ESTATE CAPITAL INVESTMENT PORTFOLIOS
OUTLOOK

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ESTATE CAPITAL

An optimistic outlook can be held if inflation in the US is well behaved.

2017 was a year of exceptional equity returns for investors as global growth was synchronised across developed and emerging economies. The combination of both low inflation and low interest rates has been the foundation of strong returns across risk assets.

The recent macro-economic conditions have been described as 'Goldilocks' for being 'neither too hot nor too cold'. There has been simultaneous growth across the world while inflation has remained low, corporate profits have improved, and equity markets have responded.

Many analysts fear that this strong stock market performance has pushed risk assets into overheated territory and are awaiting a correction in values. Others believe it is a result of better corporate fundamentals that should continue in the near term. Looking forward, we need to consider if the 'Goldilocks' environment can persist.

The stock market falls of February and March now look to have been no more sinister than the repricing of risk in the form of inflation and trade restrictions. The International Monetary Fund (IMF) is forecasting that 2018 will be the strongest year for growth since 2011. The IMF is concerned that both private and government debt levels are historically high and any expected rise in interest rates from the US Federal Reserve would impact on the cost of borrowing.

Overall we expect the co-ordinated global growth that we enjoyed in 2017 to continue through 2018 but that the rate of growth will slow.

There is a genuine feeling that the world economy is still in a period of expansion. The IMF is predicting growth of around 3.9% in both 2018 and 2019. These figures reflect the strength of leading confidence indicators, low interest rates, globally subdued inflation and US tax reform.

The IMF's global inflation forecast of 2.5% was increased up from 2.3% at the beginning of the year. This is due to late stage growth which is expected to increase inflation and rising oil prices. US inflation has now hit 2.5% up from 2.1% at the end of 2017, while UK inflation is forecast to fall from the current CPI rate of 2.4%.

The US Federal Reserve is expected to raise interest rates at least three if not four times this year with

each rise expected to be 0.25%. The Fed will seek to bring any inflation under control by slowing growth through increasing the cost of money.

Both the Federal Reserve and European Central Bank (ECB) will tighten monetary policy either through interest rate rises or through the unwinding of their asset purchase programme. The levels of dollar liquidity are likely to reduce and act as a brake on global growth. US corporations are likely to repatriate the cash they are holding elsewhere in the world which will also have some impact on liquidity.

The general forecast is for slower growth this year but with some concern over rising inflation.

Overall we expect the co-ordinated global growth that we enjoyed in 2017 to continue through 2018 but that the rate of growth will slow.

We may be heading for a combination of inflation and slowing growth.

The USA is further down the path to normalised economics than any other developed country.

The labour market is tight with only 3.9% of the eligible workforce unemployed, wage growth is improving, and the combination of President Trump's recent fiscal stimulus and tax cuts are set to support further growth in the US throughout 2018 and 2019. Consistent with this growth is the expectation of rising US inflation. The broad measure of US inflation is trending upwards and is likely to rise further on a weaker US$ and significant oil price rises. Some analysts are predicting the US Consumer Price Index (CPI) to be 3% this year while the consensus is currently lower at 2.5%.

Inflation is however beginning to rise at the same time as ultra-accommodating monetary policy is coming to an end. Many analysts fear that the unwinding of the Federal Reserve's Quantitative Easing (QE) programme and a rise in inflation could have a negative impact on both bond and equity markets.

Despite the evidence of growth in US inflation, other countries are at very different points in their economic cycle. Inflation in Europe and Japan continues to remain below target and wage growth is subdued. While the annual US CPI increased by 2.5% in April up from a 2.2% increase in February, this is not the story around the rest of the developed world. Eurozone inflation stood at 1.2% in April well below the ECB's 2% target. Japan's CPI is standing at 1.1% up from 0.5% in November 2017. China's year on year CPI fell from 2.1% in March to 1.8% in April. In the UK, inflation has fallen from a high of 3.1%in November 2017 to 2.5% in April. The OECD has confirmed that inflation is falling in the majority of member countries.

Recent strong US wage and job growth spooked markets over the expectations of inflationary pressures. Core inflation, which excludes energy and unprocessed food prices, remains unchanged at 2.1% so recent wage rises seem not to have so far impacted inflation as much as some feared. The link between wage growth and inflation has been weak for some time. Therefore the heavy sell off over inflation looks as if it could have been an overreaction.

The American economy has been regularly adding an average of 200,000 new jobs per month. The number of non-farm payrolls increased by 103,000 in March and 164,000 in April when economists were expecting around 192,000 new jobs to be created. Despite this, the US unemployment rate fell below 4% to 3.9% for the first time since 2000.

Wage growth stood at 2.9% in January but fell to 2.6% in March and April. This reduction in wage growth may however start to rise as employment levels are now so high. The number of workers now voluntarily leaving their jobs for a better paid one is historically high reflecting confidence amongst employees. Wage growth has in the past been a lagging indicator of price inflation.

Jerome Powell, the newly appointed Chair of the US Federal Reserve has set out his plans for steady tightening of US interest rates. Mr Powell believes that the US is still yet to hit full employment and is waiting for a sharper acceleration in wage growth to signal that the labour market is getting too tight before he takes any additional action.

