Quarterly Report

February 2018

The Future Money strategies are run with the aim of providing investors with carefully risk managed investment solutions.

This report is designed to provide an insight into how the four strategies have been managed, along with the thought processes behind the investment decisions made by the fund managers.

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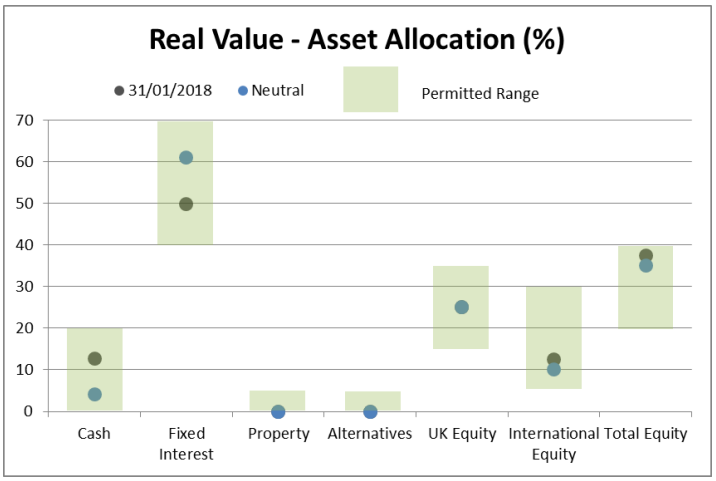
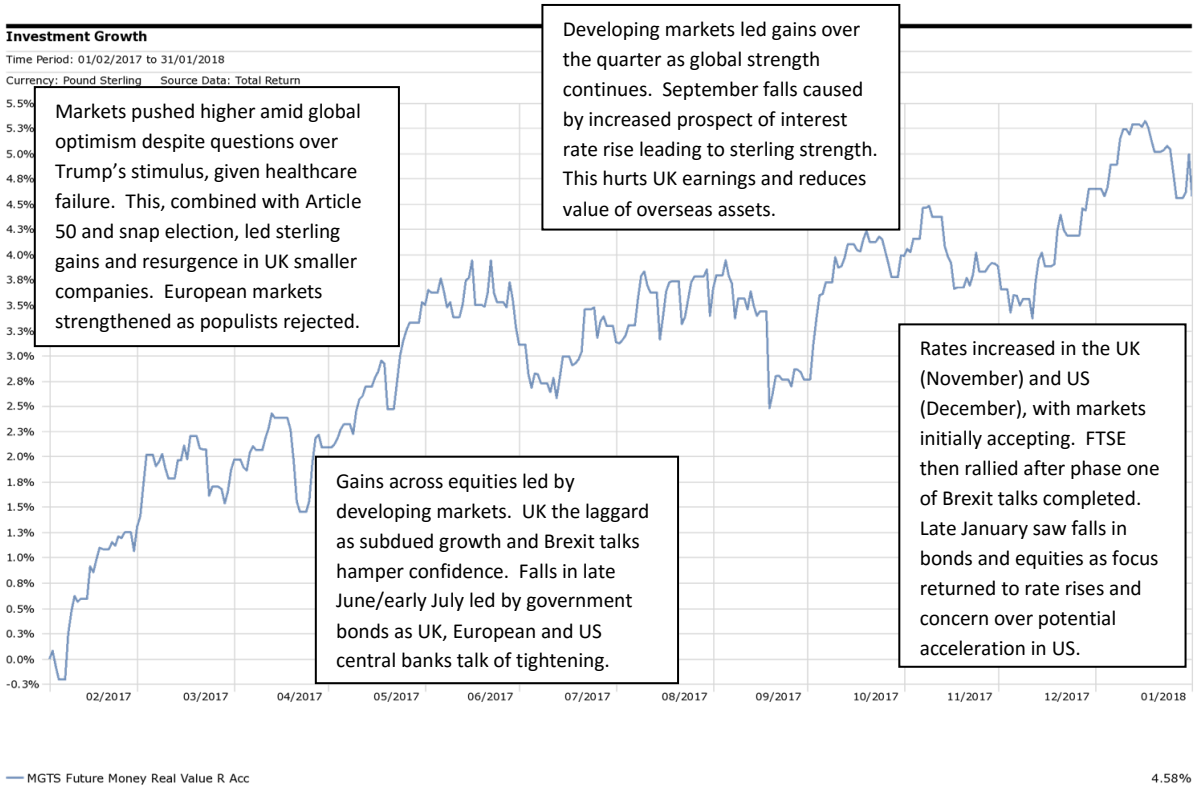
MGTS Future Money Real Value

No changes were made to Real Value's fund selection during the quarter, yet the target equity allocation was increased to 37.5%. This represents the mid-point between the portfolio's neutral and maximum allocation and reflects our belief that equities are the most attractive asset class looking over the medium term.



