ESTATE CAPITAL INVESTMENT PORTFOLIOS

OUTLOOK

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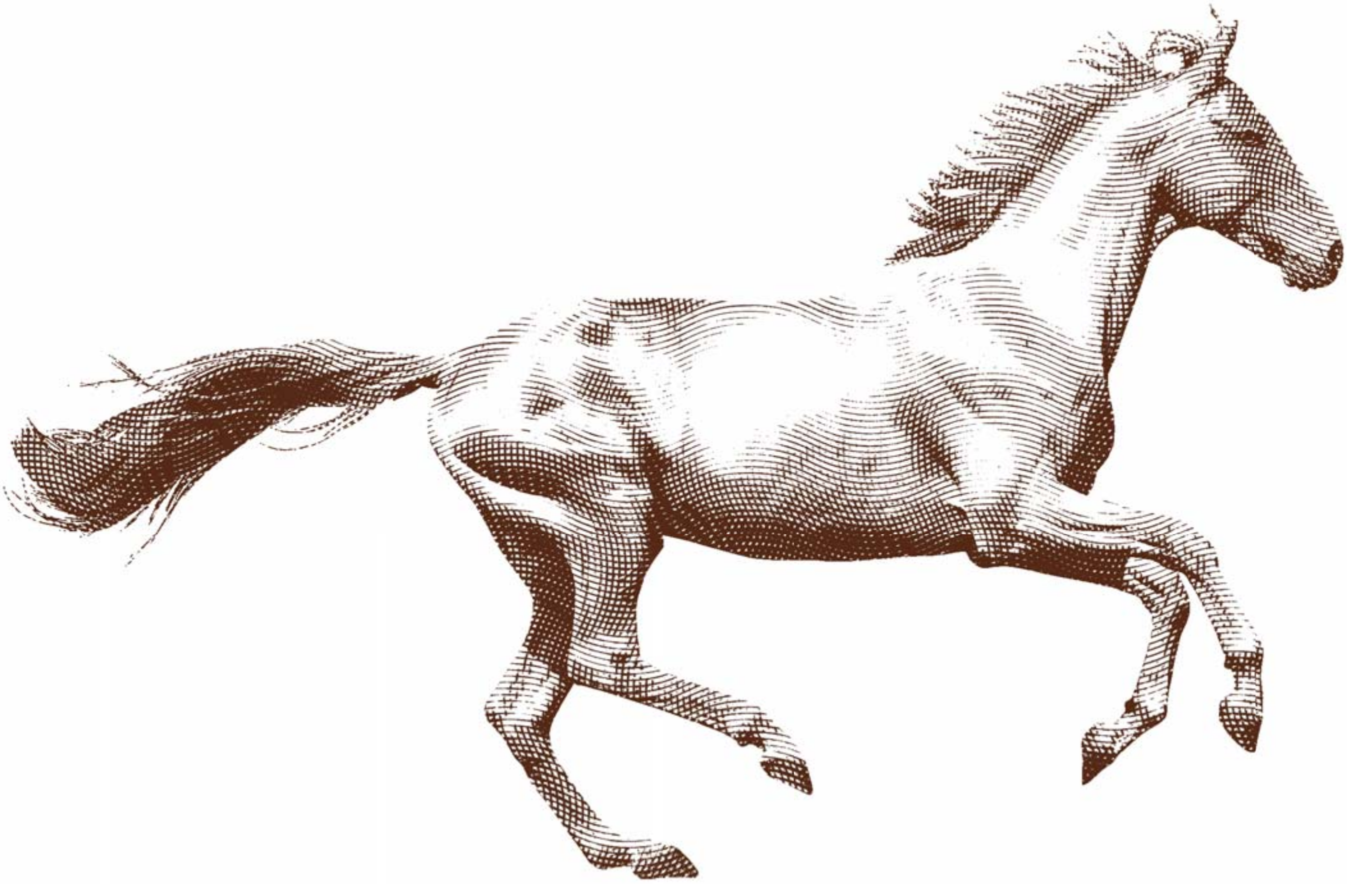

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ESTATE CAPITAL

Some air is starting to leak out of the reflationary balloon

Since the summer of 2016, when evidence of China's economic stimulus started to impact upon markets, the hopes of a rise in global growth and a return of inflation have grown.

This hope gained impetus when Donald Trump was elected President of the USA as he was expected to implement tax cuts and increase government spending. The major stock markets of the developed world reached new all-time highs in 2017 but some air is now starting to leak out of the reflationary balloon. Markets are starting to rein in their expectations of inflation growth over the next few years in the US, UK and EU.

The International Monetary Fund (IMF) are forecasting world growth to hit 3.5% this year and 3.6% in 2018 as overall global inflation is expected to rise. Economic surveys continue to show improving global activity driven by a manufacturing upturn in many countries which in turn is boosting international trade.

However, there is always need for caution. China, a key driver of global growth, is now starting to tighten monetary conditions and credit controls. China led improvements in global activity throughout 2016 and into 2017 with an 'official' GDP growth of 6.9%. Recent mortgage restrictions and tighter monetary policy are expected to moderate 'official' growth to 6.6% this year and 6.2% in 2018.

Confidence in Mr Trump's ability to push his election campaign policies through Congress has suffered a blow since the initial failure to repeal the Affordable Care Act. It is looking increasingly likely that the fiscal stimulus and tax reforms promised by President Trump will be delayed and most likely smaller than originally promised.

US economic data recently fell behind expectations. Inflation dipped from a year on year increase of 2.7% in February to 2.2% in April while GDP growth has flattened, it should still hit 2.3% this year. Against this backdrop it is expected that the Federal Reserve will still raise interest rates twice more this year and begin to reduce the size of its balance sheet towards the end of the year.

US equities are now looking expensive relative to other developed markets. Equity in Europe, Asia, Japan and emerging markets are more reasonably priced and gains in these regions are being driven by earnings growth.

