EQUITY FUND, MANAGED BY BAILLIE GIFFORD

Developed Asian markets fell slightly during the final quarter of 2016 but generated a positive return over the full year. Japan, however, delivered a positive quarterly return. The quarter saw investors switch from rapidly growing new economy companies into sectors which had previously been out of favour due to the prolonged era of low interest rates; banking and insurance companies, and some Japanese exporters. Although a difficult backdrop, the fund delivered a positive return in sterling terms, with the fall in sterling boosting relative returns. Major detractors were rapidly growing new economy stocks or steady-growth franchises but which the manager continues to believe can deliver significant upside. The two top performers were both Japanese: insurance business MS&AD and semiconductor company Advantest.

The manager believes that successful investment does not come from forecasting market movements. Rather it comes from identifying and owning high quality companies over the long term while not getting distracted by short-term noise. The manager therefore made very few changes to the fund during the quarter. They sold Australian gaming business Aristocrat Leisure, after strong performance, reinvesting the proceeds in ideas which they believe have greater potential. The manager expects 2017 to yield exciting new investment ideas and looks forward to challenging existing holdings for their place in the fund.

OMNIS EMERGING MARKETS EQUITY FUND, MANAGED BY JUPITER ASSET MANAGEMENT

Global emerging equity markets suffered a second turbulent year in 2016. Just as commodity prices seemed to recover along with global growth, Donald Trump's rhetoric during the US presidential campaign and his eventual success at the polls, has weighed heavily on these economies. Trump's anti-globalisation stance, his threat to tear up the Trans-Pacific Partnership Agreement, and a proposed trade war with low-cost exporter nations have all piled on the woes. Investors are also having to consider what rising US interest rates – and a rising dollar – mean for emerging markets.

Despite the political traumas, the manager believes emerging markets are in a strong position. The currency adjustments represented by a strong dollar provide emerging markets exporters with a competitive advantage. And historically, emerging markets have generally outperformed developed markets during periods of rising interest rates. From a valuation perspective, companies look attractive not only in comparison to their developed world peers, but also in comparison to their historical averages even given the recovery from the lows of last summer. Within the emerging market universe a large number of companies are likely to benefit from the kind of structural changes that can only occur in less mature economies. These include increasing domestic demand, and rising productivity from improvements in technology and infrastructure investment.

As bottom-up stock pickers, the manager is far more interested in the business models of the companies they invest in and their abilities to exploit gaps in the market than in political or economic issues. Fund positioning at both



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a sector and a country level is, as always, a function of where the GEM team identifies compelling businesses at attractive valuations.

OMNIS UK BOND FUND, MANAGED BY COLUMBIA THREADNEEDLE INVESTMENTS

The fourth quarter reminded us that politics can continue to surprise. Following the UK's decision to leave the EU in Q3, Donald Trump (the outside candidate) was elected president of the United States of America and Matteo Renzi lost his referendum bid to change the Italian constitution. Expectations for when the Bank of England will increase interest rates have been pushed out by at least two years. The UK economy appears to have shaken off Brexit fears, but corporate investment and hiring intentions remain subdued at best as Brexit uncertainty picks up in the approach to the triggering of Article 50. Inflation is also likely to increase further as sterling weakness pushes up the price of imported goods and as fuel prices continue to rise. These will weight on consumers who, up until now, have appeared sanguine.

Bond markets have generally done well, with both UK government bonds (gilts) and corporate debt enjoying a robust period of performance. However, risks are rising and the manager thinks 2017 will not see a repeat of this performance. Corporate borrowing (from bank loans and bond issuance) has risen. Over the next 12 to 18 months, the support from central banks in the form of quantitative easing in general, and bond purchases in particular, will begin to wane. This is likely to lead to lower returns in the near to medium term.

Whilst yields have risen since the US election, it is hard to argue that value has been completely restored. In reality, government bonds have gone from being really expensive to just expensive. Corporate bonds still appear to offer reasonable valuations, with credit spreads (the increased level of yield over that of government bonds) around their long-term averages and the manager retains a preference for corporate bonds in the fund.

OMNIS GLOBAL BOND FUND, MANAGED BY SCHRODER INVESTMENT MANAGEMENT

During Q4, the global bond market was principally driven by political factors. The election of Donald Trump was particularly notable. Prior to the election, the manager reduced a number of emerging market currency positions to decrease risk. Active currency positioning drove outperformance in December, after a challenging post-election month. However, Trump's election and the Federal Reserve's decision to raise interest rates caused US Treasury yields to rise, which and this dragged on total performance. Overall, the fund's interest rate, credit and currency strategies contributed positively to returns, whilst some shorter-term trades detracted.

