LF BENTLEY
STERLING INCOME FUND

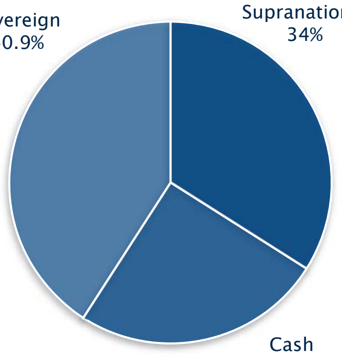
31ST MARCH 2019

BENTLEY REID

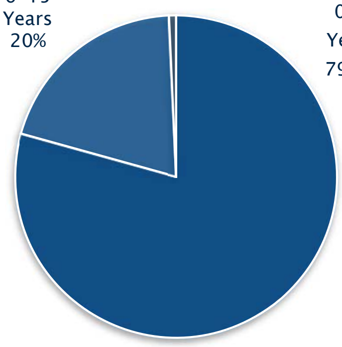
INVESTMENT OBJECTIVE

The Income fund invests in a diversified portfolio of high quality fixed interest investments. The aim of the fund is to achieve a return in excess of sterling cash rates over any three year period. The fund seeks to achieve this goal with low volatility and limited downside. To limit the currency risk the fund may only invest in sterling assets.

ASSET ALLOCATION



BOND MATURITY BREAKDOWN



SUPRANATIONAL BONDS	**34.0%**
EIB 5.375% 07/06/2021	15.7%
KFW 0.375% 15/12/2020	11.1%
KFW 5.55% 07/06/2021	7.2%
SOVEREIGN BONDS	**5.8%**
Vanguard US Govt Bond £ Hedged	5.8%
SOVEREIGN INDEX-LINKED BONDS	**35.1%**
UK Index-Linked Gilt 1.875% 22/11/2022	13.1%
UK Index-Linked Gilt 0.125% 22/03/2024	12.3%
UK Index-Linked Gilt 2.5% 17/07/2024	9.2%
UK Index-Linked Gilt 0.125% 22/03/2068	0.5%
CASH	**25.1%**

QUARTERLY INVESTMENT REPORT

The major Central Banks have staged a complete U-turn since the start of the year by promising to end their tightening plans, whilst laying the foundations for a return to rate cuts and potentially more QE. This caused global bond yields to slump, benefiting the fund's supranational and index-linked holdings. It produced a 0.4% gain over the quarter, which takes its annual total return to 1.4%.

The UK index-linked gilt positions responded well to the fall in inflation-adjusted (real) yields. This occurs when nominal bond yields fall, but inflation remains sticky or rises. UK CPI continues to oscillate around the Bank of England's 2% target, but the 10-year gilt yield fell by almost 0.3% last quarter. It briefly traded below 1% for the first time since 2017. This had a significant impact on the 2068 UK linker position that we established last year. Such is its (inverse) sensitivity to real yields that its price rallied by 15% over the quarter. We booked some profits after a 25% intra-month spike in March, taking it back to a 0.5% weighting, but despite the modest allocation it contributed most to the fund's quarterly return.

continued overleaf

PERFORMANCE (NET OF FEES)*

Cumulative	3 Months	YTD	1 Year	3 Year (Ann.)	5 Year (Ann.)
Fund	0.4%	0.4%	1.4%	0.3%	0.3%
Benchmark	n/a	n/a	3.1%	3.0%	4.5%

12 Months to	31 Mar 19	31 Mar 18	31 Mar 17	31 Mar 16	31 Mar 15
Fund	1.4%	-2.0%	1.5%	-0.8%	1.6%

** the 3 and 5-yr figures for the fund and benchmark return are annualised averages.*

The fund's conventional bond holdings also made progress as yields fell across the curve, meaning capital values increased. We continue to allocate a third of the fund's exposure to a quasi-UK gilt exposure (via 3 supranational issues that provide a modest yield uplift compared to a pure government bond issue), but this is exclusively via short-dated paper with maturities of less than 2 years.

The Bank of England (BoE) also retreated from its future rate hike plans because of mounting growth concerns. It has cuts its forecast for 2019 GDP growth from 1.7% to just 1.2%. If this proves to be an accurate projection, it will be the UK's weakest growth since the financial crisis a decade ago. Recent economic indicators reinforce the BoE's gloomy outlook; quarterly GDP growth came in at just +0.2% in the 3 months to the end of January. The manufacturing sector remains weak as Brexit and the global trade slump take their toll, but household spending is proving resilient (for now), buoyed by a record 76.1% employment rate for the 16-64 age group.

UK recession risks are clearly building, but this is a global trend. Indeed, parts of the European economy are already contracting with Italy entering a technical recession (defined as 2 consecutive quarters of negative growth) as 2018 drew to a close. Of greater concern is Germany's pronounced slowdown that has caused the 10-year German Bund yield to turn negative for the first time since 2016. This means that at the quarter-end, investors were willing to pay 0.07% p.a. to lend funds to the German government for a decade. In fact, it is worth noting that a total U$10trn worth of global bonds now have negative nominal yields.

A sluggish Eurozone will likely weigh on the UK economy regardless of the Brexit outcome, which argues against there being a marked acceleration in UK activity. However, it seems reasonable to assume that Brexit will determine the near-term outlook for UK gilt yields; a "hard" exit will likely spark a renewed safe-haven bid for government paper, leading to even lower yields. Conversely, any "soft" withdrawal from the EU should see gilt yields trade above their current levels. Either way, with UK CPI inflation of 1.9% y/y, negative real yields help to explain our preference for owning only ultra-short dated conventional paper; longer-dated gilts would suffer a capital loss if nominal (and real) yields were to increase on a benign Brexit outcome.

The fund still owns a 6% exposure to the Vanguard US Government Bond index, which is hedged back into sterling and produced a total return of almost 2% last quarter. The Federal Reserve has adopted a more dovish stance, promising no more rate hikes and a premature end to "Quantitative Tightening" (the process of selling the bonds bought during its quantitative easing program) later this year. The removal of this structural seller has caused US Treasury (UST) yields to tumble with the 10-year UST now yielding just 2.4%. It peaked slightly above 3.2% last November.

In general, the economic evidence is consistent with a marked slowing of US growth rather than an outright recession, suggesting bond yields may have fallen too far. However, US recession risks remain sufficiently high for us to retain the hedged UST exposure; an economic contraction would almost certainly see bond prices rally (and yields fall) even further.

PORTFOLIO ACTIVITY

INCREASE CASH EXPOSURE (14.3% to 25%):
Bond maturity EIB 1.5% 01/02/2019 (-10.7%)

KEY FACTS

Price	£0.9167	NISA	Yes
Fund Size	£13.8m	Launch Date	06/02/2007
Distribution Yield	0.62%	Bloomberg Code	CFSTIIN LN
Benchmark	Composite*	ISIN	GB00B1LHH164
Initial Fee	0%	ACD	Link Funds Solutions Limited
Fees	0.5% AMC	Depositary	BNY Mellon Trust & Depositary (UK) Ltd
Ongoing Charge Figure	0.91%	Prices Published	www.bentleyreid.com
Minimum Investment	£5,000		

CONTACTS

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