ESTATE CAPITAL INVESTMENT PORTFOLIOS
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ESTATE CAPITAL

Easy Money.

With US interest rates increasing, the days of easy money are coming to an end and markets know this. The bond yield rises of mid-October took the US 10-year Treasuries to 3.25%, the highest in 7 years.

This was the start of the rout in stock values which some analysts thought would be short lived as US corporate earnings results had been very strong in Q3. The resilience of the market was tested by the range and potency of uncertainty with which the global economy is currently faced.

Many analysts expected Donald Trump's late-cycle stimulus through corporation tax reductions and government infrastructure spending to give equities a boost until at least mid-2019. But faced with uncertainties, many of Trumps own making, the president is now looking at a stock market correction on his watch.

US corporate earnings have been very strong this year with many reporting earnings up 20% over last year. For example, Amazon a real growth stock, delivered a profit of US$ 3bn for the three months of trading in Q3. Despite this level of profit, the stock still fell 18% in October from its September high as its revenue and fourth quarter outlook were lower than expected. Tech stocks were particularly hit hard. Through October the FTSE 100 lost 8%, the S&P 500 lost 9% and Japan's Nikkei 225 fell 12% in value. October was also notable for the number of days that returns were negative. The S&P 500 posted losses for 13 days over the three-week period of volatility.

The trigger for this asset drop was the Federal Reserve Chairman Jerome Powell's warning that the Fed planned to push interest rates above the so called 'neutral rate' in order to prevent overheating. Markets were not quite ready for this and it brought into close focus rising credit costs and liquidity restrictions. The Fed is reducing its balance sheet of bond assets by US$50bn per month while the European Central Bank (ECB) is planning to bring its €80bn per month bond purchasing programme to an end this December.

The market falls in October were similar to those that triggered losses back in February and March. Both started with a spike in US bond yields and a concern about the pace of US interest rate rises. In March, strong corporate earnings and declining wage inflation reassured markets so that stock values recovered and continued to grow. Again, in October the stock sell-off was heavy for the economic fundamentals.

Third quarter corporate earnings announced in October have been very good and have helped bolster markets after the heavy falls. The Q3 earnings from the S&P 500 companies were up 21.5% year on year with very strong performance from Comcast, Microsoft, Twitter and Telsa. However, results from major tech stock like Amazon and Alphabet (Google) fell below expectations.

President Trumps entrenched trade war with China has hit corporate profits around the world. US Companies reporting strong results are being impacted by the new tariffs and higher labour costs. The Federal Reserve is tightening the money supply and raising interest rates to rein in inflationary pressure building due to Trump's stimulus, all of which is pushing up the value of the US$. A high US$ is hitting emerging markets as US$ denominated debt is getting more expensive to service. Rising interest rates and expected inflation is forcing bond issuers to improve yields to attract investors. High yields means falling bond prices and more expensive borrowing costs for consumers, companies and governments.

As well as the slowing of economic growth in Europe and China, global markets in 2019 also face potential increases in crude oil price caused by the sanctions placed upon Iranian oil exports, the political and economic impact of a potential disorganised Brexit, and an Italian bond and banking crisis. It is no wonder stock values have been challenged.

This end-of-cycle reality check has come sooner than some commentators and analysts had predicted mainly due to the strength of the US economy. Markets are now facing realities previously put aside. The world has become used to low and falling interest rates. With cheap money, households, corporations and governments have borrowed so much that the level of global debt is now US$247tn which is up from US$173tn at the time of the 2008 financial crisis. The world is mortgaged at over three times the global annual GDP. As this debt pile starts to get more expensive, the consequences will make life a lot harder for a world where growth is slowing.

It is commonly agreed that economic cycles end in recession because central banks get base rate settings wrong by misreading the trends and turns in economic data. Global indicators are showing that annualised growth is falling from 3.4% in Q2 to 2.4% in Q3. Even in the USA there are signs of slowing in car and home sales.

We will await any reaction from the Fed to see if it retreats from its publicised course of action. This occurred in May 2015 when quantitative tapering was postponed due to the negative reactions in emerging markets. Commentators are not expecting any significant change in policy unless the US 10-year treasury yields go over 4%. Recently they have fallen back slightly to 3.21%. The Fed is concerned about inflationary pressure and is likely, for now, to stick to its plan of four more rate rises of 0.25% before the end of 2019. However, Jerome Powell has indicated that the Fed will keep reviewing their position.