For diversification purposes and to limit volatility, the portfolio has approximately half its assets in bonds. This contains a significant bias towards short dated funds. These have less exposure to moving yield levels and therefore typically produce more defensive performances. Corporate bonds are preferred to government bonds due to the value still available in credit spreads, and the higher quality area of investment grade is favoured within this.



Past performance is no guarantee of future performance. The value of investments can fall as well as rise and investors may not get back their original investment.

Source: Morningstar Direct

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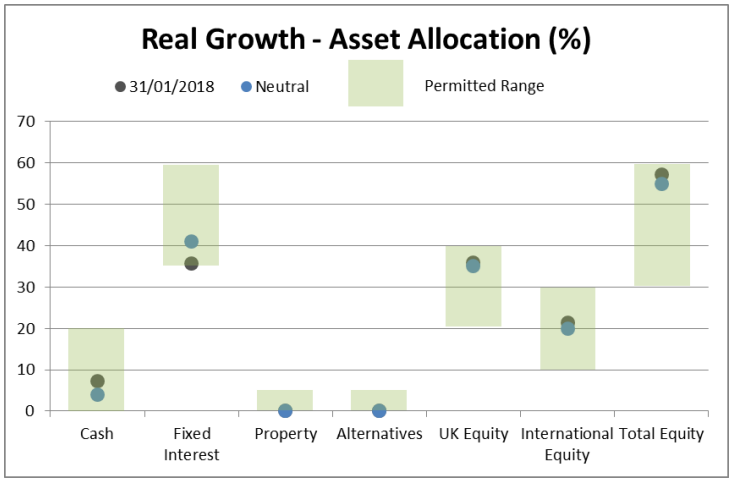
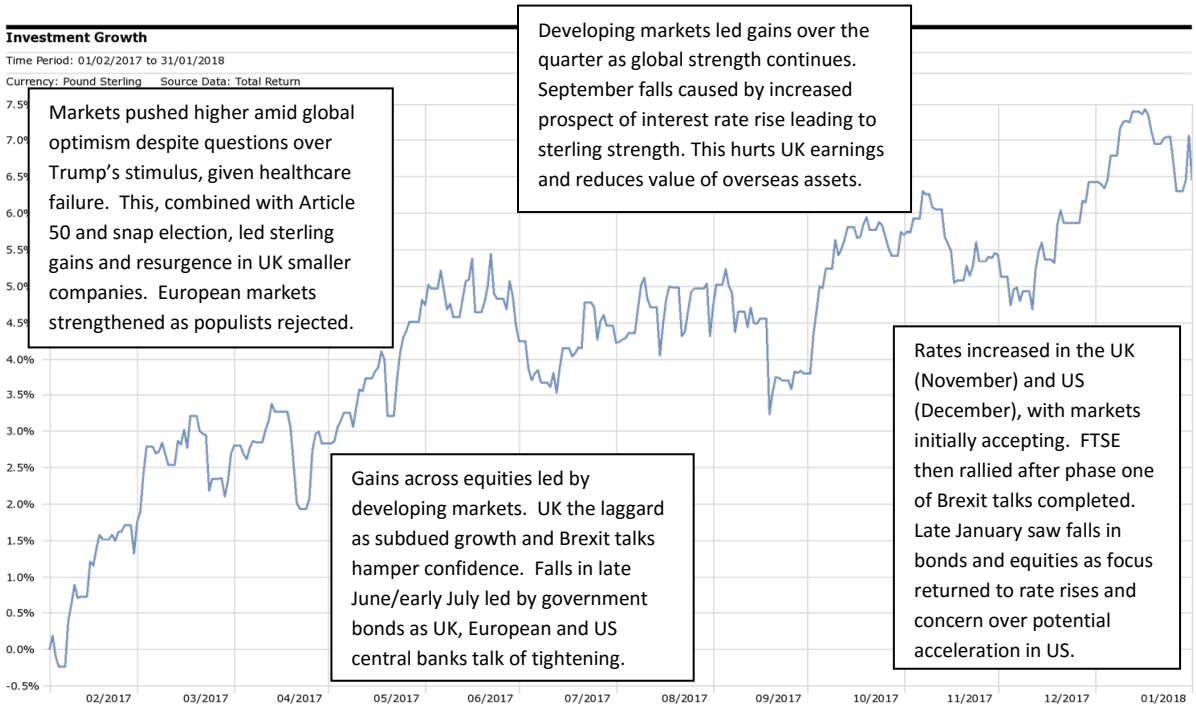
MGTS Future Money Real Growth

