Waverton Cautious Income Fund

Annual Investor Letter 2018

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WAVERTON
INVESTMENT MANAGEMENT

PERFORMANCE

	Since Inception	2017	2016	2015
Waverton Cautious Income Fund	28.2%	4.7%	12.6%	3.6%
IA 20-60 Peer Group	26.8%	7.1%	11.0%	1.2%
MSCI AC World	67.8%	13.8%	29.4%	3.8%
iBoxx Gilts	17.2%	2.0%	10.5%	0.4%
iBoxx Credit	21.2%	5.0%	11.8%	0.6%

Source: Waverton: Morningstar; Factset,

Since inception the Fund continues to outperform its peer group, courtesy of a strong 2015 and 2016-relative. 2017 was a frustrating year; although we made a decent return of 4.7% on very low volatility, we would have liked to have achieved more for our investors. There were a number of key detractors from performance which we will go into later. There were some positives also, which we wil also cover, and some lessons learnt.

Our hope is that in reading this letter our investors will better understand our thought process when managing your money; what we seek to achieve, how we seek to achieve it, and the discipline with which we invest. Perhaps most importantly, it is an opportunity to share our thoughts for the future with our investors; after all, returns to date are in the past, and what matters today is prospects for returns.
We are 100% focused on the performance of the portfolio, and maintain that our three areas of emphasis should remain the delivery of a consistent & sustainable income, drawdown management and growing your capital in line with inflation.

Important Note:
All data displayed within this letter is for the P Share Class of the Cautious Income Fund.
The Inception Date is: 16th October 2014
Performance is calculated on a NAV to NAV basis and does not take into account any initial fees. Performance displayed is net of fees and assumes income is reinvested.
The Waverton Cautious Index is a composite benchmark of 45% MSCI AC World Index TR, 17.5% Iboxx Sterling Gilts Index 17.5% Iboxx Sterling Corporates Index, 20% GBP 1 month LIBOR.

MARKET PERFORMANCE

2017 was a strong year for equity markets, with the All Country World Index up 13.8% in GBP terms. Asia and Emerging Markets led the way, returning 29.8% and 25.8% total return, respectively. The S&P 500, FTSE 100 and Euro Stoxx 50 pulled up the rear, with 11.3%, 11.9% and 13.5%; Japan's Nikkei 225 saw a surge in the final quarter to finish in the middle of the pack, with 14.8% total return in GBP terms. Growth (18.9%) once again outperformed Value (8.9%), while government and corporate bonds generated positive returns of 2% and 5% respectively[1].

The Sterling Broad Effective Exchange Rate was little changed over the year, however this masks some significant moves between individual crosses. For example, Sterling appreciated 9.4% against the US Dollar and 5.4% against the Japanese Yen. Versus the Euro, Sterling *depreciated* 4.1%.

The table below shows the performance of the Cautious Income Fund, currency exchange rates and the returns of key market indices for the year to 31st December 2017:

Fund & Key Markets	2017
Waverton Investment Funds PLC - Waverton Cautious Income Fund Class P GBP	**4.7**
Broad Effective Exchange Rate: GBP	0.9
GBP/USD	9.4
GBP/EUR	(4.1)
GBP/JPY	5.4
MSCI World Index	12.4
MSCI AC World	13.8
MSCI AC World IMI Value	8.9
MSCI AC World IMI Growth	18.9
MSCI World High Dividend Yield	8.9
S&P 500	11.3
FTSE 100	11.9
Euro STOXX 50	13.5
Japan Nikkei 225	14.8
MSCI AC Asia ex JP	29.8
MSCI EM (Emerging Markets)	25.8
iBoxx Sterling Gilts	2.0
iBoxx Sterling Corporates	5.0
Gold NYMEX Near Term ($/ozt)	13.6

Source: Factset, Waverton

[1] Waverton, Factset; 31/12/2016 – 31/12/2017

FUND PERFORMANCE

The portfolio generated a positive return of +4.7% in 2017, fulfilling its objectives but behind what we would have liked to have achieved.

Before delving into the drivers of returns, it is important to understand how we invest within the Waverton Cautious Income Fund. The Fund follows a “Top-Down” investment process, where we analyse the economic & market cycle and decide where best to allocate capital in order to exploit the inefficiencies and asymmetries we see in market prices. (This compares to a “Bottom-Up” investment process, where the first port of call for analysis is company accounts. We do employ bottom-up analysis, but it is not where we begin). We can (and do) invest in equities, bonds (both government and credit), alternative assets (property, infrastructure, catastrophe insurance, amongst others), currencies and derivatives in order to deliver our stated long term return objective of CPI+2.5%.