The central aim of QE was to aid money supply, improve liquidity, and push down interest rates and inflation. Now that QE is being reversed, investors are concerned how far and how fast interest rates may rise in future. If interest rates increase at the expected levels that the Fed has intimated then markets will take this in their stride. If inflation behaves so will interest rates and equity values. Markets can withstand higher rates, but investors will be sensitive to the pace of rate rise increases if the Fed does have to bear down on inflation. The risk of an accidental crisis or policy mistake remains.

Recent strong US wage and job growth spooked markets over the expectations of inflationary pressures.

The world has started to slow.

There is some evidence of the world economy slowing in part due to a reduction in global money supply.

Europe is starting to feel the effects of the European Central Bank (ECB) reducing its quantitative easing (QE) bond purchasing programme from €60bn to the current level of €30bn per month. This reduction in bond purchases started in January and is planned to end or taper off from September. There are however commentators expecting the ECB to review this strategy and continue with QE to support the European economy as it would seem that European inflation growth is still dependent on bond purchases.

In the US, Quantitative Tightening (QT) is well underway and the level of dollar liquidity is reducing. The Federal Reserve is expected to raise US interest rates by 0.25% on three more occasions this year while at the same time reducing their balance sheet and cash supplies at a rate of US$50bn per month. The rise in the Fed Funds rate will impact on the cost of corporate credit globally. These tightening initiatives are to a large degree countered by a combination of President Trump's recent fiscal stimulus and tax cuts.

Growth in China has slowed as a matter of policy and a desire for achieving levels of sustainable growth with new pollution controls and greater credit controls on mortgages.

The price per barrel of crude oil has risen to US$80pb due to production cuts agreed between OPEC producers and Russia in order to clear the glut in oil. President Trump has as was expected re-imposed sanctions on Iran and further reduced global oil production by some 700,000 barrels per day. A world with lower stocks and less supply will result in higher prices. The effect of higher energy costs and slowing economic growth could be significant.

Big tech offering big growth?

Facebook's abuse of personal data has brought mega tech companies under the spot light of regulators keen to bring them to book and recover more tax revenue from them. While regulators consider their moves to further protect consumers, Amazon Prime has just attracted more than 100 million subscribers; Netflix boasts 125million subscribers and Google posted a 73% rise in Q1 profits.

The mega tech companies with their vast resources and customer base are now looking to spread their influence and impact upon other market sectors that are prime for disruption. Amazon, Apple and Google are looking at more sophisticated ways of payment, money transfer and banking. Amazon and Apple are looking at opportunities in the healthcare market. Apple has also been working on electric cars, while Amazon is experimenting with delivery drones.

Voice recognition technology has advanced and it is becoming common for smart speakers using voice recognition to integrate with smart devices. Consumers can order through voice command and their deliveries will arrive the same day.

Politicians may be thinking about imposing stricter rules and taxing the tech giants more but consumers like what new technology brings, better services at lower cost. No one will be giving up Google, Amazon or for that matter Facebook in great numbers. Profits in this sector can be expected to rise at the expense of older industries.

Analysts continue to be positive about the US.

Analysts continue to be positive about the US even after a strong 2017 and the fall offs in February and March. Dividend growth from corporate earnings is a significant contributor to investor sentiment rising. Analysts are expecting over 60% of leading US corporations to increase their dividends to shareholders this year.

Corporate earnings in the US are expected to show some significant increases this year over last providing upward pressure on share values. This will in part be due to the corporation tax deductions agreed on Capitol Hill last December. Analysts expect this tax reduction to add 7% to earnings per share growth and profits could rise by 20%. Further dividend pay-outs and share repurchases will support equity values as companies look to deploy their corporation tax reductions. The combination of earnings growth and dividend growth will offset the potential volatility in markets particularly if or when rising interest rates and inflation threaten to erode corporate profit margins.

The large corporation tax reductions and the personal tax rate reductions have provided the US economy with an additional late-cycle stimulus. The Bipartisan Budget Agreement (BBA) passed by Congress in February will further fuel growth. The BBA increases the expenditure caps for defence spending and non-defence spending to a total of US$165bn and US$131bn respectively for both 2018 and 2019. This added to new infrastructure spending has taken additional US spending to US$ 400bn. Altogether tax cuts and government spending increases will amount to 2% of GDP over two years. These US tax rate reductions and public spending plans will boost US growth and corporate earnings at a time when the US economy is already very strong. These stimuli do add a degree of uncertainty to the economic outlook as they also bring a risk of overheating and inflation. The Federal Reserve will have a difficult job balancing the need for continued growth with the control of inflation.

There is a general expectation that the Federal Open Markets Committee (FOMC) will raise rates three times this year, but this could, with additional growth expected, stretch to four.

The increase in inflation in Q1 was not only a result of higher oil prices but also a lag in inflation from 2017. Last year annual US inflation was 2.1%, it is now running at 2.5%. Some fund groups are suggesting the inflation rate could exceed 3% this year. This sort of increase will test the Federal Reserve's new Chair Jerome Powell particularly if wages do start to accelerate. January's average hourly earnings data was up year-on-year by 2.9% but fell back in March and April to 2.7% and 2.6% respectively. It is encouraging that there has not been a sustained improvement in wage growth.

It is a challenge for central banks, when at the end of a growth cycle and with inflationary pressures rising to get the right level of tightening to control inflation without creating a recession. Overtightening the Federal funds rate remains a risk to asset values.