No changes were made to the fund selection of Real Growth over the quarter. Equity allocations were increased, however, with 2% being added across the existing exposure.

With global economies experiencing synchronised growth and with inflation levels starting to increase, we believe conditions over the medium term will favour equities above other asset classes.



Following strong gains in late December, some profits were taken in January, but the portfolio remains overweight to stocks. The market falls in late January (and into February), have affected the portfolio, but elsewhere, the exposure to short dated bond funds has been beneficial, as long duration assets sold off amongst the rising yields of this period.



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Source: Morningstar Direct

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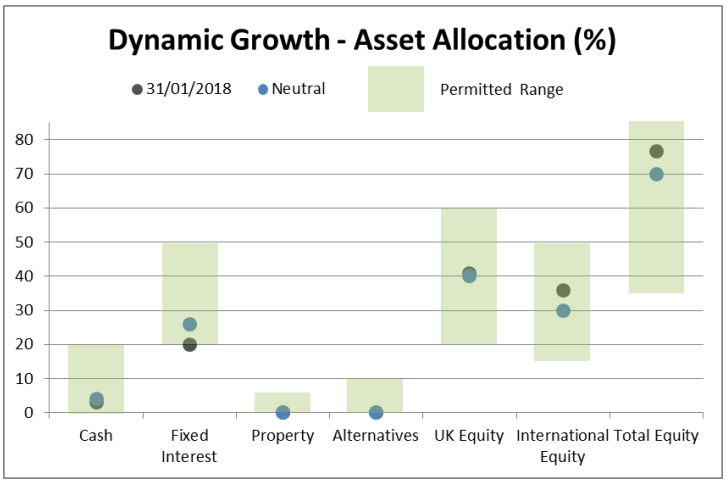
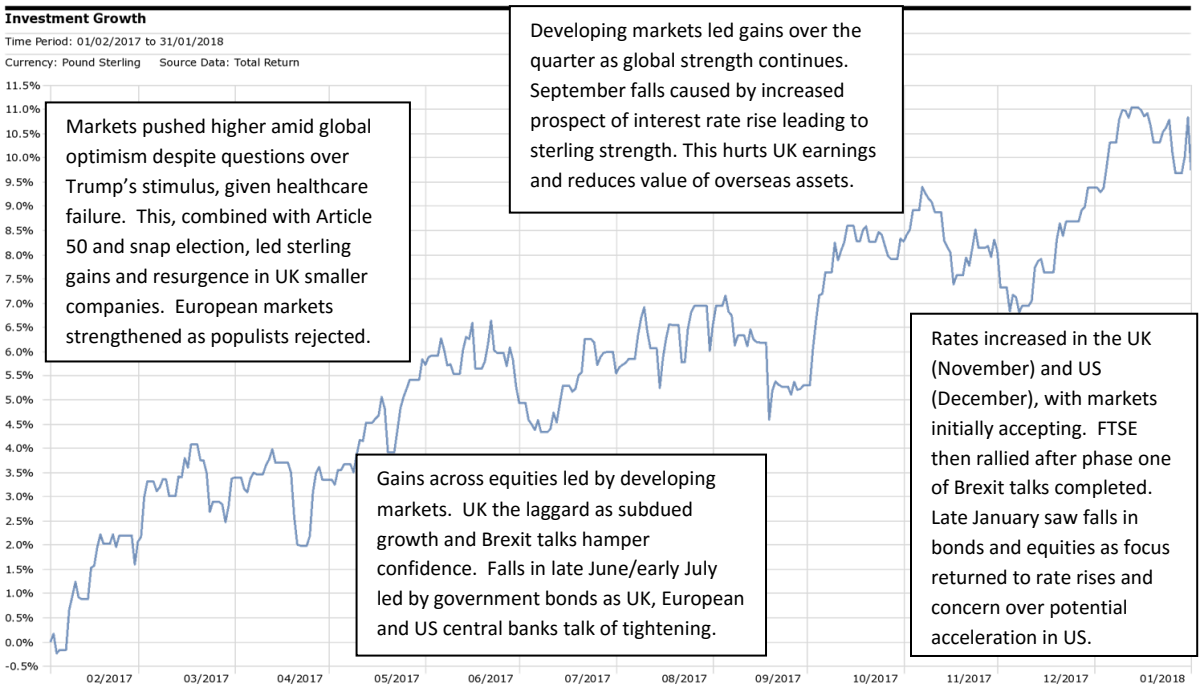
MGTS Future Money Dynamic Growth