Many economists expect a slowdown in the UK as higher inflation dents consumer spending, a key driver for the UK economy. According to The Office

for National Statistics (ONS), UK growth fell more than expected to 0.2% in the Q1 from 0.7% in Q4 2016. UK growth is still forecast to hit 2.0% this year but reducing to 1.5% in 2018 as activity slows. We feel that the UK economy will remain more robust than some expectations and that inflation will not hit the higher predictions recently made instead peaking at 3%.

The Eurozone is showing economic improvement. The continuing strength of business surveys and economic data suggests that European GDP growth will hit 1.7% in 2017 as strong export growth from 2016 continues into 2017. Labour markets have continued to strengthen as more jobs are created. Reflecting this more favourable outlook, the European Central Bank (ECB) improved its Eurozone growth forecasts. The bank is still however content on maintaining its current level of monetary easing but may start to reduce its quantitative easing programmes by the end of the year.

Japan's economy has gained momentum. The forecast for GDP growth is 1.2% this year and 0.6% next as both global demand and the weakness in the ¥ has resulted in export growth. Improvements in consumer confidence, continuing government stimulus and improved labour markets should all support consumer spending. Despite this good news, Japanese inflation is still expected to fall below the Bank of Japans (BoJ) 2% target. For this reason, loose monetary conditions including 0% bond yields are expected to be maintained.

Despite the tightening of monetary policies in China, the emerging economies are doing well. Emerging markets are on a much better footing this year than last and the pickup in global trade is benefiting economic prospects. The growth in the Indian economy looks particularly favourable driven by a growth agenda including the passage of the sales tax reform and a standard state taxation rate. It is forecast that India will grow by 7.2% in 2017 and 7.7% in 2018.

A hung parliament for Prime Minister May

One immediate outcome of the General Election result was that sterling fell in value by 2% to US$1.27. A fall in the value of the pound will increase the impact of imported inflation. British manufactures and exporters have benefited from a devalued currency and if sterling weakens or retains its current value this advantage will be retained. The value of sterling has fallen from US$1.46 prior to the June EU Referendum and was trading on 1st June at US$1.285, a13.6% fall in value.

Oxford Economics are expecting sterling to rise to US$1.32 by the end of 2017 which is still competitive compared to the exchange rate prior to the referendum. Deutsche Bank has raised its outlook for sterling from negative to neutral.

Britain's economy outperformed all but one of the G7 economies in 2016. Although the economy faltered a little in Q1, the latest UK Purchase Managers Index (PMI) survey results make very good reading. The PMI gives an indication of confidence at the beginning of the production process with figures over 50 representing a positive outlook. Construction PMI was 53.1, manufacturing 57.3 and the service sector 55.8. The average of these numbers suggests that the economy is likely to grow 0.6% in Q2 and 2% for the whole of 2017 according to Capital Economics.

These figures are also encouraging as they reflect a move from consumption towards production. The post-Brexit British consumption boom came at just the right time to ensure that there was no slowdown in the economy after the Leave vote. With sterling at a depressed value our manufacturers now need to exploit this advantage. A great example is that British car manufactures produced 170,691 cars in March, the most in one month for 17 years.

UK consumers are still feeling optimistic but less so than before as inflation has started to rise this year. Wages have struggled to keep pace with inflation which, if continues, will erode purchasing power.

UK inflation hit 2.7% in April but with oil prices looking to have stabilised at around US$ 50pb and the most recent inflation figures remaining static, perhaps the prediction of inflation this year may not be as high as some had forecast.

FTSE 100 has hit new all-time highs

British blue chip stocks have barely looked back since the EU Referendum. The FTSE 100 reached a new all-time high of 7575 on 2nd June. The market has been assisted by a weak sterling, low interest rates and rising inflation. Rising inflation tends to make stocks more attractive than bonds.

FTSE 100 companies derive 70% of their sales from overseas while the FTSE 250 index companies derive 50% of their sales from abroad. The gradual pick up in global growth that the International Monetary Fund (IMF) is predicting, along with a solid domestic economy and the devaluation of sterling should give UK corporate earnings a significant boost. Barclays are predicting a 22% rise in earnings per share for FTSE 100 companies in 2017 compared to 10%-13% for companies in America, the Eurozone and Japan.

The UK current account deficit has also narrowed to 2.4% of GDP, a five year low, reflecting better trade performance and higher overseas earnings. A sustained improvement will support sterling despite the Brexit uncertainty.

This tail wind from sterling cannot continue. The UK exit from the EU single market and customs union will impact sterling and stock values. Sterling will materially strengthen in the near term if Teresa May is able to maintain the UK's access to the EU single market on attractive terms, but at this stage that looks a big ask. The inevitable ups and downs of protracted and difficult Brexit negotiations will increase market volatility.

Bank of England (BoE) Governor Mark Carney has warned of a consumer spending squeeze in the UK as inflation rises but real wages do not. However, he is upbeat about wage growth beyond 2017 but only if the UK Government secures a smooth exit from the EU.

Mr Carney's predictions came as the BoE trimmed its UK economic growth forecast for 2017 from 2% to 1.9% and held interest base rates at 0.25%. Critics of the bank's forecasts say that too much of the forecasts are based on the assumption of a smooth Brexit which at this moment is not clear.

The General Election result however has created uncertainty as a hung parliament will do nothing to strengthen our national hand during the Brexit negotiations.

Britain is Europe's top destination for foreign direct investment

Britain is Europe's number one destination for foreign direct investment (FDI) after a surge in capital inflows not seen since the financial crisis. FDI rose to US$253bn in 2016 up from US$33bn in 2015 according to the Organisation for Economic Cooperation and Development (OECD).

Britain accounted for the bulk of the 17% increase of FDI into the EU climbing above Ireland, Switzerland, Holland and France to become the top destination for inward FDI across Europe and second only to the USA in the OECD's top 35 richest economies.

The FDI inflows were driven by a number of mega deals, such as AB Inbev £79bn take-over of SAB Miller to create the world's largest brewer, Shell's £34bn acquisition of BG Group and Softbank's purchase of ARM Holdings. Even with these deals excluded, Britain remained the top FDI destination in Europe.