The consensus of economic forecasters expects inflation to pick up in the US this year. However, inflation over the past eight years has been running behind the Federal Reserve's inflation target of 2%. With the labour market tightening, forecasters are expecting inflation will increase. However, in most developed economies underlying monetary growth has remained low and below the rate required to generate a real surge in inflation. As long as money flow and bank lending growth remain modest, we should avoid an inflationary shock that would warrant monetary tightening and could threaten the end of the global growth cycle.

10 year Treasury Bonds have risen above 3%.

Yields on the benchmark US 10 year Treasury Bonds have risen above 3% for the first time in more than four years.

The US 10- year Treasury is the benchmark for world credit costs and rising yields will result in higher borrowing costs for companies. Some leading US manufacturers have recently cut their profit forecasts going against the trend of corporate earnings growth forecasts from analysts.

As the Federal Reserve has indicated a further three interest rate increases of 0.25% this year, the next likely increase will be in June. The Feds first rate rise of 2018 in February prompted the 10- year Treasury yields to increase from 2.4% to 3%. This suggests that bond investors have not fully accepted the Fed's forward guidance, instead thinking that inflation and bond yields are both heading higher due to inflation-adjusted yields. As inflation has picked up due to oil prices not wages the Fed need not yet adjust its current expectations.

A yield of 3% is still low historically, but the use of QE has distorted asset prices including the suppression of bond yields. Analysts looking at the future movement of yields are predicting a rise to a mid-range figure of 4.29% by the end of the year. One driver for higher yields will be the Fed's unwinding of QE which will place high volumes of bonds on the market. This balance sheet reduction exercise will be accelerated from the current US$20bn per month to US$50bn per month by the end of this year.

A forecast of a rise to 4.29% would be significant as this would imply that there could be a considerable upside to Treasury yields but an equally considerable downside to market prices in bonds and equities as bond yields start to look more attractive than potential equity returns.

Given the combination of US interest rate hikes, US treasury yields rising, fiscal expansion and quantitative tightening we should expect the US$ to strengthen. Any surge in US$ values will have a big impact on the cost of the world dollar denominated debt. This will particularly hurt weak emerging market economies such as Turkey and Argentina.

A trade deal looks the most likely outcome.

The IMF has warned that the on-going threat of a trade conflict between the USA and China has the potential to hurt global growth. We have already seen that President Trump's trade tariffs and the Chinese retaliations can hit confidence. In April the US placed a 25% tariff on 1,300 Chinese imported goods targeting about US$50bn of imports. This was countered by 106 US products being targeted with high Chinese import duties. These protectionist activities only diminish global trade and the impact is felt around the world not least in Europe.

It is thought that President Trump's threats are intended to persuade China to level the playing field for US and other foreign businesses particularly in intellectual property rights and technology. A deal looks the most likely outcome.

Retirement as early as 52!

European companies seem to be benefiting from a combination of years of cost cutting, global growth and low borrowing costs resulting in growing profitability and balance sheet strength. European companies are showing confidence by increasing their capital spending. Greater levels of employment are building across Europe, wages are rising and consumer spending has improved.

Synchronised global expansion has benefited Europe with Eurozone job growth and manufacturing orders hitting a seventeen year high at the end of 2017. This upswing in growth has carried over into the first half of 2018, but there are clear signals that growth is slowing most notably in the German economy. Consumer spending has fallen, and business surveys show weakened confidence.

Dusseldorf's Macroeconomic Policy Institute (IMK) has warned that Germany's economic outlook is deteriorating. This signals that global growth may be stalling as Germany is heavily reliant on world trade. Germany's economic well-being is a measure of the state of the global economy. For example, as Germany is a major supplier of precision machine tools to China, the slower growth in China is starting to impact German demand and other supply chain nations.

The global supply of money is decreasing due to quantitative tightening and US interest rate rises. Money supply has reached a nine-year low which will have the impact of slowing the rate of growth. The ECB is also preparing to taper its own QE programme by €30bn of debt per month until September when it is expected to then start tapering the programme, further reducing world liquidity. While overall the Eurozone area is currently enjoying a good rate of growth and year-on-year inflation for April is 1.2%. The ECB may still review its tapering plans as inflation may fall and growth may decline if QE is ended altogether.

In France, protest are mounting as President Macron's reforms confront the privileges of the states railway workers which include, lifetime employment, retirement as early as 52 and free family travel on the rail network.

During his presidential campaign Macron consistently opposed the entrenched rights of public monopoly workers that cost consumers and tax payers dearly. President Macron has therefore extended Sunday trading; supported taxi hailing apps such as Uber against the taxi lobby and opened up access to long distant coach travel operators. In the case of the SNCF, France's nationalised railway company, it will face open EU competition from 2021 but is currently struggling under €46bn of debt which grows every month.

Macron's plans to reduce union control over professional education schemes, and to reform unemployment benefits and healthcare funding are all areas likely to further heighten social tensions. With the French public mostly backing their President, it seems unlikely that these reforms will be easily abandoned this time.

32.25 million people are in work in the UK.