Two changes were made to Dynamic Growth's exposure to developing markets during the quarter. Both the M&G Asia and Somerset Emerging Markets Dividend Growth funds were sold in November. M&G was replaced with BlackRock Asia, which is available at lower cost and which is considered an attractive pairing alongside the Fidelity Asia fund already held. The different allocations of each fund provides elements of diversification, and specifically, the lower weighting to the technology sector in BlackRock is attractive, given strong gains in this sector recently.

Somerset was replaced with Invesco Perpetual Global Emerging Markets. The Invesco fund is cheaper than Somerset and also has a more balanced approach to investing compared to the defensive profile of Somerset. We believe this move is appropriate given our view that emerging economies are set to benefit from a continuation of global economic strength.



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Source: Morningstar Direct

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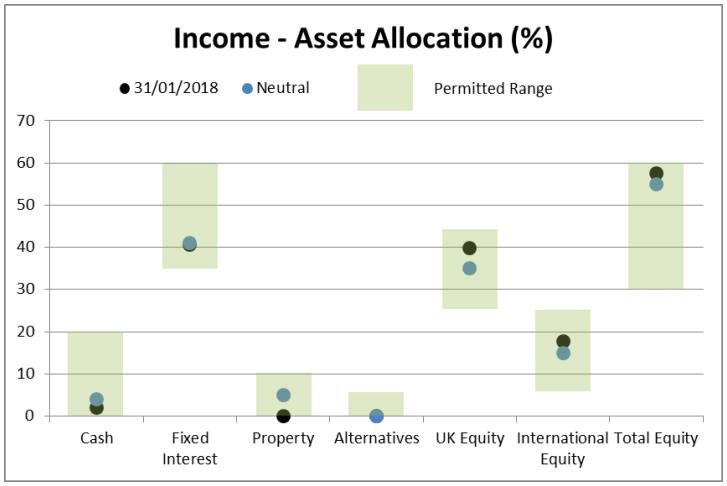
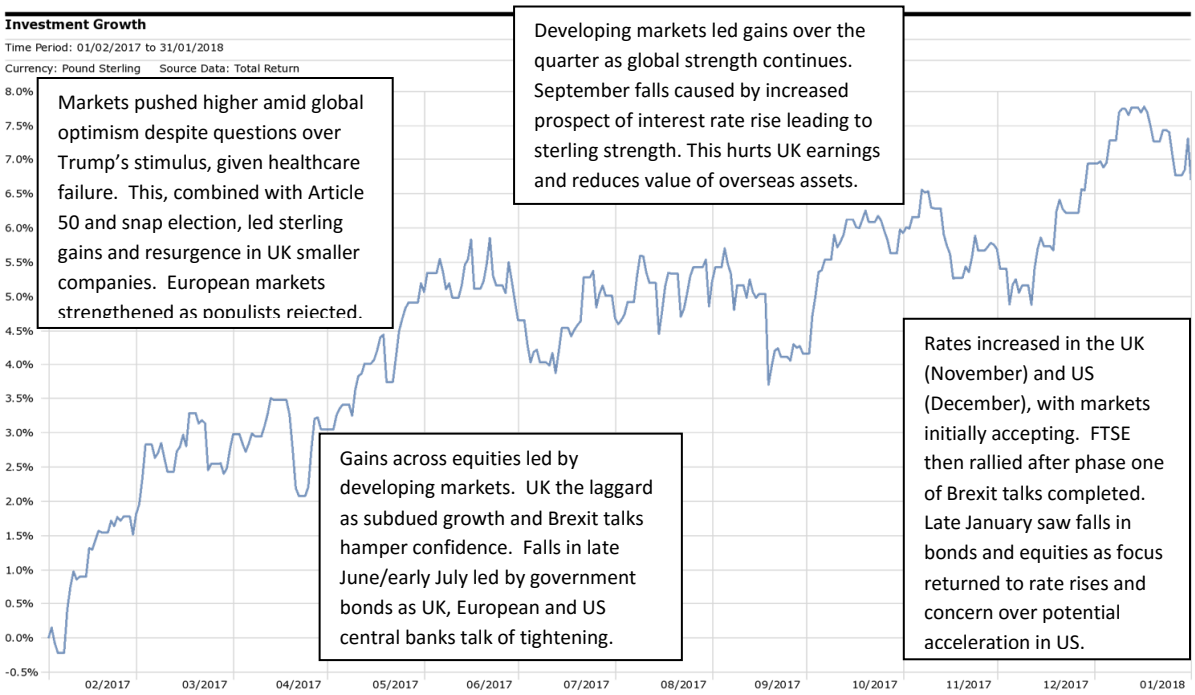
MGTS Future Money Income