The Top-Down process leads us to make calls on which asset classes we expect to outperform (equities, bonds, alternatives or cash), which regions (the US, Europe, the UK, Asia & Emerging Markets) and which sectors (cyclical or defensive). We look to how much duration we are carrying in our bond holdings, and whether we prefer government bonds or corporate credit. We also consider how the portfolio may perform if we get it all wrong, and hence look to hedge systemic risks where it is cost efficient and appropriate to do so.

Given our investment process, then, we naturally analyse the Fund’s performance on all of these axes. We do so by looking through any funds we may hold, down to the individual security level. For example, rather than analyse the portfolio’s performance by considering simply the performance of our holding in CF Morant Wright Nippon Yield, we look through the Morant Wright fund wrapper to the individual Japanese equity securities held. This is important; without this capability we would be stumbling in the dark – believing we are taking a specific industry, sector or country bet, but perhaps not. This ability to look through to the individual security level enables us to make purposeful decisions about the Fund’s positioning; the granularity with which we can analyse the portfolio at once improves the prospects for returns (as we can be more nuanced about how we invest your capital) and reduces the risk to the portfolio (that is, the risk that we are not allocated as we fully intend to be).

So, turning to positioning and performance…

Equity Performance

The below is a snapshot of the Fund’s equity performance in 2017, divided into regions. The blue bars on the left indicate the average weight allocated to the region in the portfolio (i.e. in 2017 we had an average allocation of 20.92% in US equities). The green bars in the middle indicate our holdings’ contribution to returns over the course of the year (i.e. our holdings in North America contributed 0.63% to the portfolio’s total return in 2017). The two columns to the far right display the following: blue bars indicate the Fund’s weight in each region *relative* to the Global Equity Benchmark, and the green bars in the final column display the performance of the Fund’s holdings *relative* to the Global Equity Benchmark.

Waverton Cautious Income Fund					
	Port. Average Weight	Port. Total Return	Port. Contrib. To Return	Weight Rel	Contr Rel
Total	100.00	6.34	6.34		
Equities	48.90	11.48	5.54	3.90	-0.40
North America	20.92	2.68	0.63	-3.33	-2.01
United Kingdom	3.78	15.53	0.55	0.91	0.23
Europe ex UK	10.38	16.34	1.75	3.04	0.70
Japan	5.28	20.78	1.09	1.79	0.64
Asia Pacific ex Japan	5.15	29.12	1.19	-0.39	-0.09
Emerging Markets	2.13	16.57	0.28	0.63	0.08
Global	1.24	1.80	0.05	1.24	0.05
Government Bonds	0.00	9.01	0.00	0.00	0.00
Unassigned	0.02	-5.29	0.00	0.02	0.00

Source: Factset PA3, Waverton

There are a few things to comment on here. First, the bad: a 21% allocation to the weakest performing equity market was clearly an issue for performance in absolute terms. Second, our holdings *within* North America were weak relative to the American equity market: the average return for US equities over the year was 10.63%; our holdings generated 2.68% - this is an almost 8% relative underperformance in the year.

The detractors to relative performance were our holdings in PowerShares S&P 500 High Dividend Low Volatility (+1.52% return in 2017), SPDR S&P US Dividend Aristocrats (+3.24%) and WisdomTree US Total Dividend ETF (+1.24%). Each was a stellar performer in 2016, but a change in the economic and market environment led to a material underperformance during the time held in 2017. We were not quick enough to pivot from these holdings, and have learnt from the mistake: we are more stringent in our monitoring of portfolio positions relative to their respective benchmarks, and have initiated a -10% relative position review rule, where all positions that have underperformed their benchmark by 10% or more *over any time period* must be reviewed and other investment opportunities considered. We sold the positions to zero over the course of the year, and reinvested into a diversified basket of direct US equities, selected by our excellent US equity team at Waverton. Of the positions recommended and invested in, five are ahead of the S&P 500 benchmark and two behind. We will be divesting of one of these in the foreseeable future to be replaced with a position we see material upside for in the foreseeable future.

Notwithstanding the fund's US equity performance in 2017, our equity allocations in other regions was a more positive story. While we carried a high weight to the US in the portfolio in absolute terms, we were underweight relative to the global index. Though this may not be particularly important to you as investors (after all, you can't eat relative performance), it did mean that we had capital to invest in other regions. This can be seen in the penultimate column in the table above: we used an underweight US position to fund an overweight Europe & Japan in particular, and added to our weight in Asia and EM throughout the year to reflect an increasingly positive outlook for the global economy and cyclical markets. This led to outperformance of the global equity benchmark across all regions other than the US and Asia ex Japan (final column).

Turning to sector performance, we can see from the below that the equity portfolio was broadly diversified in absolute terms (blue bars on the left), and that all sector allocations bar Energy contributed positively to performance (green bars in the middle). The -0.13% contribution from Equity Investment Funds was driven by a brief holding in Pershing Square Holdings equity (which we cover below), and the -0.31% contribution from equity derivatives is the result of our put option expiring out of the money (again, covered below).