Several factors have helped the UK economy to outperform the pessimistic pre-Brexit forecasts. The UK is a highly competitive market-driven economy that does not rely on state favour or subsidies, and has a skilled and flexible workforce. Consumer credit growth was the primary source of faster spending which boosted the UK economy. The economic tailwind of a weaker pound also enabled export order books for British manufacturers to hit their strongest growth rates for decades.

The flexibility of the UK labour market is reflected in the record number of people in work and an unemployment rate of 4.2% down from 4.7% twelve months ago. This is the lowest level of UK unemployment since 1975. There were 32.34 million people in work in February with an employment rate of 75.6% up from 74.6% last January. This is the highest employment rate since records began in 1971. While employment is up it is only just recently that wage inflation has overtaken CPI inflation. Wage inflation grew by 2.6% year on year in March as workers enjoyed increases in pay in excess of the rate of price inflation which slipped to 2.5% in March and 2.4% in April.

The wage growth figure for January and February were the strongest for 30 months as employers had some difficulties recruiting the workers they need. A rise in salaries above prices is a boost to future consumption.

These are good figures for the UK economy which may prompt the Bank of England (BoE) to raise interest rates this year. Governor Mark Carney has said that UK interest rates are likely to rise but not necessarily as soon as many expected. Weaker retail figures in part due to the very bad weather in Q1 and a fall in inflation to 2.4% has reduced pressure on rates.

While the FTSE 100 hit a high of 7780 in January, its value then fell heavily to 6870 in late March due to concerns over UK economic prospects, global inflation sentiments, trade concerns and the rise in sterling back to the pre-Brexit levels of US$1.43. The uncertainty over Brexit is also reflected in stock market values. However, many valuation measures suggest that the UK is better value than most other developed markets. With FTSE All Share yields running at 4% we have now seen values overtake the highs of January with the FTSE 100 standing at 7821 in mid May. This recovery being supported by oil price raises, a weaker pound and the movement of capital to Britain. If investors continue to undervalue UK companies it is likely that there will be further mergers and acquisitions activity.

After eight years of austerity, UK borrowing has returned to pre-crisis levels. The government's annual overspend in 2017/18 was £42.6bn which is £2.6bn below the previous year's borrowing and its lowest for eleven years. Our overall debt levels stand

at 86% of GDP and is expected to start falling as tax revenues increase due to the high employment numbers. Growth and revenue should make the Chancellor more able to invest in the economy and public services.

The long divorce from the EU is deterring outside investment into the UK. Analysts covering FTSE 100 companies are commenting over the unease about the level of uncertainty still surrounding the final UK/EU deal. Markets however are becoming less concerned instead believing that many of the key financial issues have already been agreed but not announced.

The agreement over a transitional period gives a sense that not that much will change for the next three years. Even with disagreement within the Cabinet over the customs union and an impasse over the Northern Ireland boarder, there are good reasons to believe that there will be a deal so that the UK and EU countries can trade in goods and services with limited friction. It remains in the EU's interest given the trade surplus in goods with the UK is £100bn. No Eurozone government or company would wish to lose this amount of custom.

It is also in the EU's interest to strike a deal on services as the UK financial services industry helps meet the financing needs of governments and companies across Europe. Any fragmentation of the market will likely raise the cost of capital in Europe. The need for public financial bailouts in the event of a future financial crisis may not be to the liking of many European countries so keeping the financial centre in London may benefit everyone.

The issue of the cross-border euro denominated derivatives market is perhaps the most significant of Brexit issues at this time. There are currently around £443bn of euro-denominated derivatives traded in the City of London each day. The UK-based market in euro-derivatives amounts to £26tn in contract which stretch out beyond Brexit. No European government will want a problem over an agreement to retain the regulatory and legal status of existing contracts and counterparties.

The economic fundamentals in many sectors of the UK economy are improving despite some significant headline grabbing failures such as Carillion, Carpet Right, Toys r Us and Maplin as well as predictions of slowing growth. UK employment is at record levels, wages are growing ahead of inflation, there has been a significant boost to UK manufacturing and the public finances have improved on the back of higher tax receipts. While the tailwind of low currency values has reduced the UK can expect attractive growth particularly within domestically focused businesses where valuations are attractive.

Growth is expected to be slower but more stable.

There is a growing feeling that the priorities of the Chinese government have moved to a more sustainable economic agenda and away from growth at all costs. The Chinese authorities are no longer ignoring the financial risks that come with years of credit growth and have set an economic growth target of 6.5% for 2018.

Officially the Chinese economy grew by 6.8% year-on-year to the end of March. About 80% of this growth in GDP in Q1 was down to domestic consumption suggesting that China's objective of rebalancing their economy from traditional industries towards retail and service led industries is working. Independent analysts who question the reliability of China's official growth figures believe the real growth rate is more likely to be 4.5% but still consider the Chinese economy to be in good health.

Since becoming President in 2013, Xi Jinping has consistently emphasised the sustainability of growth over the pace of growth. The acceleration of reform has been marked. President Jinping's anti-corruption drive has improved China's corporate governance particularly in China's vast state-owned enterprises. The financial sector has faced challenges over debt levels and shadow banking but has improved through proactive credit limits and regulatory tightening. Chinese debt levels are very high, but the risk of an inter-bank crisis has reduced significantly.

The Beijing authorities are taking action to slowly but surely reduce debt levels in their traditional industrialised corporations in the steel, coal, chemical and manufacturing sectors as well as in regional government borrowing. Chinese regional banks are being refinanced.