The portfolio's European equity exposure was changed during the quarter, with BlackRock Continental European Income fund replacing Standard Life Investments European Equity Income. The switch was made primarily due to the greater yield available on the BlackRock fund (c. 3.6% vs c. 2.8%) and its focus on sustainability in this yield.



The target equity allocation of the portfolio was increased in mid-December to halfway between the portfolio's neutral and maximum allocation. Valuations rose strongly over the following weeks and hence sales were made in early January to crystallise the gains above this new target. We believe an overweight equity allocation remains attractive given the ability for companies to generate both capital gains and dividend yields above the rate of inflation, despite expected increases in the price level.



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Performance

	Year to Month End	1yr	3yr	5yr
	01/01/2017	01/02/2017	01/02/2015	01/02/2013
	31/01/2018	31/01/2018	31/01/2018	31/01/2018
MGTS Future Money Income R Acc	-0.23	6.70	17.32	37.98
MGTS Future Money Real Value R Acc	-0.07	4.58	11.40	26.24
MGTS Future Money Real Growth R Acc	0.02	6.45	16.76	34.54
MGTS Future Money Dynamic Growth R Acc	0.33	9.74	24.00	47.45

	2017	2016	2015	2014	2013
MGTS Future Money Income R Acc	7.30	9.21	2.60	4.59	13.03
MGTS Future Money Real Value R Acc	4.61	6.99	1.10	4.87	8.57
MGTS Future Money Real Growth R Acc	6.66	9.61	1.76	4.60	11.40
MGTS Future Money Dynamic Growth R Acc	10.36	13.88	1.45	3.11	16.86

Source: Morningstar Direct. Currency: Pound Sterling. Total return. Past performance is no guarantee of future performance. The value of investments can fall as well as rise and investors may not get back their original investment.

Economic and Market Commentary

All figures sourced from Morningstar Direct unless otherwise stated.

31 October 2017 to 31 January 2018

Whilst our quarterly reports cover a specific period of time, they are actually written a few days after the end date. For this quarter, we expect investors will be interested in the events that triggered sharp falls in the first few days of the next quarter, especially given the media coverage this has attracted. Therefore we are extending the period slightly as this review has been edited into the final form on 09 February 2018.

In terms of the quarter itself, markets continued to provide positive returns for equity investors with the FTSE 100 returning 1.13% and the FTSE World Index returning 2.11%. Fixed interest investors have seen small returns from corporate bonds (measured by the Investment Association Sterling Corporate Bond sector) which rose by 0.81%, and there was a small fall in the value of gilts, with the FTSE Actuaries UK Conventional Gilt index falling by 0.35%, the second quarter in a row that UK gilts fell in value.

Within the various equity sectors the most notable performance came from Global Emerging Markets, returning 4.31%, Asia Pacific ex-Japan returning 3.12% and North America returning 2.65%. Europe ex-UK, which performed well generally during 2017, lagged in the last quarter returning 0.78%.

As at the end of the quarter, investors had generally enjoyed another quarter of strong returns capping off a good year during which, the FT World Index increased in value by 12.72%.