Waverton Cautious Income Fund	Port. Average Weight	Port. Total Return	Port. Contrib. To Return	Weight Rel	Contr Rel
Equities	48.94	10.78	5.23	3.94	-0.71
Energy	4.03	-4.78	-0.13	1.14	-0.03
Materials	1.41	16.68	0.25	-0.99	-0.18
Industrials	6.23	22.11	1.31	1.39	0.62
Consumer Discretionary	5.30	7.64	0.41	-0.13	-0.36
Consumer Staples	4.79	13.62	0.62	0.66	0.30
Health Care	3.66	10.93	0.43	-1.32	-0.07
Financials	8.45	16.87	1.24	-0.23	0.01
Information Technology	5.15	26.50	1.15	-2.23	-0.80
Telecommunication Services	2.57	5.06	0.17	1.10	0.20
Utilities	2.60	3.26	0.21	1.20	0.14
Real Estate	2.28	8.33	-0.00	0.87	-0.11
Equity Investment Funds	2.42	-6.12	-0.13	2.42	-0.13
Equity Derivatives	0.05	-99.86	-0.31	0.05	-0.31
Unassigned	0.00	-0.91	-0.00	0.00	-0.00

Source: Factset PA3, Waverton

You can broadly determine our view of the world in 2017 by looking at our sector weights relative to the global equity index (penultimate column). A view that energy assets were pricing in lower-oil-forever and a recognition that we may be at the beginning of a reflationary cycle led us to favour energy and industrials over the course of the year. We added to our positions in financials (mainly banks) throughout the year, bringing us in-line on average, but overweight by year-end. These three allocations took us into 'Value' territory. Perhaps the key underweight during the year was in technology; this was an error, as FANG[2] stocks pulled away from the market. Overweights to Telcos, Utilities and Real Estate reflected a caution that the "reflation cycle" thesis was incorrect.

Bond Performance

Turning to the table below[3], our average exposure to bonds throughout the year was just over 20% (top-left), which we diversified by investment type (government bonds, corporate bonds, etc.). We allocated away from a purely government bond index, preferring the return available in credit and other areas of the fixed income market. Our largest exposure was to Corporate Bonds, followed by Government and real estate ("Bond Investment Funds) & infrastructure ("Infrastructure") debt investment trusts.

Waverton Cautious Income Fund	Port. Average Weight	Port. Total Return	Port. Contrib. To Return	Weight Rel	Contr Rel
Bonds	20.07	4.03	0.81	-14.93	-0.44
Government Bonds	5.41	-0.92	-0.09	-12.69	-0.45
Corporate Bonds	8.69	3.99	0.30	-8.76	-0.59
Convertibles	1.56	8.68	0.14	1.56	0.14
Floating Rate Notes	0.01	0.31	0.00	0.01	0.00
Bond Investment Funds	2.12	10.94	0.16	2.12	0.16
Bond Futures	-0.23	2.46	-0.00	-0.23	0.00
Bond Options	0.01	-50.65	-0.00	0.01	0.00
Infrastructure	2.15	7.23	0.27	2.15	0.27
Loans / Private Lending / Deb	0.29	3.01	0.03	0.29	0.03
Corporate	0.06	6.92	0.01	0.06	0.01

Source: Factset PA3, Waverton.

[2] Facebook, Amazon, Netflix, Google

[3] This table applies look through; i.e. we are looking through open-end funds and ETFs to the individual bond level; as such, the weight and performance data is slightly different to the figures on the next page, which does not look through the holdings.

Encouragingly, all bar four individual bonds generated positive performance for the Fund overall (below table, middle column). Outstanding performers included the two Burford issues, Nationwide Building Society AT1s and Real Estate Credit Investors. The Waverton Sterling Bond Fund was also a strong performer; a position we hold for its reflection of our own top-down views and the quality of the manager. The position also charges zero fees to the Portfolio, thus providing our investors with access to a diversified portfolio of fixed income holdings with a 5.2% distribution yield for free. We are happy with the performance of our bond allocation, and continue to be on the lookout for new ideas.