The Chinese housing market has been cooling and so effecting labour and key sectors linked to house building. Control over credit growth has stabilised the market through loan-to- value and loan- to-income limits as well as a restriction in the number of mortgages one individual can have.

A big factor in China's recent expansion has been a rebound in commodity prices. China is the world's biggest producer of copper, iron ore and aluminium.

Analysts see signs that China's economy has changed with management confidence rising across a range of indicators. There is an expectation that capital expenditure will rise this year along with the drive to innovate and upgrade domestic supply chains.

While growth is expected to continue it will be slower but more stable.

Analysts are very bullish about Japan.

Japan's economy has been progressively improving over recent years due to the progressive reforms introduced by Prime Minister Shinzo Abe's government.

A key objective was to introduce inflation and wage growth into the Japanese economy. Unemployment is at its lowest levels since the mid 1990's and corporate profits are at a record high. Japanese employers will be paying their employees an increase of 2.1% this year, the biggest rise since 1998. The overall improvement in the economy, a shrinking workforce and skill shortages in the technology sector has helped.

Japan has benefited from the global demand for technology products which have encouraged higher capital expenditure in many of the country's most productive sectors such as motor manufacturing, semi-conductors and precision engineering. The Japanese economy has now grown for the past eight quarters which is the longest consistent growth run for twenty eight years.

Japans labour market remains tight with an unemployment rate of just 2.5% in March, yet wage growth remains subdued and as such consumer spending is not growing. The inflation rate was 0.6% in March which is still some way off the Bank of Japan's (BoJ) 2% target. Japan is unlikely to reach this inflation target given the current rate of monetary easing. The BoJ are likely to keep interest rates unchanged at -0.10% but are starting to reduce the amount of QE bond purchases they make, which is now ¥270bn per month.

Analysts are very bullish about Japan as company finances are robust and expectations are of stable and increasingly generous dividend pay-outs.

India

India is struggling to maintain its growth momentum.

India is struggling to maintain its growth momentum and needs further fundamental reform in order to address its underlying problems. The recent reforms that have included removing certain bank note denominations as legal tender, the introduction of a uniform national goods and services tax and the re-capitalisation of state owned banks have all been helpful but together insufficient.

Other reforms are needed such as limitations over environmental pollution, corruption, income inequality and tax evasion. Despite these issues Indian equities, while having been volatile in recent months, may still offer decent returns if earnings forecasts are fulfilled.

Oil

Oil prices hit US$80pb.

Oil prices hit US$80pb in mid-May. This is the highest price for oil in nearly four years due to the decision of the USA to impose new economic sanctions on Iran. Such a move will result in oil supplies losing their third largest producer in OPEC tightening global supply.

The high oil price has also been boosted by the agreement between OPEC and Russia to reduce the amount of global oil glut. The surplus in oil has now fallen from 340m barrels to 10m barrels. Strong demand due to increasing global growth has also pushed up oil prices. In Q1 it is expected that 2.5m barrels per day will be consumed. Demand for oil in Asia has hit a record high resulting in new refineries being built in China and Vietnam. China's oil imports are the second highest ever recorded and US demand for petrol is at its highest since 2007.

If there was a further reduction in oil supply this could push prices towards US$100pb and impact upon global growth. Increasing oil prices along with wage inflation will impact price inflation and prompt faster interest rate rises than markets would want.

While strong global demand and cuts to OPEC production have pushed up the price of oil, increased shale oil production in the US should keep a lid on future price rises.

Low yields and high prices offer little protection from raising US interest rates, inflation and quantitative tightening.

The demand for high quality income is a major financial demand with ageing demographics around the world.

Too much money has been chasing bond yields at historically low levels. Low yields and corresponding high prices offer little protection from raising US interest rates, inflationary pressures and quantitative tightening. We feel that government bonds are overvalued and vulnerable to rate rises. There has been some resilience in corporate bonds in terms of prices while default risks have been falling due to global growth. Greater corporate earnings have provided support to interest repayments.

European bonds have received some additional support from more dovish comments over monetary policy from the ECB. There are signs that economic growth is slowing in Europe so the ECB may extend their QE Bond buying programme. While corporate bonds are offering insufficient reward to compensate for gradually rising yields, high-yield bonds are better placed to offer investors better performances. Short-dated corporate high-yield credit is less at risk of rising interest rates.

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

30th May 2018

Estate Capital launches a new portfolio – The Conservative Alpha Portfolio.

We have taken a strategic review of our current eight investment portfolio range and decided to add a new portfolio to our client offering. This new portfolio will be an active growth portfolio with a risk profile of 4.

The investor risk profile 4 is a popular one and the current offering is our Balanced Income Portfolio. This portfolio has a dividend and yield focus and due to these income requirements has an overweight position in FTSE 100 stock. This portfolio like others in our range has been temporarily holding higher levels of cash as a volatility protector. While this strategy has aided portfolio values in Q1 the cash holding does nothing for returns or income. This is why our Edition 28 income levels have reduced compared to previous editions. We will be reducing cash holdings in the next Edition 29 of the portfolios

We have decided to offer two different portfolios in the investor risk 4 space and rename some of our existing portfolios to reflect their position on the spectrum better.