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The areas we intend to cover in this update are; why investment markets have performed so strongly in recent years, what caused the recent fall in values, and what the outlook is from here.

The strong performance from equities in recent years has been due to the global economy performing better than expected, and the higher forecast for economic growth leading to increased confidence that company earnings will rise in the future, boosting share prices.

This current environment of economic strength emerged slowly from a period of intense anxiety in 2009 following the systemic failure of the global banking system. The path to recovery was created through dramatic action from central banks, cutting interest rates and printing trillions of dollars (or their equivalent local currency) in order to reduce borrowing rates to historical lows. This provided cheap finance and liquidity to the entire global economy and was ultimately successful in restoring economic growth.

At the present time the International Monetary Fund (IMF) is predicting that all of the economies it represents will experience positive growth in 2018. This picture of synchronised economic growth is a firm signal of confidence and is reinforced by various other economic leading indicators. The Purchasing Managers Index is considered to be a reliable indicator of the future as the information is gathered through business surveys and provides an understanding of current business conditions. This index is also showing expansion in all of the major economies, with a reading above 50.

These factors combined to provide further upward momentum to stock markets which had already enjoyed a sustained period of growth with historically low levels of volatility. Towards the end of the quarter some falls were seen, which accelerated in recent days. At the time of writing the Dow Jones, which measures the performance of the largest US company share prices, has fallen by approximately 10% from the peak whilst the FTSE 100 has fallen by around 8%. What has triggered these falls and what should investors expect from here?

Whilst the recent downturn has been in contrast to the previous period of stable upward returns, corrections of this type are normal, and occur frequently in both upward and downward long term trends. One of our responsibilities as investment managers is to stress test these types of events when constructing portfolios, to establish that the level of risk is appropriate to the objectives that we are aiming to achieve. The timing of a correction is often a surprise but the correction itself is expected.

Corrections often indicate a change in market expectations and understanding, which can be used to identify investment opportunities going forward and also have a useful cleansing effect. This can be visualised as the outgoing tide levelling the sand, after a sunny day at the seaside. On this occasion it has been interesting to note that some assets, which have shown bubble like tendencies, have been hit hard with the obvious example of Bitcoin, which has fallen from a peak around $20,000 to under $10,000.

The cause of the alarm on this occasion is good news, in our opinion, and closely follows the views we have expressed in previous updates. Figures from the US, relating to the labour market, showed healthy levels of employment and wages increasing at a higher rate than previously thought. The prospect of people earning more and finding work easily is a sign of strong economic growth and is usually something to be cheered. On this occasion stock markets greeted the news with pessimism; why?

Within our previous updates we have discussed the interest rate cycle, which has been falling since the 1980s, representing a very long cycle length. In addition, we proposed that few investors had experience of a rising rate environment as most careers of investment professionals did not go back that far. Furthermore we felt that the improvement in economic conditions suggested that this long term cycle was changing and we were now entering an upward interest rate cycle, which would change the behavioural characteristics of many asset classes.

The recent market downturn is a reflection of investors generally coming to the same conclusion and becoming concerned that interest rates will now rise, as central banks take action to keep inflation at around 2%. The era of cheap money is coming to an end and undoubtedly there are many assets which have seen their valuations fluffed up by this phenomenon and are now looking vulnerable. Where assets sell-off in one sector the effect of market correlations often causes sell-offs in other assets.

Some assets go on to recover their value whilst others do not. Fixed interest investments are sensitive to interest rate rises, as are companies reliant on ongoing capital raising, because the increase in interest rates has a detrimental effect on both of these asset values. Within these markets there are some worryingly high valuations, particularly within high yield bonds, long dated bonds and companies with massive valuations, but with negative earnings. We have been positioned away from these assets prior to the recent downturn and we expect that some of the losses being experienced in these areas may not be recovered.

In terms of the broader markets we have reasons to expect asset prices to regain their upward momentum and these falls represent a buying opportunity rather than a signal of a prolonged downturn. Whilst central banks are moving into a rate rising cycle we expect this to be a very slow and measured process. Given the significant efforts which have been made to drag the global economy out of the 2009 credit crisis we believe that central banks will be anxious about choking off the economic recovery and therefore inflation will be allowed to run over target rather than pursued aggressively, at least in the early years of the rate rising process.