Waverton Cautious Income Fund	Port. Average Weight	Port. Total Return	Port. Contrib. To Return	Weight Rel	Contrib. Rel
Bonds	**20.65**	**5.28**	**1.07**	**-14.35**	**-0.18**
Apple Inc. 3.05% 31-jul-2029	0.27	2.74	0.02	0.23	0.02
Burford Capital Limited 5.0% 01-dec-2026	0.41	10.85	0.07	0.41	0.07
Burford Capital Plc 6.125% 26-oct-2024	1.18	10.46	0.13	1.18	0.13
CVC Credit Partners European Opportunities Ltd GBP	1.16	2.21	0.06	1.16	0.06
GCP Infrastructure Investments Ltd GBP	2.15	7.23	0.27	2.15	0.27
Government Of Saudi Arabia 2.375% 26-oct-2021	0.68	-2.45	-0.06	0.68	-0.06
Government Of The United States Of America 2.25% 15-nov-2027	0.06	-2.21	-0.04	0.06	-0.04
Government Of The United States Of America 3.625% 15-feb-2044	0.80	0.20	0.02	0.80	0.02
Government Of United Kingdom 2.75% 07-sep-2024	1.74	1.07	0.02	1.35	0.02
Helical Plc 4.0% 17-jun-2019	1.52	8.70	0.14	1.52	0.14
iShares Core UK Gilts UCITS ETF	1.14	0.63	-0.01	1.14	-0.01
Lucent Technologies, Inc. 6.45% 15-mar-2029	0.65	-5.53	-0.12	0.65	-0.12
Nationwide Building Society 6.875% Perp	1.02	11.21	0.11	1.02	0.11
Nationwide Building Society Frn 25-apr-2019	0.64	0.61	0.01	0.64	0.01
Pershing Square Holdings Ltd. 5.5% 15-jul-2022	0.81	1.22	0.02	0.81	0.02
Real Estate Credit Investments Limited	0.30	13.58	0.05	0.30	0.05
Real Estate Credit Investments Limited Shs GBP	0.25	3.37	0.01	0.25	0.01
Sequoia Economic Infrastructure Income Fund Limited Ptg.Shs GBP	0.41	0.80	0.00	0.41	0.00
Starwood European Real Estate Finance Ltd GBP	0.29	3.01	0.03	0.29	0.03
Valeant Pharmaceuticals International Corp. 6.75% 15-aug-2021	0.16	5.95	0.04	0.16	0.04
Waverton Investment Funds PLC - Waverton Sterling Bond Fund Class A GB	5.01	6.94	0.30	5.01	0.30

Source: Factset PA3, Waverton

Alternatives Performance

Our Alternatives allocation generated positive returns in 2017, with the main contribution coming from our Asset Backed bucket. Detractors were Low Vol and particularly Hedging, as should be expected in a rising equity market. Again, we will go into detail regarding individual positions later, but the headline performance numbers are below. (Perhaps worth highlighting is the fact that both absolute and relative performance numbers in the below table are the same. This is because Alternatives are measured relative to cash, which is currently returning just above 0% per annum.)

Waverton Cautious Income Fund	Port. Average Weight	Port. Total Return	Port. Contrib. To Return	Weight Rel	Contr Rel
Alternatives	27.41	1.75	0.61	27.41	0.61
High Vol	1.56	11.38	0.17	1.56	0.17
Low Vol	2.35	-0.95	-0.04	2.35	-0.04
Asset Backed	21.02	2.27	0.62	21.02	0.62
Commodities	1.84	1.86	-0.02	1.84	-0.02
Hedging	0.64	-17.25	-0.12	0.64	-0.12

Source: Factset PA3, Waverton

Winners & Losers

Below we list the fund's top 10 and bottom 10; our "Winners & Losers". A glance at the list will tell you that our best performers were principally equity investments, while key detractors came from the Alternatives bucket. We go into detail below.

Holding	Port. Contrib. To Retu
CF Morant Wright Nippon Yield	0.95
Schroder European Alpha Income	0.90
Somerset Emerging Markets Dividend Growth	0.77
Prusik Asian Equity Income	0.46
Guinness Global Equity Income	0.40
3i Infrastructure	0.36
Waverton Sterling Bond Fund	0.30
Buy 4072905 GBP Sell USD 5400000	0.29
GCP Infrastructure Investments	0.27
Schroder Asian Income Maximiser	0.23
Microsoft Corporation	-0.04
U.S. Bancorp	-0.06
Government Of Saudi Arabia 2.375% 26-oct-2021	-0.06
Waverton Protection Strategy	-0.12
Lucent Technologies, Inc. 6.45% 15-mar-2029	-0.12
Pershing Square Holdings Ltd Public Class	-0.21
PIMCO Funds MLP & Energy Infrastructure	-0.23
CATco Reinsurance Opportunities	-0.24
S&P 500 EMINI Fut September 2017 1900 Put (Long)	-0.31
Blue Capital Alternative Income	-0.58

Source: Factset PA3, Waverton

Beginning with the losers…

Blue Capital Alternative Income (BCAI). BCAI is a fully collateralised catastrophe insurance provider, structured as a close-end investment company. Put more simply, the fund provides insurance to insurance companies, and gets paid a premium to do so. This premium is accumulated in the fund's Net Asset Value (NAV) and paid out quarterly as income. The principle risk with such an investment is that the insured make claims against the fund. Unfortunately this was the case in 2017, and BCAI's NAV was marked down to reflect this, hence the poor performance. **CATCo** suffered a similar fate, being exposed to similar risks.