We are introducing a new Risk 4 portfolio aimed at growth investors and will be named the **Conservative Alpha Portfolio**. This portfolio will be a more equity focused version of our existing Risk 3 Conservative Portfolio which will stay a Risk 3 but will be renamed the **Cautious Portfolio**.

Our existing Risk 4 Balanced Income Portfolio will be renamed the **Conservative Income Portfolio**.

Our existing Risk 6 Balanced Higher Income Portfolio will be renamed the **Balanced Income Portfolio**. The risk profile will remain 6. Both the renamed Conservative Income and Balanced Income Portfolios will be aimed at investors seeking income from either an investment or pension fund and will therefore hold higher weightings in fixed interest securities to achieve this.

Our new range of portfolios will therefore be:

Risk 2	Defensive Portfolio
Risk 3	Cautious Portfolio
Risk 4	Conservative Income Portfolio
Risk 4	Conservative Alpha Portfolio
Risk 5	Balanced Beta Portfolio
Risk 6	Balanced Income Portfolio
Risk 6	Balanced Alpha Portfolio
Risk 7	Speculative Beta Portfolio
Risk 8	Speculative Alpha Portfolio

At this rebalancing request we will allocate clients to the portfolio that best reflects their current risk profile and objectives. For example, an existing Risk 4 Balanced Income investor who is not seeking income but growth would be allocated to the new Risk 4 Conservative Alpha Portfolio rather than remain in the renamed Risk 4 Conservative Income portfolio.

PORTFOLIO SELECTIONS

This edition of the investment portfolios has been one of the most demanding with so many factors at play at one time. We have taken into consideration global inflation, interest rate rises, US tax incentives and government spending, Brexit, trade wars between the US and China, corporate earnings, oil prices and late cycle nerves. Our overall view is that equity assets have the ability to continue to offer growth to investors but the levels of growth are likely to decline as global growth slows.

The rate of slowing will be impacted by the tightening of UD$ liquidity, US interest rate rises, US treasury yields and the Federal Reserve's quantitative tightening. US inflation is standing at 2.5% with most institutions expecting US inflation to stay at around that rate but HSBC is predicting US inflation will hit 3% by the end of the year. Inflation should be impacted by wage growth, but recent levels of wage inflation have been declining.

An optimistic outlook can be held particularly if inflation in the US is well behaved and US interest rates rise along the gradual path the Federal Reserve has signalled. However, with 10-year US treasury stock yields now rising to 3% there is a feeling that inflationary pressure is growing. Any policy error with respect to the curbing of future inflation could be a catalyst for market falls.

There is some concern that at this late stage in the economic cycle, stock markets are heading for another significant correction. Opinions differ considerably between those that see the economic fundamentals such as raising corporate earnings, low interest rates and lacklustre inflation still supporting global growth to those commentators that fear overvalued stock will be hit by the threat of higher borrowing costs. We continue to take a cautious stance, one that has held up well during recent volatility but without losing out on growth opportunities that do exist around the world.

We made the correct call in January to increase our cash holdings to offer capital protection against significant market volatility in February and March. Our portfolios performed very well against the national averages benchmarks over this period.

We are more confident, post correction, that we can now reduce our cash holdings. Cash is an inefficient asset but useful in times of overvalue and uncertainty. We have continued to avoid any directly held government gilts funds due to poor yields and the potential price impact of raising US treasuries. We have replaced our UK index linked gilts with global inflation linked bonds as there is little inflationary pressure in the UK but raising inflation in the US. US inflation will have a major bearing on US interest rates and if inflation takes off this will have a negative impact on bond and equity values. If inflation rises as expected so that the Federal Reserve increases interest rates in line with their own forward guidance, we can expect bond and equities to respond favourably.

We have increased our overall weightings in UK bricks and mortar property funds as they have performed well and offer diversification from equity and bonds. Property yields look favourable from the funds selected.

The UK FTSE 100 has seen significant volatility in the first few months of 2018. This was due to a recovery in sterling values, Brexit uncertainty and underinvestment. However the UK main stock

market has fully regained its lost value and more as investors see the UK as an undervalued asset. We have therefore increased our holdings in UK equity funds particularly those funds with a value investment style.

We have been positive about the US for many years and remain so. Stock valuation have been trading at 18.4 times forecasted earnings which is the highest rate for many years and one with little room for upward movement. Thanks mostly to the Trump tax cuts and spending, the corporate earnings of S&P500 companies is expected to increase by as much as 18% this year over last, meaning that stock valuations will come in at around 16 times forecast earnings and are therefore not so stretched. The US may be still overpriced and under threat of correction but look as if there is still some more to come so long as the Fed keeps to its plan.

We were proved right to come out of US mid cap and small cap funds and move to mega cap companies. Our tech giant holdings surpassed expectations while the US smaller companies did not benefit as well from the Trump tax reforms and capital repatriation incentives.

We are reducing our weighting in Europe as there is evidence of some slowing in economic growth. We have enjoyed some very good returns from our European funds in last year but are now taking some profits. The managed slowdown in China will have an impact on Europe. We expect that the European Central Bank (ECB) to continue to buy bond assets beyond September as part of an on-going Quantitative Easing (QE) programme to encourage inflation and growth. For this reason we think that European corporate bonds will retain their prices.