Clearly, a depressed GB£ has had some influence upon inward investment as UK assets are now relatively undervalued. However, Britain also remains attractive for its underlying appeal.

Jobs in the city

The Brexit referendum result caused significant uncertainty over the future of the City of London's banking and investment activity. Commercial property values fell on the expectation that there may be lower occupancy demand if institutions move to Dublin, Paris or Frankfurt. That exodus has so far not materialised and commercial property has retained its value. International banks have committed to London and only a relatively small number of positions have so far relocated.

The official triggering of Article 50 failed to dampen the City job market. In Q1 there was a 13% rise in financial services vacancies with over 8000 new jobs announced in the past twelve months.

UK based financial services companies are increasingly looking to keep their headquarters in London while also expanding operations in other European financial centres. More than one million people work in the UK financial services sector which pays £70bn in total tax revenue per year or 11.5% of all UK tax receipts. Not surprisingly, other EU heads of state want to try to gain a slice of this revenue.

New office buildings completed in London have hit a 13 year high

The number of new office buildings completed in London has hit a 13 year high after continuing demand from financial services and technology companies. In the past six months 3.9 million sq. ft. of new office space was completed, the most in a half year period since 2004 according to Deloitte's. The demand for financial services space may fade as firms reassess their requirements post Brexit.

With such an increase in space, vacancy rates could rise pushing down rents and prices, but Deloitte's believe the demand for good quality accommodation is stable.

A Chinese investment company has made China's biggest investment in the UK market by purchasing 122 Leadenhall St, commonly known as The Cheese Grater, for £1.135bn.

The deal is the second biggest ever in the UK property market and is the latest in a string of London commercial property purchases by Chinese investors who have spent a record £3bn in the UK in 2016 alone.

A Chinese investment company has made China's biggest investment in the UK market

The Game of Brexit

The logic behind Teresa Mays decision to call a snap General Election was understandable. She faced an extended period of difficult negotiations with the EU that would run into a General Election. The EU expected to deal with a UK government without a clear mandate for its Brexit strategy leaving it vulnerable on several fronts. Mrs May did not need this pressure and wanted to strengthen her hand. The outcome was very different to the one she wanted, one that resulted in a weaker position and a hung parliament.

Teresa May believes that the June 2016 EU Referendum result was a strong indication that the country wants greater control over immigration into the UK and therefore end the free movement of people. It was clear from the manifesto that the government would seek a clean exit from the EU, one that leaves both the single market and the customs union and will seek to negotiate a bespoke EU exit agreement. The implications of a hung parliament are that the UK's negotiation position may now need to be reassessed with a softer Brexit being sought.

EU officials want to start talking about a divorce settlement and not a trade agreement, while the UK wants to resolve both at the same time. Either way, we are unlikely to see any real progress until after the German Federal Election on the 24th September. At the October EU Heads of State meeting, Teresa May is likely to be presented with a large divorce bill.

The UK may need a clear Plan B if faced with protracted negotiations, a big bill and a stalemate. David Cameron did not have this option but Teresa May does. Even without a parliamentary majority she has to be prepared to leave and accept a 'hard' Brexit, one that falls back on the World Trade Organisation's (WTO) tariff terms. This will be seen as failure for both sides not to secure a mutually beneficial UK Brexit deal. Some economists see this as a realistic and attractive outcome while critics suggest that such an outcome could cost the UK 2.5% of GDP when compared to full EU single market access.

Plan B may be temporary membership of the European Economic Area (EEA), sometimes called the Norwegian option. This option could offer some attraction as an 'off the peg' solution without some of the acrimony that is becoming evident in trying to negotiate a bespoke deal. Britain would then have time to move on to a preferred position.

Daniel Korski, Deputy Head of the Downing St Policy unit, has suggested that EU counterparts have agreed that it is in everyone's interest to avoid a cliff edge in negotiations and that they accept the need for some form of temporary arrangement after the two year Article 50 period is over and before a new permanent UK-EU trade deal comes into effect. Therefore, it still remains reasonable to assume that the two sides will eventually work out a sensible deal.

Many informed observers are expecting the UK to eventually agree to a reasonably significant divorce bill paid over several years to help the EU with its funding gap after the loss of the UK contributions. In return we will secure attractive access to the single market, passporting rights for UK financial services and acceptable tariffs for key sectors such as agriculture and the auto industry. These outcomes will help preserve and grow the mutually beneficial £600bn annual cross channel trade between the EU and UK. Such an outcome will boost the UK and EU economy and likely raise the value of sterling.

Whatever the eventual outcome, there will be changes needed. The UK will have to re-adjust our economy. We will need to rely less on financial services, with banks and fund managers looking more to new global markets than European. Manufacturing exports will need to develop in the US and Asia. Our services industries and agriculture will have to rely less on cheap migrant labour and train local staff.

The future for UK free trade agreements

A key outcome for Britain as we negotiate our exit from the EU is to establish new trade agreements around the world. While within the EU, Britain cannot cut bilateral free trade agreements. New free trade agreements can help a post Brexit UK flourish economically.

The UK has the opportunity to strike new deals with leading economies where we have well established commercial and cultural links, not least the USA, China, India and the Middle East. In this area, the EU's track record on trade agreements is poor because the interests of the 28 member states often conflict. The UK could therefore see a new position in taking the lead in global free trade.

Mexico's former lead trade negotiator Luis de La Calle, recently stated that Britain should be confident about our ability to conclude free trade agreements outside the EU. La Calle considers the UK to have strong historic relationships and a world class service sector that does not currently benefit that much from existing EU free trade agreements. He stated "Britain is probably the only country that can realistically cut bilateral trade deals with the US, China, India, Japan and the Middle East as well as the EU." Such deals would cover over 75% of world GDP while current EU trade deals cover less than 10%.

The nationalist tide may now have peaked

The Eurozone has dodged the nationalist threat that was risking political and financial stability. The recent election of President Emmanuel Macron in France led a surge in the value of the Euro and European stock values. This election brought an end to the fear that parties in Europe would seek to re-negotiate their membership of the EU and leave the Eurozone.