The question might be asked: "why do you allocate to such strategies given the potential severe drawdown risk?" The answer is that over time the probability of loss is low[4], and it is the insurance *provider* that is often the ultimate beneficiary of a risk-averse culture (and regulator). In the same way we all pay home and car insurance but rarely make a claim, insurance companies "reinsure" themselves with providers such as BCAI and CATCo for peace of mind, and in the long term do not claim enough to be detrimental to the insurance provider. Furthermore, where there are material industry losses following an event, pricing goes up; that is, BCAI and CATCo charge the insured higher insurance premiums. Importantly, both BCAI and CATCo will be charging more in 2018 than they were in 2017 *for exactly the same (if not lower[5]) risk*.

Despite the poor performance of both holdings in the fund in 2017, we continue to hold BCAI and have bought into CATCo's November C-Share issue in order to benefit from improved pricing (CATCo management expect pricing for its product to be up between 30% and 50%) and a potential corporate action in BCAI (as it trades materially below Net Asset Value; happy to discuss the detail with any investors that wish to).

[4] Swiss Re & Munich Re note that insured losses exceeding $100bn (as was the case in 2017) is a c.2.5% probability event

[5] Statistically, having had a 2.5% probability (circa 1 in 50 year) event, it is very unlikely we will see the same in the year following

The **S&P 500 PUT** was a loser for the fund, as the position expired worthless. It is important to highlight that *this is good news*: it means that the equity market rose and volatility declined, meaning the equity allocation within the portfolio (by and large) went up in value. Without getting into the mechanics of options pricing, the important points are as follows: (a) the S&P 500 went up, and so the value of the put (effectively short the market) went down, (b) the position was taken as a hedge against a systematic weakness in equity markets, not as a store of value or because we believed that there was a high probability of making a positive return out of it[6], and (c) the benefit of holding puts (as opposed to simply being short equity index futures) is that as soon as we invest, we know our loss to the fund cannot exceed 0.31%.

Much like the above explanation of BCAI and CATCo, insurance costs the insured party money over the long term. In this instance, by buying a put option we were the insured party, and so paid a premium (0.31%) for "peace of mind". Clearly we do not want to lose money on any position in the fund, however the hedge enabled us to remain invested in equity risk during a still highly politically uncertain period for markets.

PIMCO MLP was also a detractor from performance. The fund invests in the "picks and shovels" of the oil world; the pipes. We initially bought the fund in 2016 on the basis that oil has likely bottomed and would be range-bound between $40-60. In the event, this proved to be correct; oil bottomed below $30 and traded between $40 and $50 for a considerable period. The differentiating factor of the PIMCO fund is that invests in the debt and equity of what are called Master Limited Partnerships (MLPs)[7], the cash flows of which are less affected by the oil price or the volume of oil pumped along the pipes due to pre-agreed contract terms, making the position a "low beta" play on the oil price. Given that we were not expecting oil prices to run away to $100, we believed the holding made sense.

The defensive position relative to out-and-out oil equity or debt proved to be a good call; in 2017 the Accumulation shares generated +6.5% in USD-terms (i.e. in the fund's local currency), while the S&P 500 Energy index returned -1%[8]. The reason we lost money in the positon last year was due to the US Dollar depreciating against Sterling. We were also early into the Energy sector, however we have carried the allocation to energy into 2018, as can be seen below. We have sold PIMCO and reinvested in **Royal Dutch Shell**, taking the view that higher oil was probable given increasingly tight supplies, rising demand as the global cycle picked up, and a determined OPEC. The position has been a strong performer for the fund since purchase (+19%[9]).

Pershing Square Holdings (PSH) is the close-end investment vehicle that Pershing Square Capital Management investor Bill Ackman launched in 2014. We studied the vehicle in detail, met with management on numerous occasions, analysed the underlying positions within the fund and already owned the bonds. At the time we invested, PSH was trading at a c.20% discount to its Net Asset Value, meaning that if the company was wound-up that day we would have benefitted from a +20% return. Our intention was to buy a small position in the equity while holding the bonds; the bonds would "pay us to wait" for the equity to perform, the key catalyst for which we believed would be a pick-up in performance. (We had already successfully made a similar trade in Real Estate Credit Investors (RECI) equity and preference shares).

At the time of investing, Pershing Square Capital Management had a compound annual return rate of +10% net of fees (down from +20% three years previously, but still pretty strong). Our thesis was that (a) the discount was unlikely to widen further and (b) in time, performance would improve, as we did not believe that the team's ability to select investment opportunities had vanished. In the meantime, we would be paid a yield by the bonds already held, as mentioned. Unfortunately, PSH's portfolio came into further bad news while we held it, and the NAV deteriorated. The discount also widened slightly, meaning we suffered a double-whammy. We held the position too long, and it is partly this experience that led us to introduce the -10% relative rule, mentioned previously.

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[6] We held a Put on the S&P 500 in 2016 also, which benefitted the fund in both Brexit and Trump's unexpected election win (we were able to trade in the latter instance at 6am GMT, when the markets reacted negatively to the news and before they did a 180-degree reversal throughout the day.

