WAVERTON CAUTIOUS INCOME FUND

HUMILITY BEFORE HUBRIS

A risk in the investment management profession is that one becomes overconfident in one's abilities. Positive outcomes can be misinterpreted in hindsight as being "right", and negative as "wrong". Where performance is strong for reasons other than accurate objective analysis and forecasting, there is a risk that subjective confidence in one's abilities becomes greater than objective accuracy, which in turn leads to inappropriate portfolio construction. A key skill, then, is to distinguish between when one has been "right" and lucky.

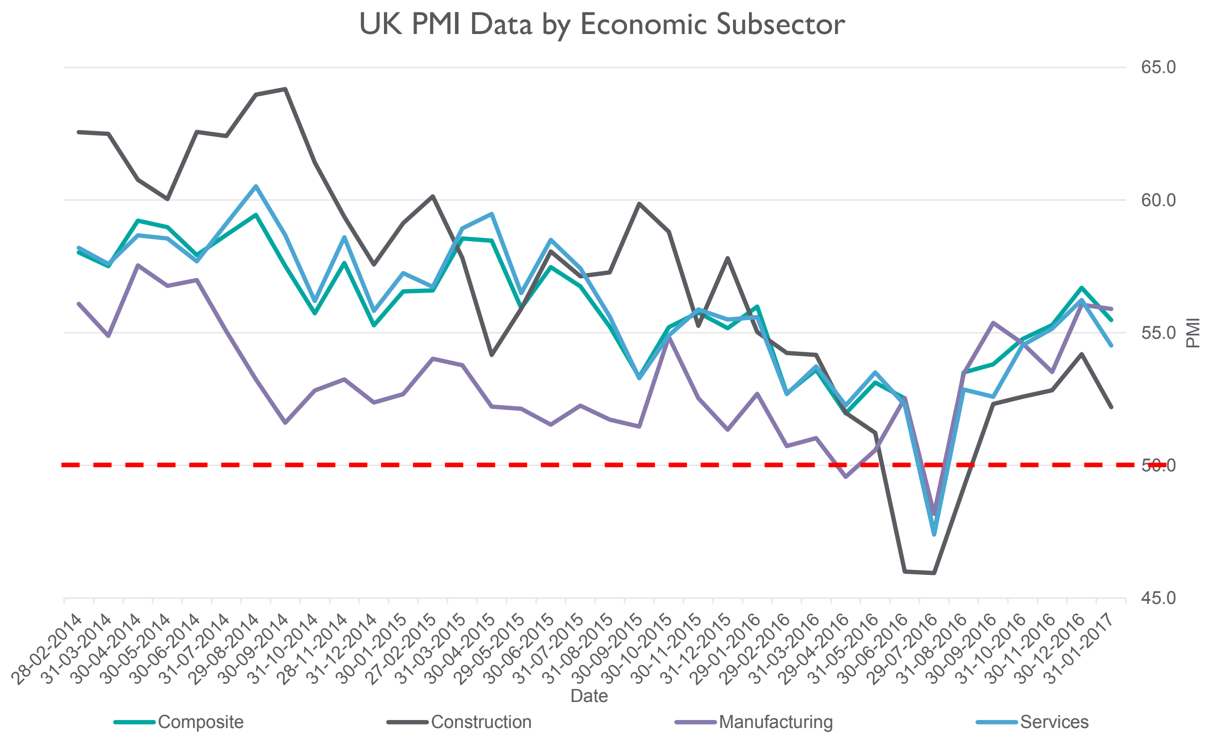
On 17th February 2016 I wrote:

"What we can (perhaps) predict, however, is that the uncertainty itself, both in the run-up to and following a Brexit vote, will be bad for the economy: businesses may be unwilling to invest, consumers unwilling to spend, and the government will be reticent to plug the gap … [and] it seems plausible that the currency will be weaker."

(Waverton Insights - http://www.waverton.co.uk/media-centre/insights/article/2016/02/17/brexit-and-the-uk-equity-market)

We were not in bad company. Indeed, the Bank of England published its bearish outlook for the UK economy in November 2016 (after the referendum result), only partially tempered in its February '17 Inflation Report . However, our assertion that "uncertainty itself … will be bad for the economy" appears now to be misguided.

Taking PMI data (below) as a proxy indicator for economic health, it appears that despite the uncertainty surrounding Brexit, the economy appears to be in rude health, with even the Construction subsector printing above 50 (numbers above 50 indicate economic expansion; below 50, contraction).



Source:: Factset, Waverton

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Consumer confidence and retail sales volume has also picked up post-referendum.

Source: Factset, Waverton

One thing we did get right was the fall in value of Sterling. The below is a one year chart of the currency versus the US Dollar, and indicates a 14% devaluation.