The nationalist tide may now have peaked as populism did not succeed in Austria last December, in the Netherlands in March, and France in May. The strongest potential threat to the Euro and EU stability is now decided. In Germany, Chancellor Angela Merkel is expected to win her fourth term in office. Only Beppe Grillo's Five Star Movement (M5S) in Italy remains a strong political force. M5S are ahead in Italian polls by 8% and offer the Italian people their Lira back by running the Lira and Euro in parallel. Markets will react badly to a M5S win.

While Europe puts the threat of countries joining the UK in leaving the EU behind, they can now concentrate on growing their economy. The Eurozone is improving with growth as strong as in the US. Employment rates are growing and core inflation is rising.

France's unemployment rates remains stuck at around 10% compared to 5% in the UK and 4% in Germany. The French economy has grown at half the UK average since 2010. For France to prosper, reform is needed over labour flexibility, pension reform and de-regulation. Emmanuel Macron's challenge will be to turn around the French economy. However, President Macron does not have an established political party behind him and may be undermined in the Assemblée Nationale by the old guard. Any lack of reform and progress will re-open the door to Marine Le Pen.

If economic reform is successful in France, this could provide a welcome boost to European growth. France is the 3rd largest economy in Europe and the 6th largest globally. It is also the 3rd biggest UK export market after the USA and Germany. An improvement in French fortunes could also boost our own.

The French economy has grown at half the UK average since 2010

What is happening to the Trump bump?

It has been a very successful eight months in US equity markets with the election of Donald Trump giving markets fresh impetus.

The main stock market index in the USA, the S&P 500, stood at 2100 in early November and on 1st June stood at 2411, a rise of 14.8%. The performance of sectors, such as financials and industrials, was quite pronounced as investors moved to a pro-growth agenda. However, since Easter there has been a mood of scepticism. The enormity of Trump's tasks following his campaign promises is starting to dawn on investors.

Analysts feel confident that many aspects of President Trump's policies will be enacted into law, but the aggressive policy targets such as a 15% rate of corporation tax, 4% economic growth, border taxes, the Affordable Care Act repeal and the US and Mexico wall are unlikely to be achieved in full. It is felt that there will be broad reform that will benefit the economy, but it will take longer to approve.

The ambitious tax reform policy statement aimed at reducing US corporation tax from 39.6% to 15% and the simplification of personal tax bands from seven to three relied upon the hope and expectation of higher tax revenue through economic growth. America already has US$19.9tr of national debt so there is little chance of getting this plan in its current form past the deficit hawks in Congress.

The question now is how much of Trump's reform has been priced into stock values? Some sectors have prices well above where they have historically traded and seem unsustainable. Other sectors still offer good value with the potential for reduced regulation which is less troublesome to bring in and a welcome benefit of the Trump administration.

With recent oil price stability, shale oil companies in the US are attempting to take advantage and have started to drill more aggressively. Despite the OPEC - Russia production deal, an increase in shale oil may be necessary to meet growing demand as world output is pegged to maintain price stability.

The US Federal Reserve kept interest rates on hold at 1.00% at its May meeting, stating that the recent softening in economic data was temporary and unlikely to prevent further increases in the interest rate. This decision came after the Q1 economic data for the US proved disappointing. However, employment levels reached the highest since 2007 with only 4.4% of those in working age unemployed. The US economy created 76,000, 211,000 and 138,000 new jobs in March, April and May respectively. These figures give strength to the Feds view that Q1 was a blip and that the Fed is still likely to raise interest rates again this year.

The impact of monetary tightening

Both the US and China are tightening credit. The US is raising interest rates while China is controlling credit limits.

The US bond market has been nervous about the Federal Reserve's rate rising policy and the fall in US growth to 1.2% in Q1 down from 2.1 in Q4 2016 suggests that these fears could be well-founded.

In the real economy, US car sales have fallen and six million people are 3 months or more in arrears on their car loan payments totalling US$1.16tr of car loans. This is causing banks and credit companies to tighten controls and as a result the US$12.5tr market for bank loans has been flat over recent months.

Therefore, there are concerns that with rising job numbers the Federal Reserve will still go ahead with further interest rate rises when higher borrowing costs are not something that many in the economy desire.

The Fed wants to control inflation, but a fall in personal consumption may do that job for them. If the monetary indicators are reporting these trends, will the Fed want to further tighten and exacerbate a downturn? It is therefore not surprising that the big US banks are advising clients to take money off the table and reduce US exposure.

The latest Chinese mini boom was driven by the Chinese authorities concerns after the economy deteriorated in 2015. The Bank of International Settlements (BIS) has warned that the credit to GDP gap in China has reached 30 points and that anything over 10 is a warning sign. Beijing began to tighten credit last year in order to rein in the US$9.4tr shadow banking system.

The Chinese economy grew well in 2016 and peaked in Q1 2017, but is expected now to slow down with a reduction in direct investment; more credit controls and housing curbs which could cause the Chinese economy to slide into recession this year. Denmark's Saxo Bank believes there is a 60% chance of this happening and also believe that no central bank should be tightening right now.

History tells us that economic recovery invariably ends when policy makers hit the brakes too soon. When both the US and China tighten, the world will likely tighten.

The build-up of debt cannot be sustainable

Due to the Chinese economic slowdown in 2015, the Chinese government prioritised growth over reform and injected a massive US$1.4tn stimulus package into manufacturing, infrastructure and industry in 2016. Not surprisingly, Chinese manufacturing PMI confidence and activity has hit a five year high achieved mainly through this stimulus and government investment rather than market growth.

This stimulus package was seized upon by the market as a sign that global growth would improve. In order to keep the economy growing at or near to 6.5% per annum, Beijing recognised the economy needed more stimulus. The economy had been labouring under the weight on non-performing loans. State owned banks were not revealing bad debts, but balance sheets were full of loans to local government on which they were receiving no return.