[7]A legal structure much like a Reit, which requires a certain portion of earnings (90%) to be paid out as dividends to equity holders.

[8] Factset data; 31/12/2016 – 31/12/2017

[9] Factset data; 01/08/2017 – 26/01/2018

The other underperformers in the portfolio were less of a drag and so I will not go into detail here. As ever, though, should you want more detail please do get in touch.

Turning to the winners…

Morant Wright Nippon Yield was our key holding in Japan in 2017, and a position we added to in the latter part of the year (hence the strong positive contribution). We have again gone overweight Japan to reflect a positive outlook for the Japanese economy and market. An extremely tight labour force coupled with further (possibly more potent) attempts by the government to stimulate wage growth, a global cyclical pick-up and a reflation cycle makes us positive on the country. The Bank of Japan is also likely to be the last Central Bank to maintain a loose monetary policy, providing a comparative benefit for the Japanese economy as the Fed, ECB and BoE all look to tighten. Wage inflation ought to lead to spending and/or investing, both of which will be positive for the Japanese economy and markets. Importantly, we have seen a rally in the Japanese equity market with little foreign investor participation. We believe we were (and are still) early into the trade; our hope is that the thesis plays out and attracts other foreign buyers into the market.

Schroder European Alpha Income was our main holding in Europe in 2017, and benefitted from a pick-up in economic activity across the region. Political risk subsided and the industrial economy picked up as China and the rest of the world grew faster than expected. The Schroders Fund’s key sector overweights were Financials and Telcos; regionally, the fund was overweight the Netherlands & Spain, while being in-line Germany & France. The manager, James Sym, has an excellent long term track record, and we are happy holders of the Fund.

Somerset EM Dividend Growth and **Prusik Asian Equity Income** were our main Emerging Market and Asia ex Japan holdings. We added to both early in 2017, reflecting a view that the Dollar was likely to weaken, benefitting the global financial system (due to a loosening of liquidity on a global scale) and risk-assets generally. We continued to add to the positions throughout the year, as well as supplementing the Asia position with the **iShares MSCI Far East ex Japan**. A relatively cautious stance in both funds led to their underperformance relative to their respective benchmarks in 2017. We are watching both closely with this in mind, however the defensive positioning is not out of kilter with the objectives of the Cautious Income Fund itself, and a focus on finding value in investments is more important than chasing a runaway market, in our opinion. We continue to hold both, and are benefitting from the tailwind of a weaker Dollar.

Skipping **Guinness** (because we have written about the fund in some detail before), we want to highlight **3i Infrastructure (3IN)**, which was a strong contributor into the end of the year. As with all holdings, we meet with 3IN management on a regular basis, and in such meetings in 2017 we were made aware of an intention to sell the two biggest assets within the fund; Elenia and AWG. The hope was that both would be sold by January 2018, and at a premium to the value at which they were held on 3IN’s balance sheet. Following the meetings we modelled possible scenarios of sale prices, consequent portfolio valuations and possible use of cash proceeds, and came to the view that we were likely to see a special dividend payout some time following a completion of the sales. In Q4 2017, management announced the sale of both assets in quick succession and a material uplift to NAV, resulting in a <5% premium at the time of writing. We continue to hold a meaningful position in the investment company, and expect to be paid a c.10% special dividend at some point in 2018 (assuming both sales are completed without issue; this, of course, is the main risk in the position today).

Finally, on the winners, it is worth noting that the 8th best performing position in the fund is our **USD/GBP Hedge**, in place to offset the currency risk that we naturally carry in the portfolio, given our global investment mandate). This speaks to the headwind faced by the fund as Sterling appreciated against the Dollar, Yen and other currencies. It also highlights the importance of having the ability to hedge such risks out.

Overall, our Top 10 outperformed our Bottom 10 by 2.96%. Our hope is to increase this spread meaningfully in 2018.

OUTLOOK

Coming into 2018 we are positive on the global economic and market outlook. The global reflation cycle (first identified in 2016) appears to be in full swing; coordinated global GDP growth, strong demand for commodities, a pick-up in manufacturing, capex and trade, rising nominal wages and, dare we say it, what appears to be the green shoots of sustainable inflation in many developed markets. A weakening US Dollar is providing for a global economy that was, until recently, starved of liquidity, notwithstanding successive bouts of Quantitative Easing (QE) following the Global Financial Crisis. Such a positive picture points us in the direction of more cyclical industries, including energy, industrials and financials, as well as Emerging Markets and Asia ex Japan. Our allocation to all of these can be seen in the "Positioning" section below.