Wall St and the other world markets have enjoyed an upswing in equity values due to strong Q3 earnings growth and the suggestion of a resolution to the US-China tariffs war. However, analysts are of the view that we may have seen the best of the business cycle and with the reversal of quantitative easing (QE) we have moved into new territory.

Markets will have to cope without easy money as central banks end their fiscal stimulus and start taking money out of the system for the first time in nearly a decade. It is estimated that the Fed will have taken US$ 900bn out of the money supply by the end of 2019.

Investors are concerned about the 2019 outlook but healthy earnings are still being forecast. The combination of solid earnings as well as a resumption of extensive corporate share buybacks will provide comfort for US equity investors.

The USA's loose fiscal but tightening monetary policy combined with the US$ repatriation policy and trade tariffs could lead to difficulties starting in the emerging markets which could, if not managed, spread to developed markets.

There is a dilemma for devising an investment strategy when world events are conspiring to accentuate the negatives. Any post-correction defensive move reduces a portfolios recovery opportunity but does add protection against the threat of further more significant falls, as has happened in the past. Remaining within an established risk-related asset allocation strategy provides diversity and opportunity for the recovery of lost value, but does not provide additional capital protection in times of higher volatility.

Our established position is to remain invested in a suitable risk-controlled asset allocation using our biannual rebalancing to reinforce risk control. The world, however, is entering a tipping point phase, therefore, in the balance of outcome we will be continuing our progressive de-risking of all portfolios to reinforce downside protection. With this in mind, we are increasing our holdings in cash, index-linked bonds, short duration high yield bonds, longer dated higher yielding investment grade bonds and introducing some gold while also maintaining our normal equity diversity but at lower percentages.

The world has re-mortgaged.

In the ten years since the financial crisis, the combination of central bank's increasing their bond buying program's and an increase in household, corporate and government borrowing has taken world indebtedness from US$173tn in 2008 to US$247tn in 2018.

Over that ten year period government borrowing have seen an increase from US$37tn to US$67tn taking nominal debt as a percentage of GPD from 58% to 85% of global GDP.

Thanks to the reforms and regulations that have been introduced in the banking sector since 2008, our financial institutions have reduced their debt levels and become more resilient to a potential financial shock. In the same decade, banking debt has risen from US$58tn to US$61tn but as a percentage of GDP has fallen from 88% to 78%. However, non-financial corporations have used ultra-cheap borrowing to increase leverage in order to increase profits. Borrowing has risen from US$46tn in 2008 to US$74tn in 2018 which is over 90% of world GDP.

Household debt in the developed world is down compared to ten years ago but globally families are this year holding US$47tn of borrowing which is US$10tn up on 2008.

Now, ten years after the collapse of Lehman Brothers, we are seeing the start of the reversal of the greatest central bank experiment of all time. Quantitative easing looks to have saved us and reversed the world's fortunes but look deeper and we are actually more in debt than ever and that this debt will have to be repaid. To pull the global economy back from the brink, central banks borrowed from the future and that future is now starting to catch up.

A changing world.

The world has come a long way since the collapse of Lehman Brothers in September 2008. Regulators have overhauled the rules of banking and brokering in an attempt to correct the imbalance that triggered the financial crisis. But ten years later, the asset value rally has covered over distortions and debt levels are far higher than back in 2008.

Financial markets enjoyed the high tide of liquidity and cheap money as central banks slashed rates to unprecedented lows, pushing up real assets values and causing negative cash returns. This was the outcome of quantitative easing (QE).

A decade of quantitative easing has meant that markets have invariably outperformed the underlying economy. Now, as quantitative tightening (the withdrawal of monetary stimulus) develops, markets may start to underperform economies. The narrow nature of recent stock market growth is also a concern as the best stock returns in 2018 were mainly concentrated in the US and in particular the tech sector which fell the heaviest in the October and November correction.

There are signs that parts of the US economy are overstimulated which is a late cycle dynamic. The labour market is at its strongest for 49 years. Inflation and wage growth have remained contained, but they are starting to pick up with inflation in October at 2.5% and wage growth at 3.1 %.

Donald Trump's tax breaks are expected to fuel growth in the US economy throughout 2019, but as the Fed gets increasingly concerned about the economy overheating, it is likely to stick to its plan to raise interest rates at a rate of 0.25% per quarter. We expect one further rate rise in December 2018 and two or three more in 2019. This rate of interest rise might, as we saw in October, prove too much for the US economy as well as the rest of the world.