Japan has proved to be firmly on the path of reform. Corporate earnings are strong and stock values attractive. We have therefore increased our support for Japanese businesses over European.

We are feeling more comfortable about China now that the Beijing government is pursuing a more sustainable form of growth. Credit restrictions and banking reform and recapitalisation have reduced concerns over a property collapse and banking problems. We expect the US and China to agree over tariffs and that there will be greater open market access in order to avoid a damaging trade war.

With sustained global growth and commodity prices rising, particularly oil, the emerging markets have had an economic boost. We remain attracted to emerging market investment and in particular to South East Asia. However, any US interest rate rises will consequently strengthen the US$ and will impact dollar denominated debt and encourage currency repatriation which will hurt weaker emerging economies the most.

In order to broaden the diversification within the portfolios we have allocated assets not just on a geographical basis but also on a sector level. We have invested into sectors that have scope for long term returns. We continue to hold specialist healthcare funds, infrastructure funds, global insurance funds and technology funds. These funds have with the exception of our infrastructure holding, performed very well so far this year and provide diversification to the portfolios.

As far as our fixed interest securities are concerned we have supported leading strategic bond funds,

short dated high-yield stock, and also have a small holding in European Bonds. Our global inflation linked bond fund is mainly invested in US indexed linked treasuries.

We will remain overweight in cash but we know cash is costly to performance and is only used at times of volatility to protect capital from any potential correction that may or may not occur. An overweight poisiton in cash allows us a higher equity allocation and remain within agreed risk tolerances.

At this rebalance we will redirect some cash holdings to other areas that provide protection but offer the potential for higher returns such as global inflation linked bonds, short duration high yield bonds, property funds and target return equity funds.

As of 21st May 2018, our best performing funds held within our portfolios over the last 12 months have been;

Legg Mason Japanese Equity	38.10%
Baillie Gifford American	33.22%
Janus Henderson China Opportunities	30.91%
Lindsell Train Japanese Equity	29.04%
Veritas Asian	22.51%
Lindsell Train Global Equity	20.97%
Fidelity Emerging Asia	18.59%

The reason behind these particular returns were the growth in the US, Asia, Japanese and Chinese stock markets. Stock markets in these regions have been hitting new market highs.

As on 21st May 2018 our poorest performing funds held within our portfolios over the past 12 months have been.

Jupiter India	-12.12%
L&G All Stock Index Linked Gilt Index	-2.49%
First State Global Listed Infrastructure Fund	-1.67%

The reasons behind these negative returns are that India has slowed down after the initial momentum of Prime Minister Modi's reforms and also that the Jupiter India fund has performed poorly. We have reduced our India holdings and switched funds to the Goldman Sachs Indian Equity Fund to stabilise returns. The First State Global Infrastructure fund has gone through a period of poor performance but has just recently recovered significantly and therefore we have retained this fund. The L&G All Stock Index Linked Gilt Index has been affected by falling UK inflation and rising bond yields in the US. We have redirected our inflation linked holdings to the L&G Global Inflation Linked Bond as it holds mainly US index linked Treasury Bonds.

Collectively our eight portfolios outperformed their respective national benchmarks on 47 out of 50 occasions.

PORTFOLIO PERFORMANCE

As far as the 29th Edition of our portfolios is concerned, nine of the funds from the 28th Edition have been substituted while fifteen new funds are added.

The funds removed are:-

	TER
Jupiter India	1.32%
Old Mutual UK Mid-Cap Fund	0.95%
Kames Investment Grade Bond	1.16%
L&G All Stock Index Linked Gilt Index	0.21%
Janus Henderson UK Absolute Return	3.38%
Kames Property Income Feeder	1.38%
Marlborough Multi-Cap Income	1.22%
Schroder Asian Income Maximiser	1.06%
Threadneedle UK Property	0.81%

The new funds and replacement funds are:-

	TER
L&G UK Property Feeder	1.01%
L&G Global Inflation Linked Index	0.49%
Liontrust Special Situations	1.11%
Fidelity Global Financial Services	1.23%
M&G Global High Yield Bond	0.92%
Polar Capital Global Technology	1.92%
Schroder High yield Opportunities	0.80%
Fidelity Special Situations	0.93%
Goldman Sachs India Equity	1.4%
Artemis Strategic Bond	0.84%
Miton UK Multi-Cap Income	1.00%
Schroder Income	1.04%
Jupiter Japan Income	1.21%
Royal London Corporate Bond	0.53%

New regulations recently brought in across Europe called The Markets in Financial Instruments Directive (MIFID2) has made fund managers disclose the full costs of managing a fund not just their own management fees. The total fees now include trading costs, research and analysts charges on top of management fees. These costs have always been charged but not previously required to be disclosed. It therefore looks as if fees have risen considerable but this is not the case. We select funds on the basis of both performance and cost.

Our asset allocation remains broadly in line with that of Editions 27 and 28. We are still holding significant levels of cash and are underweight in fixed interest, primarily as markets are high and US inflation is a threat to interest rate rises. We have increased our Japanese, US and UK exposure across the portfolios. We have increased our specialist holdings to give additional sector diversification and have retained across all of our portfolios some Absolute Return Funds that invest in short and long equity positions that can provide both growth and protection. Our general strategy is to remain very well diversified across all portfolios.