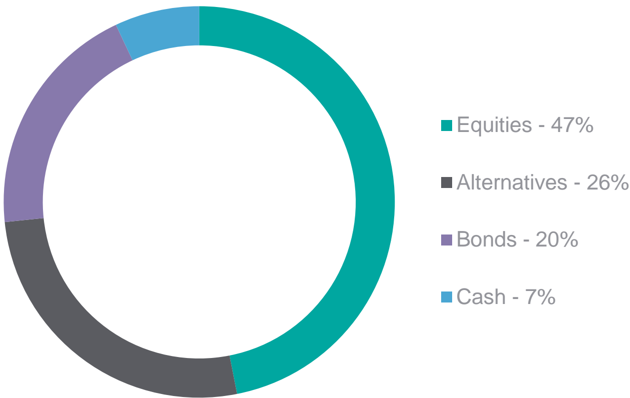
Such positioning is not without risk, however, and we are cognisant that a "left tail" (or, "unexpected") event could be detrimental to performance and present a risk to your capital. As a result, we continue to allocate to UK Gilts and US Treasuries as a hedge, as well as gold, a holding in the Waverton Protection Strategy and an allocation to US Dollars and Japanese Yen, all of which have historically been good stores of value (or indeed appreciated) in periods of market stress.

Current risks we see in the market today are as follows: first, some Chinese activity indicators are slowing, potentially implying a weaker global growth outlook than is currently priced. Second, trickles of inflation could become a flood, requiring central banks to raise rates and quantitatively tighten further, faster and more than the market is currently anticipating. Presently, we do not expect this, but an increasingly tight labour market and sustained loose financial conditions could lead to a consumer spending boom. Third, a return to disinflation or out-and-out deflation. This would be particularly damaging for a portfolio constructed to benefit from a *re*flation cycle (although we expect our bond and gold holdings to do well in such an event). Fourth, an oil price collapse or spike, a la 1970s/80s. Fifth, a return to a strong Dollar environment, which would reverse the recent benefits enjoyed by the global economy and likely result in global risk assets underperforming.

Notwithstanding a positive global outlook, as stewards of your capital we will remain vigilant in our efforts to achieve a consistent & sustainable income and protect your portfolio from permanent capital loss. Day to day, our focus is on identifying interesting risk adjusted investment opportunities to which to put your capital to work; our hope (and belief) is that we will continue to do so in 2018.

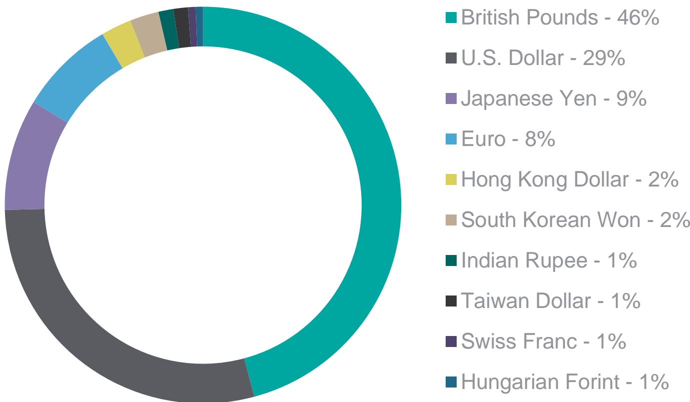
POSITIONING

Portfolio Asset Class Weights – as at 27/01/2018



Source: Waverton

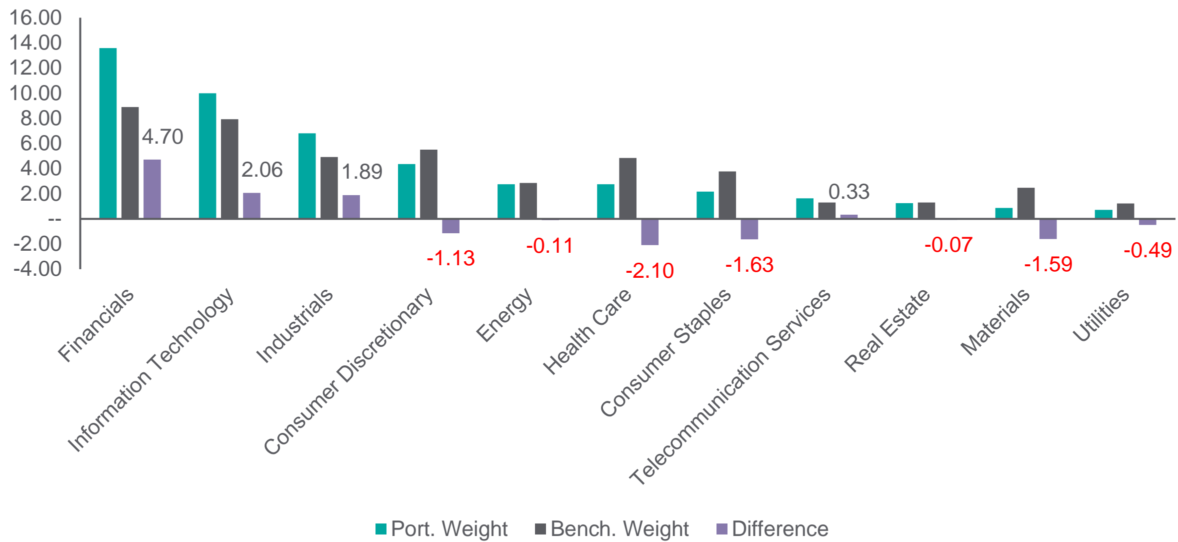
Portfolio Currency Allocation – Top 10 – as at 27/01/2018