For example, interest rates in the UK are currently 0.5% and, at the most, are expected to rise to 1% by then end of the year even after the latest comments from Mark Carney, the Governor of Bank of England, suggesting that rates would move earlier and higher than previously expected. A future

rate of 1% is hardly an economic activity choking prospect and would still be a historically low level although it would be bad news for interest rate sensitive assets as mentioned previously.

Furthermore the wage inflation which has caused the recent concern is actually preferable, in the medium and long term, to the alternative of stagnant wages. In order to continue an upward economic cycle it is important that wages rise in real terms in order to allow future consumption to rise. If wages do not rise faster than inflation then consumer debt builds to the point that consumption falls dramatically and leads to a recessionary outcome.

It is our view that the current shakeout of asset prices is a useful and necessary event. The assets most at risk are these which have benefited from speculative interest or where the valuation is heavily dependent on a low interest rate environment. Growth stocks have benefitted considerably in the market rises and some of these stocks now look vulnerable.

Tesla is a useful example, and this business requires new capital of hundreds of millions of dollars a year in order to keep trading, as revenues do not come close to meeting operating costs. Whilst a company like this may change the world in the future the inherent risks to investors are obvious and if capital is more expensive in the future this will add additional costs to the business model pushing the breakeven position even further into the future.

Value orientated stocks have provided reasonable returns but have not generally kept up with their growth counterparts. These companies have mature and predictable business models and whilst their upside potential is more modest they tend to be driven favourably by economic growth and are not sensitive to the relatively modest interest rate rises which are now expected.

Strategy

In conclusion, whilst it is difficult to predict how long or how low a correction will go, we remain confident that global equity markets will continue in an upward cycle. The current market conditions provide an opportunity to increase equity positions with a bias towards companies linked to economic growth, which is expected to remain positive. The rate rising cycle will be gentle, but negative for fixed interest investments, which have a high degree of sensitivity and we have already limited our exposure to these areas.

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Asset Class Review

The following table shows the performance of the major asset classes over the past ten years, as well as year to date. This highlights the difference in returns achieved from one year to the next and shows the importance of actively managing asset allocations.

Investment Returns (%)

As of Date: 31/01/2018 Currency: Pound Sterling Source Data: Total Return

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	YTD
Best	Gilts 12.8	UK Small Cap 63.4	UK Mid Cap 28.4	Gilts 15.6	UK Small Cap 35.0	UK Small Cap 44.2	North America 19.6	Japan 17.6	Emerging Markets 35.4	Asia ex Japan 23.4	Emerging Markets 3.6
	Cash 4.6	Emerging Markets 62.5	Asia ex Japan 23.9	Corporate Bonds 4.3	UK Mid Cap 28.7	UK Mid Cap 34.9	Gilts 13.9	UK Small Cap 13.6	North America 34.1	Emerging Markets 21.1	Europe ex UK 1.4
	Japan -1.1	Asia ex Japan 55.5	Emerging Markets 23.6	North America 1.2	High Yield 18.9	North America 28.3	Property 12.8	UK Mid Cap 12.0	World ex UK 30.4	UK Mid Cap 18.2	Asia ex Japan 1.3
	Corporate Bonds -9.8	UK Mid Cap 52.8	North America 19.1	Cash 0.5	Asia ex Japan 17.5	Japan 24.9	World ex UK 12.3	Europe ex UK 5.5	Asia ex Japan 28.7	Europe ex UK 16.9	World ex UK 0.4
	North America -13.3	High Yield 47.9	Japan 19.0	UK Large Cap -2.2	Europe ex UK 17.4	Europe ex UK 24.0	Asia ex Japan 10.0	North America 5.3	Japan 22.7	UK Small Cap 16.3	High Yield 0.4
	World ex UK -17.1	UK Large Cap 27.3	UK Small Cap 17.5	High Yield -3.1	Corporate Bonds 13.3	World ex UK 22.7	Corporate Bonds 9.8	Property 5.3	Europe ex UK 21.2	Japan 14.4	North America 0.3
	High Yield -25.4	Europe ex UK 21.8	World ex UK 16.7	Property -5.6	Emerging Markets 12.8	UK Large Cap 18.7	Emerging Markets 7.9	World ex UK 4.8	UK Large Cap 19.1	World ex UK 13.5	Cash 0.0
	Europe ex UK -25.9	World ex UK 18.9	Property 12.6	World ex UK -6.1	Property 12.5	High Yield 6.9	UK Mid Cap 2.8	Gilts 0.6	UK Small Cap 12.7	UK Large Cap 11.9	Cor-porate Bonds -0.5
	UK Large Cap -28.3	North America 14.8	UK Large Cap 12.6	UK Mid Cap -10.3	World ex UK 11.9	Property 5.4	Japan 2.7	Cash 0.5	High Yield 10.1	North America 11.3	Japan -0.6
	Property -30.0	Corporate Bonds 14.7	High Yield 12.1	Japan -12.9	North America 10.7	Asia ex Japan 1.3	High Yield 1.0	Corporate Bonds -0.4	Gilts 10.1	Property 7.1	UK Small Cap -0.8
	Asia ex Japan -33.0	Property 14.4	Corporate Bonds 7.7	Asia ex Japan -14.8	UK Large Cap 10.0	Corporate Bonds 0.6	UK Large Cap 0.7	High Yield -0.9	Corporate Bonds 9.0	High Yield 6.1	Property -1.9
	Emerging Markets -34.8	Cash 0.6	Gilts 7.2	Europe ex UK -15.0	Japan 3.3	Cash 0.5	Cash 0.5	UK Large Cap -1.3	Property 8.5	Corporate Bonds 5.1	UK Large Cap -2.0
	UK Mid Cap -38.4	Gilts -1.2	Europe ex UK 6.6	UK Small Cap -15.3	Gilts 2.7	Gilts -3.9	Europe ex UK -1.4	Asia ex Japan -3.5	UK Mid Cap 5.1	Gilts 1.8	Gilts -2.0
Worst	UK Small Cap -48.0	Japan -5.8	Cash 0.5	Emerging Markets -18.4	Cash 0.5	Emerging Markets -5.3	UK Small Cap -1.7	Emerging Markets -10.3	Cash 0.4	Cash 0.3	UK Mid Cap -2.6