The credit intensity of China's economy is becoming increasingly alarming - US$6 of incremental debt is now required to deliver an incremental US$1 of GDP growth. Nevertheless, in 2016 Chinese policymakers agreed to swap US$1.4trn local government debt for US$1.4trn of central government debt, which allowed the banks to start lending again, resetting the cycle of inefficient lending and infrastructure growth. Although this mentality is storing up more trouble for the future, financial markets saw it as a near-term positive, particularly for commodities and other more cyclical parts of the market.

The Chinese authorities are now concerned about the stress in the Chinese financial system and the slowing of growth. They are particularly concerned with China's shadow banking sector. This is lending conducted by unregulated institutions and is estimated to be valued at US$9.4tr or 87% of China's national GDP.

China is cracking down on credit. Banks have been warned against speculation that could result in asset bubbles which divert important funds away from more needed parts of the economy. Mortgage lending has been restricted to 40% of the property value for a first home and 20% on a second home. Because of this, the backlog of unsold properties in China has reached 15 million or 12 months demand. Property developers financing costs are rising and analysts are predicting a 15% fall in property values this year.

The authorities are mindful that any mismatch in lending long- term mortgage credit financed by short term debt could be a major problem if credit tightens and that debt needs to be refinanced every three months at a higher cost.

There is evidence that credit controls will hit economic growth. For example, new car and mobile phone sales have started to stall. The IHS Markit Materials Price Index has fallen by over 11% from its February high suggesting lower demand after the big spending on infrastructure in 2016.

Commentators know that the Chinese authorities have many resources at their disposal and are likely to stick to their guns to squeeze down leverage and credit levels unless there is a sharp slowdown in growth or a surge in lending costs and company bankruptcy. China continues to hold massive foreign exchange reserves of US$3tn which means that fortunately their debt mountain can be repaid.

The Chinese authorities wish to transform the economy away from export and investment led growth to a consumption and service based economy. After last year's investment and stimulus programme, China's policy makers are focussing increasingly on high tech, high value added products and services, robotics, electronics, infrastructure and power generation.

The patterns of development occurring in China are evident geographically. Coastal provinces are developing at pace and flourishing the insurance, healthcare, IT, media, and consumer industries. While creating skilled jobs with rising wages the coastal regions are thriving when compared to the more central areas.

The Japanese economy is stronger due to improved global growth

The Japanese economy is gaining mainly due to improved global growth. Last year the ¥ was weaker which gave a boost to Japanese exports particularly to the USA. The value of the Japanese ¥ has continued to decline against the US$ throughout Q1.

The outlook for Japan tends to follow the world economy and while it is relatively stable, Japan is influenced by the power of the American consumer and any future protectionist trade policies.

Industrial production and exports have been improving along with a modest increase in consumer activity, but wage growth remains less than 1%. The Bank of Japan (BoJ) has reduced its easing measures which has not caused the ¥ to strengthen partly due to the expectations of further US interest rate rises.

As of 1st June the Nikkei 225 was standing at 19860, up 17.4% over the last 12 months. This growth has been driven primarily by the weakness in the ¥. We may see the ¥ correct upwards later this year as it has started to do recently which will have an impact on the export competitiveness of the Nikkei 225

Asian equity markets have enjoyed a good 2017

Throughout Asia, equity markets have enjoyed a good 2017 so far. The current cyclical upturn in both developed and emerging markets has seen an improvement in exports from throughout the region. Asia and the broader emerging markets have made strong gains this year as capital is rotating back into the region, partly because valuations in the US appear stretched and partly due to the expectations that Asia will benefit from an improving global outlook.

One risk to this improvement is any protectionist US trade policy under President Trump. A general border tax or high tariffs on specific sectors such as steel would be unhelpful to Asia. Whether such measures will be implemented is becoming less certain.

Emerging market countries are benefiting from improving commodity prices and the continuing shift of low cost manufacturing from China to smaller Southeast Asian countries. Emerging markets are sensitive to the global growth cycle but some are suffering from the strength of the US$ which can lead to tighter financial conditions for economies with high US$ borrowings. Higher US$ raw material costs eat into profits while US$ denominated debt is more expensive. However, those countries who's exports are priced in US$ such as oil benefit from the stronger dollar.

India stands out as a key market in this region. While it experienced a sharp monetary shock in 2016 soon after the government withdrew two banknote denominations from the physical money supply, this measure was aimed at fighting corruption and to broaden the country's tax base. India has a sustainable growth rate of 6%-7% per annum driven by structural growth factors, a young population and great scope for growth in per capita income.

A more protectionist USA could affect countries such as Mexico, Vietnam, Malaysia and Thailand while India, Indonesia and Russia are less affected by any new Border Adjustment Tax if one is ever brought in. A greater number of countries may see further free trade agreements. Mexico already has 45 FTA's in place, the most in the world. Mexico is in discussions with Brazil, Argentina, Australia, New Zealand, Singapore and Malaysia to set up further agreements and reduce trade barriers further. Mexico's progress in free trade agreements is something the developed world could emulate.

India

India has a sustainable growth rate of 6%-7% pa

India's benchmark Sensex index hit a new all-time high of 31,159 at the end of May having grown 15% since January. This growth in Indian stock values was helped by the progress of world stock markets as well as foreign and domestic investment. The ruling BJP party has performed well in recent state elections, strengthening the position of Prime Minister Modi to push through further structural reforms.

India's economic data has been positive, with household spending and corporate confidence improving after the withdrawal of the 500 and 1000 rupee notes last November. The rollout of India's Goods and Services Tax (GST) across all states is set for the 1st July. Indian corporations are looking forward to the end of a complicated web of state and national taxes creating a single common rate of tax. This single market will make it easier to do business between states and lead to cost savings for companies with multi state interests.

Russia

The Russian economy has been staging a steady recovery

This year we expect Russia to finally emerge from recession supported by lower interest rates, a more stable oil price and a recovering Eurozone. Russian PMI for manufacturing and service sector are now positive suggesting further growth. There is also the prospect of improving US - Russian relations.