Source:: Factset, Waverton

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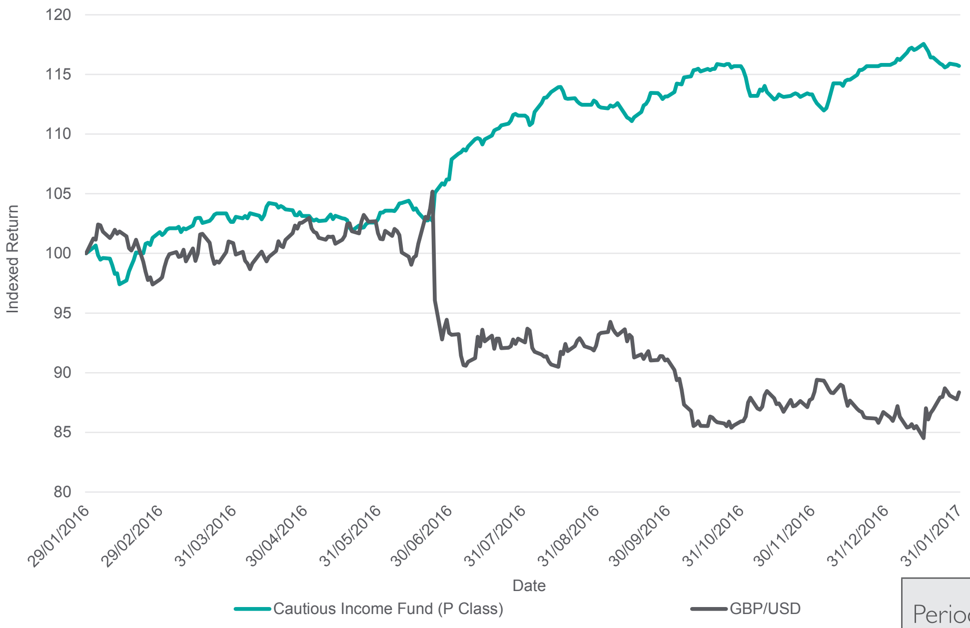
So, we are (to date) half right; the economy is holding up well, but the currency has weakened materially. The fund's one year performance versus Sterling is displayed below, which begs the question: *"why did the fund perform as it did, given just a 50% hit ratio?"*

1 Year Fund Performance vs USD/GBP Currency Move



Source: Morningstar, Waverton. Morningstar Sector: GBP Moderate Allocation

Risk Warning:

Past performance is no guide to future performance. The value of holdings may fall as well as rise and investors may not get back their initial investment. Important Information: Performance displayed is for the P Share Class. Performance is calculated on a NAV to NAV basis and does not take not account any initial fees. Performance is displayed net of fees and assumes income is reinvested.

Standardised Performance

Period 1 year to	31/01/16	31/01/17	Since Inception
Fund (%)	-1.29%	+15.72%	+22.65%
Quartile	1	2	1

The answer, in a phrase, is portfolio construction. Diversification across asset classes, geographies, styles and currencies provided a ballast to the risk that we were wrong on the specific outcome of the referendum. In addition, we were able to be agile and invest in the UK equity market on the morning of June 24th, believing that the market was misevaluating the risk to the equity market; specifically, the knee-jerk risk-off reaction was wrong in light of a depreciating currency (a lower currency means higher foreign earnings once translated back into GBP, and equity markets follow earnings).

We live in a world of probabilities; there are forecasts and scenarios around these forecasts, and we must insure against the hubris of being overconfident in our point-forecasts by having the humility to know that there is every possibility that we may be wrong. This "insurance" comes in the form of diversification. We got the call on the short-term effects on the UK economy and markets wrong, but performance was strong due to the diversified nature of the portfolio.

OUTLOOK

Today, uncertainty surrounding Brexit undoubtedly remains, and the immediate benefit of a depreciating currency on markets and the economy may soon be dominated by the negative effects of resulting imported inflation coming through the system. While sentiment readings on the economy have been resoundingly positive (see PMI chart above), we need to see "real" economic data pick-up in pursuit.

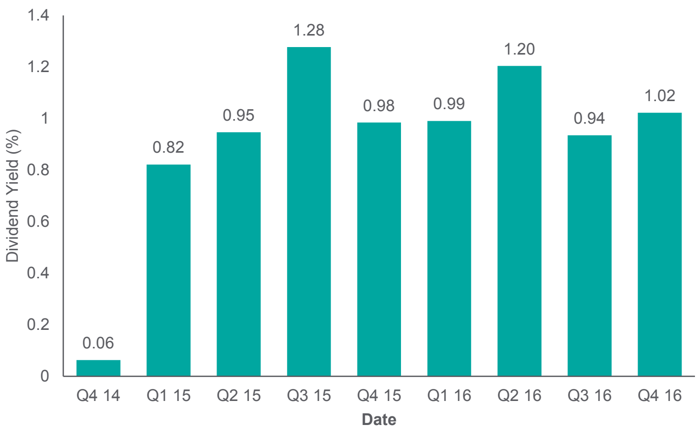
The fund remains diversified by asset class, geography, style and currency, and we continue to focus on the downside when making investment decisions

By James Mee
February 2017

WAVERTON CAUTIOUS INCOME FUND

FUND INFORMATION

Quarterly Dividend Payments



Fund Platform Availability

- 7im
- Aegon
- Alliance Trust Savings
- Ascentric
- Aviva
- Axa Elevate
- Cofunds Institutional
- Fidelity Funds Network
- Fusion
- FNZ
- Hargreaves Lansdown Vantage
- Novia
- Nucleus
- SIPP Centre
- Transact

ISIN	AMC	Ongoing Charge	Initial Charge
B Class GBP IE00BQ1KPP02	B Class GBP 0.75%	B Class GBP 1.65%	None
P Class GBP IE00BQ1KPQ19	P Class GBP 0.40%	P Class GBP 1.30%	

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