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Source: Morningstar Direct

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Asia Pacific equities excluding Japan were the strongest asset class of 2017. The developing markets of the East have very strong long term prospects given young and increasingly educated populations. This is expected to sustain high levels of economic growth and in doing so will likely be the driving force of the global economy over the coming decades. In the medium term, prospects for the region are positive as well given valuation discounts relative to the developed world. Recent years have seen the perceived security of the West prove a major draw for global investors. Looking at the short term and prospects for the region can be mixed. This has generally been determined by the Risk-On/Risk-Off mood of the market. The past year has not seen this pattern, however, given the rise of political risk in the West. Traditionally, developing markets have been characterised by the risk of political instability, but given Donald Trump's unorthodox style and the risks to both the UK and Europe from Brexit negotiations, investors are increasingly favouring the developing world. Political conditions are relatively stable allowing the growth and low valuations of Asian companies to be appreciated.

The Emerging Market region was the second best asset class of 2017. The comments made for Asian markets, above, can largely be applied here as well, given significant overlap in the geographic coverage of the classifications. However, an additional boost for the Emerging Markets has been the improved prospects for commodities. With many non-Asian Emerging Markets being net exporters of oil and other natural resources, the rising prices are helping restore cash flows to these regions after a trying few years.

Gilt yields dropped through the first half of the yield as concerns related to Brexit and the UK's economic strength arose, they then rose in latter months as inflation expectations built, but a fourth quarter rally left the benchmark 10 year gilt yield fractionally lower than at the start of the year. This led to a low, but positive, performance over the year of 2017, meaning that gilts lagged all other asset classes, as economic growth and moderate inflation created attractive conditions for assets with the ability to grow their value. Corporate bonds were the second worst non-cash asset class of 2017 as they too were eclipsed by the value creation ability of global equities. However, they beat gilts as the positive economic environment rewarded the credit risk present in corporates, but not in gilts.

Important Information

Please note that the contents are based on the author's opinion and are not intended as investment advice. This information is aimed at professional advisers and should not be relied upon by any other persons.

Any research is for information only, does not constitute financial advice or necessarily reflect the views of the author and is subject to change.

It remains the responsibility of the financial adviser to verify the accuracy of the information and assess whether the fund is suitable and appropriate for their customer.

Past performance is not a reliable indicator of future performance. The value of investments and the income derived from them can fall as well as rise and investors may get back less than they invested.

Important information about the funds can be found in the Supplementary Information Document and NURS-KII Document which are available on our website or on request.

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