After peaking at 16.9% in March 2015, Russian inflation has been on a downward trend ever since and now stands at 4.1% close to the Russian Central Banks (RCB) 4% target. Interest rates have recently been cut from 17% down to 9.75%. The rouble has also strengthened.

Given Russia's status as the world's largest energy exporter with production of 11.2 million barrels of oil per day, Russia has benefited from a stable oil price. The recent oil price reductions will not have helped the economy but the 2017 Russian budget forecast used a conservative oil price of US$ 40pb meaning anything greater than this price would further help the economy. An average price of US$ 50pb would bring in US$ 14b in revenue. The price of oil on 1st June was US$51.8pb

Oil

Looking ahead oil prices should hold firm from improving global growth

The price of crude oil rose above US$52 when the Oil Producing cartel OPEC lead by Saudi Arabia and non-OPEC producers lead by Russia signed an extension to their deal to restrict oil production. Between Saudi Arabia and Russia 20 million barrels of crude oil per day are produced which amounts to about 20% of global consumption. Under the agreement OPEC will cut by 1.2 million barrels per day while the non-OPEC countries will reduce output by 600,000 barrels per day. This latest deal will seek to drain excess crude oil out of the market and hold prices firm.

This deal was expected to stabilise the oil price, however the US is not part of this deal and not only has the US refused to cut production, but is in fact increasing it by 10% over 2016 levels. American oil production could undermine the deal. In May US oil production reached 9.3 million bpd its highest since August 2015 as the number of rigs operating in the US also reached its highest level since 2015.

Looking ahead oil prices should hold firm from improving global growth but increasing US oil production and high US crude inventories could weaken prices too.

Fixed Interest Securities

Rising bond yields have created an interest rate risk

The Federal Reserve Open Markets Committee (FOMC) increased the Federal Funds Rate by 0.25% in December and again in March. The rate is expected to rise twice again later this year from its current 1% to 1.25% then to 1.5%. The resulting Treasury bond yield rises have prompted fund managers to manage the duration of their securities more closely in order to not run an interest rate risk. The balance between the higher yielding, interest rate and inflation sensitive long-dated bonds compared to lower yielding short-dated bonds has come to the fore. Strategic bond funds have significantly moved to shorter-dated bonds with an average of 7 years being typical.

Any signs of the Fed hiking rates higher or ahead of expectations or the European Central Bank (ECB) and Bank of Japan (BoJ) tightening monetary policy would have an impact on bond prices and liquidity in the market. Most government bond markets will have seen capital losses when yields improve but there is a limit to how far yields may go as Central Banks both in Europe and Japan wish to continue with quantitative easing at least for the near term.

Investment grade corporate debt is offering higher yields than treasuries or gilts and with less volatility. Within the global fixed income markets, emerging market local currency debt offer good value with higher yields and moderate volatility as concerns about rapid US$ valuation growth have eased.

It is against this background we have set out our portfolio recommendations.

9th June 2017

PORTFOLIO SELECTIONS

PORTFOLIO SELECTIONS - JUNE 2017

Equity markets performed well in Q1 as investors responded to evidence of an improving global recovery. Markets showed resilience in the face of the US interest rate hike of 0.25% in March. However, investors are starting to question the implementation of Trump's stimulus policies. Investors want to see the implementation of a pro-growth agenda from the US administration.

Strong momentum from 2016 carried over into Q1 of 2017 in the US, Europe and Japan. Growth was better in the BRICs economies helped by the Chinese government's massive stimulus in 2016 and the increased demand and price stability in commodities. The IMF forecast for world growth this year is 3.5% up from 3.1% in 2016. The forecast for 2018 is 3.6% as improvements in the BRICs, Europe and UK are offset by a downgrade in the US and China.

Despite the high quality nature of the US market, valuations have become high compared to past valuations and other markets and expectations for fiscal expansion are being scaled back. The normalisation of monetary policy by the Federal Reserve will put a squeeze on corporate profit margins. The Federal Funds Rate is expected to rise to 1.5% by the end of 2017 and to 2.25% by the end of 2018. Against this background, the US$ has already softened and bond yields have fallen. The yields on US treasury bonds are a marker for world bond yields and if bond yields are falling then bond and gilt prices may hold. We are reducing our weightings in US equity.

In the UK, the tailwind of revenue growth of the FTSE 100 multinational companies from the post-Brexit fall in sterling has faded but the currency is still likely to stabilise in the US$1.29 to US$1.32 range. A UK slowdown has been expected due to weaker business investment and higher inflation hitting consumer spending. We are however seeing high levels of foreign investment and inflation not reaching the heights some predicted. Inflation now stands at 2.7%, above the Bank of England's 2% target.

As far as sterling is concerned if the pound was to fall significantly, this would be because markets expect an unfavourable outcome from Brexit negotiations. If the pound strengthens then the negotiation position of the government will be seen as a success. We are happy to maintain our equity weightings in the UK.

We are positive about near term growth in the Eurozone. The strengthening of European economies has revised earnings expectations upwards. While political risk has had an impact recently, the election of French President Macron has increased optimism and lifted market confidence.

The recent ruling by the European Court of Justice that clarified that the EU's Parliament does have the power to sign free trade agreements without the need of ratification of all 27 national parliaments is good news for pending free trade treaties with economic areas around the world, including a post-Brexit UK. We are increasing our weightings in Europe equity.

Japan is recovering at a faster pace than other parts of the developed world and is responding to ongoing fiscal stimulus. The outperformance of the Nikkei 225 standing at 19961 on the 1st June is up 17% over the last 12 months. This growth has been driven primarily by the weakness in the ¥. The Japanese economy's reliance on the US export markets could be exposed to slower growth in the USA. We are happy to maintain our Japanese equity weightings.

Emerging market equities continue to offer a valuation discount compared to developed market stock. The upturn in global growth is benefiting the emerging markets particularly Asian manufactures. The likelihood of a strengthening US$ has now reduced and therefore assisting growth in emerging markets. We will maintain our emerging market equity weightings particularly in India and Southeast Asia. We will reduce our Chinese exposure.