Source: Waverton

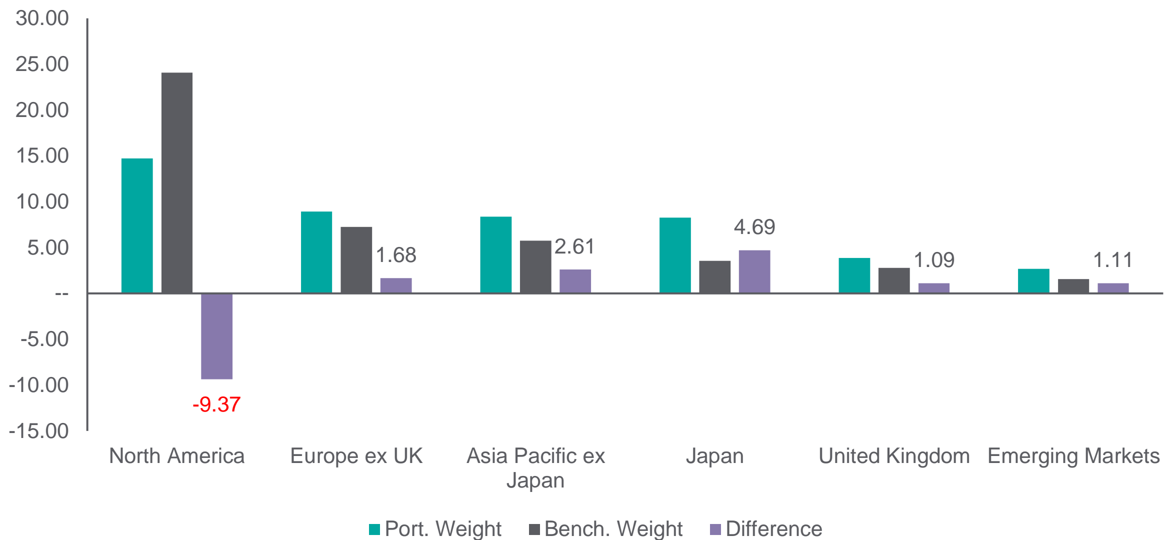
Positioning

Equity Sectors – Relative Positioning – as at 287/01/2018



Source: Waverton

Equity Regions – Relative Positioning – as at 27/01/2018



Source: Waverton

Finally, we would like to thank all of our investors for their continued support. We look forward to 2018 and beyond, and hope that we will meet and exceed your expectations of us.

James Mee
Fund Manger

January 2018

RISK WARNING

Past performance is no guarantee of future results and the value of such investments and their strategies may fall as well as rise. You may not get back your initial investment. Capital security is not guaranteed.

There is no guarantee of a return on Absolute Return Funds held. The returns for structured products may fluctuate according to different market conditions; you may get back less than you originally invested. The value of your investment is also at risk in the event that the counterparty should fail.

The opinions expressed are based on current market conditions and are subject to change. The information provided does not constitute investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security. It does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. The Fund may invest in assets which are not readily realisable or where there is counterparty risk. Changes in rates of exchange may have an adverse effect on the value, price or income of an investment.

The information contained within this document relating to 'yield' is for indicative purposes only. Clients should note that yields on investments may fall or rise dependent on the performance of the underlying investment and more specifically the performance of the financial markets. As such, no warranty can be given that the expressed yields will consistently attain such levels over any given period.

Fixed income securities which the portfolio may invest in are sensitive to interest rate risk (duration) and will increase and decrease in value as interest rates change.

The Fund may hold funds or vehicles which invest in derivative products such as futures, options, and contracts for differences. Although warrants and/or derivative instruments can be utilised for the management of investment risk, some of these products may be unsuitable for investors. Different instruments involve different levels of exposure to risk.

FURTHER INFORMATION

Where Waverton's advice is given it is restricted to discretionary investment management services. We do not provide advice on the use of tax or financial planning products (even if the service which we are managing is held within such a product) or non-discretionary investment.

All materials have been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy of, nor liability for, decisions based on such information

Should you require any further information in respect of the information included in this presentation please address all enquiries to:
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Copies of the Fund's Prospectus and KIIDs are available from the Waverton website and the administrator:
http://www.waverton.co.uk/

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