At some point, the Federal Reserve Chairman Jerome Powell may need to reassess his plan particularly considering the negative impact on emerging markets of tighter US$ liquidity. In late November he did appeared to soften his tone about future rate rises while continuing to defend the Fed's plans for gradual increases. Mr Powell said "There is no pre-set policy path. We will be paying very close attention to what incoming economic and financial data are telling us." Markets have taken this to mean that the Federal Reserve may not implement all the rate rises they have given forward guidance on. US stock markets lifted over 2% on this news.

Thanks to globalisation, economies are more interlinked than ever before. However, trade frictions have escalated mainly through the initiation of Donald Trump and his 'America First' policy. Geo-political risks have risen and emerging markets are under pressure from high US$ values and US$ denominated debt repayment. There also exists a divide in the influencers of global growth from China and global money supply from the US Federal Reserve.

China was not expecting to contest a trade war with the USA at a time that it was also seeking to manage debt and move to domestic consumption as its main economic driver. Beijing has been seeking to soften the impact of the trade tariffs by injecting money into the Chinese banking system, encouraging bank lending, reducing interbank interest rates as well as cutting personal income tax. Despite this action China, has officially reported its slowest quarterly growth rate since 2009. The official figures in September fell from 6.7% to 6.5% year on year growth. While the official figures are met with some scepticism they are a useful indicator of direction. While a deceleration in the economy is a concern, a 6.5% GDP growth rate is still a healthy pace.

Tighter monetary policies in the US and slowing growth in China are putting pressure on emerging markets including currency depreciation. Countries with high debt to GDP ratio's and weak current accounts like Turkey, Argentina, South Africa and Indonesia will be particularly vulnerable.

There are several potential triggers for the next equity correction similar to that in October. An over-reactive Fed could kill off the bull market but so far other than October's reaction, markets have taken each previous rate rise in their stride. A European credit crunch around the Italian banks looks as if it has been contained, and the US - Chinese trade dispute has entered a new phase as discussions between President Trump and President Xi Jinping at their meeting in Buenos Aires for the G20 summit on 1st December proving beneficial to world trade.

Many analysts think that the current economic cycle may have further to run and that the end of the cycle may still have more time to play out than currently expected. However, investors do need to be aware of a change and therefore asset allocation needs to reflect both the requirement for growth as well as the protection of capital values as the world economy comes to the end of this growth cycle.

Thanks to globalisation, economies are more interlinked than ever before.

Global growth downgraded.

Fund managers have continued to downgrade forecasts for global growth. The end of Q3 consensus forecasts for 2018 has been reduced to 3.2% from 3.4% in Q2 and for 2019 down to 3% from 3.2%.

The most significant changes were in Europe and Japan where growth particularly disappointed. US GDP growth looks as if it has hit its high-water mark and is predicted to finish Q4 on a year-on-year growth of 2.5%. China, despite its state-controlled growth, is expected to fall short of it 6.6% target and end 2018 at 6.2% growth for the year.

The downgrade for 2019 has been driven by the expectations of a prolonged trade war between the USA and China. While we hope that pressures on both sides will lead to a resolution ahead of January's tariff rate rises from 10% to 25% many expect this trade dispute to persist.

The consensus for US inflation in 2019 is 2.3% the same rate as in 2018. This takes into consideration the cost of goods due to import tariffs, rising labour costs, but also a strengthening US$, a fall in housing costs and a decrease in oil prices.

The inflation projection has a major bearing upon future US interest rates. The Federal Reserve has given forward guidance over its plans for the next four rate rises. Markets are expecting a rise in December of 0.25% and three more in 2019. It is expected that the Fed Funds Rate will hit 3% by mid-2019. An expectation of rising borrowing costs and the fading impact of US fiscal stimulus could lead to a US economic slowdown from late 2019 into 2020.

We think that investors should have a lower expectation of investment growth in the year ahead. Most analysts are expecting a slowdown in 2019 and a recession in 2020.


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Who holds the Trump card?