We retain an underweight position on government bonds as they remain vulnerable to a shift in interest rates as central banks attempt to normalise policy with rate rises and fiscal heightening. The valuations compared to the returns on US Treasuries, UK Gilts and German Bunds are poor, but the security and inflation protection of UK index linked gilts have relevant attractions. We believe there are better valuations and yields in emerging markets sovereign debt particularly valued in their local currencies.

In the corporate credit markets, we are more attracted to high-yield than investment grade bonds. Valuations for both are not particularly compelling. Investment grade bonds are more sensitive to interest rate rises. US, UK and Eurozone high-yield bonds look more appealing particularly if duration is managed. We intend to reduce our fixed income waitings mainly held in strategic fixed interest funds but increase our holdings in UK index linked gilts.

We have held a position in commodities over the past six months that has proved unsuccessful. The market was hit by falling oil prices and reduced demand from China after the 2016 stimulus wore off. The evidence of growth and investment in global infrastructure encouraged us on the demand side but oversupply undermined this position. There still remains the issue of falling Chinese demand and further disappointment from the Trump administration. We have sold out of our natural resources holdings.

The take up in office rental in the central London office market fell by 20% in the latter half of 2016 due to Brexit uncertainty. The indications from Q1 2017 suggest that demand remains relatively weak irrespective of strong buying activity particularly from foreign investment in London. There is also an increase of new office space available which may over supply the market. While there remains uncertainty over EU passporting rights for financial services there could be a decline in office space demand.

Outside London, rents remained stable throughout 2016 and so far into 2017 as occupiers are more focused upon the domestic market. The CBRE all property initial yield index has been steady at 5.1% since last summer so property remains an attractive asset compared to gilts or cash. We remain committed to our diversified real estate holdings and will maintain our existing weightings as we see commercial property offering better yields than bonds or cash.

In terms of monetary policy, we can expect a divergence between the Fed and the rest of the developed world. The Fed is expecting to raise rates from 1% to 1.5% by the end of 2017, but interest rates elsewhere are expected to remain on hold reflecting the earlier stage of the recovery cycle in Europe and in some parts of Asia as compared to the USA. The ECB is expected to continue with quantitative easing (QE) but also begin to reduce the level of QE purchasing in 2018. The Bank of Japan has kept its short-term interest rate at -0.1 % and will maintain its QE programme of asset purchasing. The BoJ also decided to keep its 10-year government bond yield target at around zero percent. In China, while credit control measures are being implemented to restrict access to lending, interest rates are expected to fall rather than rise.

While we have enjoyed some very positive stock market returns over the past 12 months, the markets are now high and the outlook for stocks over the next 3-6 months looks increasingly uncertain. The prospect of political instability in the US, with its negative impact on business sentiment, could create short-term headwinds for the global economy despite some firm growth data. This is further compounded by the continued monetary tightening that the Chinese authorities are inflicting on their economy in order to reign in their exposed financial sector. These issues may trigger a mini slowdown. Such a scenario leaves stock markets exposed as only a continuation of the recent strong corporate profit growth will be sufficient to maintain valuations after the stock market rally of the past 12 months. After months of extended stock market returns, we have reduced our overall allocations to equity markets across our eight portfolios, until we gain more clarity whether the economic momentum of the past year can indeed be maintained.

As of 1st June 2017, our best performing funds held within our portfolios over the last 12 months have been;

Fidelity India	53.38%
Fidelity China Focus	50.78%
Fidelity Emerging Asia	43.99%
L&G Pacific Index	42.99%
Schroder Asian Income	40.10%
Veritas Asian	39.70%
Schroder US Smaller Companies	39.42%
Old Mutual North America	38.60%
BlackRock Continental European Tracker	37.65%
Fundsmith Equity	35.88%
Schroder US Mid Cap	34.29%

The reason behind these positive returns has been the significant growth in the US economy resulting in the US stock markets reaching all-time highs. The growth in China is due to the 2016 government stimulus which we expect to start falling away, while growth in India is a result of government policy and fiscal reforms.

As far as the 27th Edition of our portfolios is concerned, eleven of the funds from the 26th Edition have been substituted while seven new funds are added. Our asset allocation remains broadly in line with that of Edition 26. However, it has have been tilted towards sectors which we feel offer better security and growth prospects over the near term. We are therefore holding higher levels of cash and have reduced our fixed interest and property exposure across the portfolios to help dampen volatility. Our general strategy is to remain very well diversified across all portfolios.

We are pleased to report that the gross performance of our portfolios in each of our eight portfolios up until 1st June 2017, as measured against the associated national Investment Association (IA) benchmark, has been quite satisfying. The relative performance is measured over six time periods from 6 months, 1 year, 2 years, 3 years, 4 years and 5 years. Five of our portfolios showed up very well producing some significant gains ahead of benchmarks over all time periods. Collectively the eight portfolios outperformed their respective benchmarks on 38 out of 44 occasions (86% competency).

Our Speculative Alpha Portfolio has for the first time produced gross returns in excess of 100% over a five year period. The actual gross returns was 102% which was 43% above the national average it is measured against over the same period

Our Defensive portfolio has fallen short of its benchmark but in some respect that is expected due to its high cash and low equity content. It did however achieve its objective of comfortably beating cash returns.

Our performance is reported on the next page of this Outlook Report as well as on our website **www.estatecapital.co.uk.**

Collectively our eight portfolios outperformed their respective national benchmarks on 38 out of 44 occasions.

PORTFOLIO PERFORMANCE

The Estate Capital Investment Portfolios

The Estate Capital Investment Portfolios now offer eight risk related investment strategies designed for medium to long-term investors seeking capital growth and income from a portfolio of leading investment funds. The individual funds that make up our diversified portfolios are selected on the quality of the fund manager and both the quality and consistency of past performance.