We are pleased to report that the gross performance of our nine portfolios up until 21st May 2018, as measured against the associated national Investment Association (IA) benchmark, has been very satisfying. The relative performance is measured over six time periods from 6 months, 1 year, 2 years, 3 years, 4 years and 5 years. Two of our portfolios showed up very well producing some significant gains ahead of their benchmarks over all time periods. Collectively the eight portfolios outperformed their respective benchmarks on 47 out of 50 occasions which is 94% competency, our highest ever.

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

Cumulative Portfolio Performance from 21st May 2018

Below are the past five year's gross investment returns for each of our portfolios from 21st May 2018

Portfolio	*6 months*	*1 year*	*2 years*	*3 years*	*4 years*	*5 years*
Defensive	1.16%	4.06%	11.13%	11.07%	18.03%	19.71%
Cautious	1.40%	5.63%	17.34%	18.03%	28.41%	30.86%
Conservative Income	1.83%	4.39%	17.77%	16.48%	24.31%	29.89%
Conservative Alpha	2.72%	8.92%	22.73%	25.27%	37.22%	
Balanced Beta	1.10%	6.11%	25.82%	22.37%	35.77%	37.68%
Balanced Income	1.95%	4.75%	21.81%			
Balanced Alpha	2.46%	9.88%	31.66%	31.67%	47.98%	48.91%
Speculative Beta	1.86%	7.45%	32.98%	27.70%	43.23%	44.28%
Speculative Alpha	2.91%	11.63%	38.16%	34.75%	57.36%	61.59%

Discrete Portfolio Performance from 21st May 2018

Below are the gross investment returns for each of our portfolios for each 12 month period over the last five years from 21st May 2018

Portfolio	*2017*	*2016*	*2015*	*2014*	*2013*
Defensive	3.94%	5.71%	0.50%	6.67%	1.61%
Cautious	5.28%	10.14%	0.92%	9.58%	2.70%
Conservative Income	4.09%	11.27%	-0.19%	7.38%	5.70%
Conservative Alpha	8.26%	11.78%	2.48%	10.03%	
Balanced Beta	5.62%	17.12%	-2.24%	12.25%	2.37%
Balanced Income	4.43%	14.45%			
Balanced Alpha	8.38%	18.99%	0.74%	11.95%	3.26%
Speculative Beta	6.30%	22.08%	-3.41%	13.49%	3.16%
Speculative Alpha	9.43%	22.94%	-1.72%	15.93%	8.14%

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 22nd May 2013 to 21st May 2018 calculated using bid prices with income re-invested into the fund net of tax.

PORTFOLIO PERFORMANCE

The Estate Capital Investment Portfolios

The Estate Capital Investment Portfolios now offer nine 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, the quality and consistency of past performance and fund management charges.

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.

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

Asset Allocation June 2018 - Edition 29

Portfolio	Risk	Money Markets	Fixed Interest	Property	UK Equity	US Equity	Europe Equity	Asian Equity	Japan Equity	Global Equity	Other Assets
Defensive	2	39%	21%	11%	5%	8%	3%	4%	3%	0%	6%
Cautious	3	29%	26%	11%	6%	11%	3%	5%	3%	1%	5%
Conservative Income	4	245%	24%	8%	22%	5%	5%	7%	4%	1%	0%
Conservative Alpha	4	24%	21%	11%	8%	14%	4%	9%	3%	2%	4%
Balanced Beta	5	23%	18%	10%	5%	12%	5%	12%	4%	3%	8%
Balanced Income	6	19%	24%	6%	24%	7%	6%	8%	5%	1%	0%
Balanced Alpha	6	19%	18%	7%	8%	16%	7%	12%	5%	1%	7%
Speculative Beta	7	13%	15%	8%	8%	19%	7%	16%	5%	2%	7%
Speculative Alpha	8	14%	13%	8%	13%	19%	8%	11%	6%	1%	7%

Perspective Range of Return & Volatility

Portfolio	Risk	Return	High	Low
Defensive	2	3.06%	11.59%	-5.47%
Cautious	3	3.99%	17.99%	-10.01%
Conservative Income	4	4.57%	21.94%	-12.80%
Conservative Alpha	4	4.57%	21.94%	-12.80%
Balanced Beta	5	5.12%	25.86%	-15.61%
Balanced Income	6	5.62%	29.72%	-18.48%
Balanced Alpha	6	5.62%	29.72%	-18.48%
Speculative Beta	7	6.26%	33.72%	-21.20%
Speculative Alpha	8	6.84%	37.67%	-23.99%

Investment Ratios

Portfolio	Risk	Beta	Alpha	Sharpe Ratio	Info Ratio
Defensive	2	0.65%	1.40%	0.00%	0.20%
Cautious	3	0.89%	2.67%	0.49%	1.54%
Conservative Income	4	0.86%	1.23%	0.30%	0.42%
Conservative Alpha	4	0.66%	4.48%	1.06%	1.42%
Balanced Beta	5	1.07%	1.91%	0.50%	1.02%
Balanced Income	6	1.09%	1.19%	0.19%	1.10%
Balanced Alpha	6	0.86%	3.78%	0.87%	1.27%
Speculative Beta	7	1.02%	1.63%	0.56%	0.63%
Speculative Alpha	8	1.06%	3.26%	0.79%	1.33%

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

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