The exponential growth in China's economy over the past forty years has brought hundreds of millions of Chinese citizens out of poverty and advanced the Chinese people's standard of living and personal wealth. This has been done through a command economy based upon deeply protectionist policies that prohibits foreign ownership of Chinese companies. A portion of their significant industrial growth has come from hacking the West's business and technology secrets which Donald Trump has called 'the biggest theft in global history'. The US is now taking a far harder line on market access, hacking and patent theft than ever before.

In September 2018, the US imposed a 10% tariff on a further US$200bn of Chinese imports. This brought the amount of goods hit by new border taxes to around half of the total imports to the USA from China. The new tariff rate was set at 10% but will rise to 25% in January 2019. The US has threatened further tariffs on the remaining US$267bn of imports from China to start in January 2019.

In response, China placed tariffs on an additional US$60bn of imports from the USA taking the total to US$110bn which is 90% of all US imports to China. These figures expose the difference between the respective import levels. China is clearly exporting a far greater level of goods to the US. This is one of the issues driving Donald Trump's desire to level this uneven playing field.

Any further trade tariffs will hit China harder than the US. This is the reason that the trade war has hit the Chinese stock market far harder. If the US impose a third round in January this would hit 3.5% of China's GDP.

China can also retaliate against these new tariffs in other ways. China holds US$1.2tn of US Treasury stock, making them the largest single foreign holder of US treasury debt. China, therefore has a significant influence on bond prices. American companies such as General Motors and Apple, who sell more of their products in China than in the US, could be targeted by excessive regulation.

This trade war has all the hallmarks of a deep and prolonged dispute before it is resolved. China sees its trade policy as an essential part of its growth strategy to bring higher standards of living to its citizens. President Trump sees the trade deficit as benefiting the Chinese ahead of American workers and wishes to deliver on his America First rhetoric and sees China as the root cause of the decline in parts of the US economy that form his base support.

In the wider context, this dispute is also affecting whole supply chains in emerging Asian economies such as Korea, Taiwan and Malaysia. This is why emerging markets have struggled in 2018.

There are likely to be both winners and losers. Both China and US companies may seek new suppliers to avoid paying these expensive additional import costs. US companies will face a difficult decision over whether to pay the tariffs and pass the cost onto their customers or absorb them in their margins. The former leads to inflation while the latter hits profits. President Trump is hoping that more US companies will bring overseas production back to the USA but this will involve set up costs and higher labour costs given the shortage of US workers.

Making imports more expensive through US tariffs are designed to boost US home-based manufacturing, push domestic consumers to buy local, boost US manufacturing and bring manufacturing jobs back to America. But major industrial manufacturers are not seeing it that way. For example, Stanley Tools are seeking to make cuts of US$250m in order to cover the new additional Chinese tariffs of US$200m that they are paying on imported parts from China. Harley Davidson is moving some manufacturing from the US to Thailand to avoid the US$100m retaliatory EU tariffs on US goods imported to Europe. Major companies such as Caterpillar and 3M have stated that tariffs are impacting on their costs and profits.

On the back of these tariffs, China has suffered months of falling export sales. The Chinese authorities are using tax cuts, infrastructure spending and lower interest rates to support the economy through this squeeze.

Washington is using these new tariffs to bring Beijing to the negotiating table and see this as a temporary necessity to secure a better deal. Recent talks between the two sides stalled as the White House pushed for an end of alleged intellectual property theft by Chinese companies and a reduction in the trade deficit.

With stock markets in both US and China having responding badly to this ongoing dispute it is not surprising that there has been encouraging news after the dinner between President Trump and President Xi Jinping. Both leaders met at the G20 Summit in Argentina on 1st December and agreed that the proposed January increase in US tariff rate from 10% to 25% be postponed for 90 days to allow both sides to negotiate a settlement over trade tariffs as well as technology transfers, intellectual property protection, non-tariff barriers, cyber intrusions and cyber theft. President Trump indicated that China will start purchasing more American goods in order to reduce the current trade deficit as well as reduce the Chine import tariff of 40% on US cars. However, this has so far not been confirmed.

There are strong incentives for both Washington and Beijing to reach a truce on trade. The US has been tough on China and this played very well ahead of the midterm elections but the political benefits are now diminishing as the cost of high tariffs are expected to fuel higher inflation in the US. With fiscal stimulus fading and the US Democrats controlling the House of Representatives, the Trump administration may want to avoid conflicts that hurt the stock market.