‘The global balance of investments across differing asset classes is the primary driver of portfolio returns’

There is a wide range of asset classes across global markets available to investors. Our portfolios bring together a diversity of global equities, fixed interest securities, cash deposits, commodities, precious metals, infrastructure and property. The global balance of investments across differing asset classes is the primary driver of portfolio returns. Our asset allocation is built using a fully modelled asset allocation tool. This system is powered by research from actuaries Willis Towers Watson and investment data from Financial Express.

This modelling system offers us great accuracy to build and test the most efficient blend of assets for our eight model portfolios. Each new edition of our portfolios is published on our website with fact sheets, performance figures, risk ratings and range of returns.

We benchmark and publish our portfolio performance against the most relevant national averages and are happy to say that our selections have enjoyed an enviable track record.

Cumulative Portfolio Performance from 5th June 2017

Below are the past five year's gross investment returns for each of our portfolios from 5th June 2017

Portfolio	*6 months*	*1 year*	*2 years*	*3 years*	*4 years*	*5 years*
Defensive	6.18%	8.03%	7.90%	13.85%	17.28%	27.33%
Conservative	7.67%	12.42%	13.42%	22.53%	27.10%	45.67%
Balanced Income	9.24%	14.64%	13.16%	20.30%	27.81%	51.62%
Balanced Beta	10.48%	19.63%	17.71%	29.50%	34.00%	59.45%
Balanced Higher Income	11.08%	17.99%	-	-	-	-
Balanced Alpha	11.91%	21.52%	22.78%	35.97%	40.99%	66.77%
Speculative Beta	11.46%	25.32%	21.79%	34.40%	40.42%	76.17%
Speculative Alpha	13.67%	25.63%	24.09%	41.81%	52.23%	102.20%

Discrete Portfolio Performance from 5th June 2017

Below are the gross investment returns for each of our portfolios for each 12 month period over the last five years from 5th June 2017

Portfolio	*2017*	*2016*	*2015*	*2014*	*2013*
Defensive	7.92%	-0.59%	5.94%	2.95%	8.98%
Conservative	12.56%	-0.09%	8.58%	3.72%	15.10%
Balanced Income	14.33%	-1.83%	6.97%	6.16%	18.45%
Balanced Beta	19.82%	-2.87%	10.77%	3.50%	19.44%
Balanced Higher Income	17.56%	-	-	-	-
Balanced Alpha	21.55%	-0.10%	11.31%	3.69%	18.29%
Speculative Beta	24.95%	-3.86%	11.26%	4.46%	25.03%
Speculative Alpha	25.46%	-2.55%	15.09%	7.32%	32.21%

The value of investments can fall as well as rise. Past performance is not a guide to future performance. Investors may not get back the money invested. Cumulative and discrete performance charts show % growth from 5th June 2012 to 2nd June 2017 calculated using bid prices with income re-invested into the fund net of tax.

PORTFOLIO PERFORMANCE

Asset Allocation

It is commonly acknowledged that 90% of long term total return comes from having the correct and most efficient blend of asset classes for any given risk level. Our asset allocation is built using a fully modelled asset allocation tool provided by Old Mutual Wealth. This system is powered by research from actuaries Willis Towers Watson and investment data from Financial Express. This modelling system offers us great accuracy to build and test the most efficient blend of assets for our eight model portfolios. Each new addition is published on our website along with fact sheets, performance reports, risk ratings and range of returns.

Here are the asset allocations for our eight portfolios.

Rates of Risk Related Returns

We have also published both the historic and anticipated future gross returns for each portfolio. These predictions are achieved through statistical modelling and provide a realistic range of expected returns going forward. Here are the prospective returns for each portfolio. These returns are not guaranteed and are only an illustration of potential gains or losses.

We have also published the investment ratios for the portfolios giving investors a risk related performance measure of each portfolio against the risk free return, the market return and the benchmark return.

Asset Allocation June 2017 - Edition 27

Portfolio	Risk	Money Markets	Fixed Interest	Property	UK Equity	US Equity	Europe Equity	Asian Equity	Japan Equity	Global Equity	Other Assets
Defensive	2	47%	16%	10%	8%	8%	4%	3%	1%	3%	0%
Conservative	3	39%	16%	9%	11%	9%	6%	6%	2%	2%	0%
Balanced Income	4	27%	16%	13%	25%	5%	6%	7%	0%	1%	0%
Balanced Beta	5	25%	13%	10%	16%	9%	7%	15%	3%	2%	0%
Balanced Higher Income	6	24%	15%	8%	31%	7%	6%	8%	0%	1%	0%
Balanced Alpha	6	22%	13%	7%	13%	15%	9%	16%	4%	1%	0%
Speculative Beta	7	19%	10%	7%	14%	15%	10%	18%	4%	3%	0%
Speculative Alpha	8	18%	8%	5%	16%	19%	10%	19%	4%	1%	0%

Perspective Range of Return & Volatility

Portfolio	Risk	Return	High	Low
Defensive	2	2.94%	11.45%	-5.58%
Conservative	3	4.04%	18.04%	-9.96%
Balanced Income	4	4.39%	21.76%	-12.97%
Balanced Beta	5	5.08%	25.81%	-15.65%
Balanced Higher Income	6	5.59%	29.69%	-18.51%
Balanced Alpha	6	5.59%	29.69%	-18.51%
Speculative Beta	7	6.21%	33.67%	-21.25%
Speculative Alpha	8	6.78%	37.61%	-24.05%

Investment Ratios

Portfolio	Risk	Beta	Alpha	Sharpe Ratio	Info Ratio
Defensive	2	0.63%	1.24%	0.31%	-0.28%
Conservative	3	0.92%	2.29%	0.85%	1.29%
Balanced Income	4	0.84%	1.04%	0.60%	0.03%
Balanced Beta	5	1.09%	1.94%	0.87%	1.03%
Balanced Higher Income	6	0.99%	3.14%	2.94%	2.25%
Balanced Alpha	6	0.89%	3.05%	1.11%	0.95%
Speculative Beta	7	1.06%	1.35%	0.85%	0.56%
Speculative Alpha	8	1.14%	2.45%	1.03%	1.07%

Maximise your returns with a level of risk you're entirely comfortable with

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