The manager is mindful of further political events in 2017. Trump's election caused inflation expectations to rise. The manager expects this to continue, principally reducing the fund's exposure to sterling, as Brexit negotiations are likely

to weigh on the currency. Additionally, the manager continues to have a negative view of the Mexican peso, as Trump may implement policies which are unfavourable to Mexico's economy. 2017 may be another volatile year and with this backdrop of uncertainty, the portfolio expects to adopt a more opportunistic strategy.

OMNIS ALTERNATIVE STRATEGIES FUND, MANAGED BY OCTOPUS INVESTMENTS

Octopus Investments utilises a variety of tools in seeking to generate positive absolute returns regardless of the prevailing economic and market conditions. Employing a broad range of specialist 'alternative' investment strategies accounts for a sizeable proportion of the fund's investments and provided welcome stability over a period of acute volatility in global financial markets. But volatility also provides opportunities for active managers to take advantage of over-reactions to company or economic news. Over the last quarter, the fund manager made a number of switches, selling the remaining holdings in some of the index-matching ETF strategies in favour of active managers.

Markets expect the era of low inflation to come to a close. Periods of inflation generally favour equities over bonds and the manager has sold down the fund's bond holdings in favour of selected equities.

OMNIS MULTI-MANAGER, MANAGED & MULTI-ASSET FUNDS

OMNIS MULTI-MANAGER FUNDS, MANAGED BY OCTOPUS INVESTMENTS

The Omnis Multi-Manager range comprises of the Omnis Advanced, Balanced, Cautious and Distribution funds. As with the Omnis Alternative Strategies Fund, Octopus actively allocates between asset classes seeking close control of investors' exposure to specific risks.

Within the past quarter allocations to equities were increased and bond exposures decreased following the surprise election of Donald Trump as the next President of the United States of America. Markets subsequently rallied as Trump is seen as broadly positive.

In addition to managing risk through asset allocation, the portfolios can be further refined by Octopus' careful selection of best-of-breed third party fund managers. Over the last quarter of 2016, Octopus continued its move from index-matching strategies to focus on more active, investment managers who can exploit wide variations in share prices between individual companies.

OMNIS MANAGED FUNDS, MANAGED BY COLUMBIA THREADNEEDLE INVESTMENTS

The Omnis Managed range comprises the Omnis Managed Advanced, Balanced and Cautious funds. Columbia Threadneedle adopts a measured, medium-term view to



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asset allocation. The fund manager currently favours Japan and the Asian economies which are cheap relative to recent history. Japan should also benefit from improved levels of corporate management and a weaker yen. Other Asian economies are enjoying better economic conditions and China appears to have entered a period of relative economic stability, despite longer-term concerns. The fund manager has therefore added to these and to emerging markets. To fund this, the manager has taken profits from the US where equities rallied following the US election. The main risks the manager sees going into 2017 come from further uncertainty over Brexit, the playing out of a Trump presidency and the forthcoming European elections. The fund manager has a slight preference for equities over bonds. Government bonds will continue to offer limited value despite the recent recovery in yields, so the manager has a preference for corporate bonds and emerging market bonds.

The Omnis Managed funds are 'funds of funds' – that is, they invest in a range of other investment funds. This range is limited to other funds managed by Columbia Threadneedle Investments. In this way, the Omnis Managed funds are able to benefit from the stock selection skills of well-regarded specialist fund managers.

OMNIS MULTI-ASSET INCOME FUND, MANAGED BY NEWTON INVESTMENT MANAGEMENT

The Omnis Multi-Asset Income fund targets an attractive, relevant and sustainable level of income, together with the potential for real capital growth over the long term. Investing directly in equities and bonds, together with a range of alternative asset classes including infrastructure, the managers are able to target the most attractive point in a company's capital structure and to ensure that pursuit of the yield objective does not subject investors' capital to undue risk. Nonetheless, a degree of fluctuation in the capital value of the fund is to be expected as the manager targets growth opportunities, provided the level of income distributed by the fund can be sustained.

The Fund's cautious stance and low weighting in bonds helped limit the impact of the sell-off that followed the election of Donald Trump as President-elect of the USA. Equity holdings were the biggest contributor to returns. In particular, holdings in financials rallied as banks benefit when interest-rates rise, profiting from the difference in between interest rates at which they borrow and at which they lend. Alternatives performed well and we increased the allocation to UK renewable-energy assets, particularly Greencoat UK

Wind. The company continued its strong performance and maintains a disciplined acquisition strategy.

While the economic backdrop remains uncertain we remain positive about future opportunities. We like companies with limited exposure to the economic cycle but which are exposed to changes in inflation. We believe that this should offer the fund some protection against any potential spike in short-term inflation. By maintaining our strict discipline of emphasising businesses with high cash flows and strong balance sheets, we aim to provide investors with a sustainable income stream.

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