Analysts feel that China is willing to reach a deal as the economic cost of tariffs is quite high and the planned increase of US tariffs from January would reduce China's GDP by 0.6% over 12 months. Markets rallied on the news with the Hang Seng rising 2.6% and Shanghai Composite Index up 2.9%.

The biggest risk to the US economy?

In early October, the Federal Reserve Chairman Jerome Powell expressed his delight that the US economy was going very well by saying, ‘We are enjoying a remarkable set of economic circumstances’. The US economy saw jobless figures fall to 3.7% and GDP growth running at 3.5% per annum. Soon after he made these comments, the US 10-year Treasury bond yield rate rose to 3.23% as investors demanded higher returns due to the expected interest rate rises and inflation. However, the good news was short lived with the start of October’s stock market falls.

To add further injury to Mr Powell, President Trump branded the Fed as ‘the biggest risk to the US economy’ and that Mr Powell was ‘happy’ to be raising rates ‘every time we do something great, he raises interest rates’.

To be fair to Jay Powell, the recent economic data has been truly exceptional. Unemployment is at a 50-year low, small business optimism is at record levels as measured by the US small business optimism index and inflation still at 2.3% in October. This economic growth has been fuelled by Donald Trump’s fiscal stimulus and government spending. Trump is deliberately running the US economy ‘hot’ by injecting US$ 1.5tn in tax cuts over the next 10 years coupled with additional infrastructure spending. This combination could push the USA GDP growth for 2018 to as high as 3%. Not surprisingly, such a policy comes with some risk. The most obvious being rising interest rates and bond yields, a stronger US$ and increases to the national debt due to the loss of corporation tax receipts in the short term.

The US budget deficit is predicted to be 3.9% of GDP for 2018 rising to 4.7% in 2019. These figures are far higher than the deficit percentages that is causing the new Italian coalition government and the EU to fall out.

Donald Trump may only be heating the economy for his own short-term electoral success but there are some positives emerging from his actions. There has been a surge in investment in the US. Companies are recognising the challenges of the future. Growth in a tight labour market with rising labour costs has accelerated investment into technology and artificial intelligence in order to boost productivity.

The US took on a further 250,000 new jobs in October well ahead of expectations. Employers are now looking to offer full-time work to part timers and re-employing workers that have recently retired to satisfy demand.

In the past the Federal Reserve has cut interest rates and markets have become used to being bailed out every time there is a hint of a stock market wobble. This may not be the case going forward. US wage growth has remained relatively modest but both wage growth and consumer price inflation have recently stated to pick up. For the 12 months to October CPI increased by 2.3% and underlying core inflation was 2.1%. Annual wage growth hit 3.1 % in October, up from 2.8% in September. Wage growth is now at a nine year high and is rising ahead of inflation. If this trend continues it is expected that the Fed will stick to its plan and implement a December rate rise. Jerome Powell’s prime responsibility is to control US inflation and maintain sound economics, while Donald Trump wants to maintain power.

This deal or no Brexit?

Ahead of the referendum on UK membership of the EU on 23rd June 2016 we took a proactive approach over the holding of UK and European equity in our portfolios. At the time, we recommended selling these holdings ahead of the vote and then reinvest once the outcome was known. This strategy avoided the initial falls but then participated in the subsequent gains to the significant advantage of investors.

We are now entering the end game over our decision to leave the EU and how this may pan out as far as investment markets are concerned. The FTSE 100 stood at 6138 on Referendum day in June 16, hit a high of 7778 in May 18 and now stands at 6791. Brexit has meant corporate investment has been delayed which has held back the economy.

After 29 months of negotiations that at times looked weakened by indecision, infighting and incompetence, we now see the full implications of leaving the EU, something that many of us would now say we did not fully comprehend at the time of the referendum.

Theresa May now has a withdrawal agreement and a declaration over the framework of the future relationship with the EU signed off by her Cabinet, the EU commission and the Heads of State of the 27-member states.

It is quite clear that there is no appetite for a no deal Brexit to occur from UK politicians and business leaders. This position is shared by our European partners as well. The parliamentary support for a hard Brexit is very small as witnessed by the limited support the European Research Group obtained in challenging the Prime Minister. The City, CBI and most business leaders are seeking as soft a Brexit as possible.

In the very unlikely event of a no deal Brexit, we would see sterling fall significantly. The Bank of England would cut interest rates back to 0.25% to reduce borrowing costs. The government would initiate a £5bn spending programme on infrastructure and house building as well as supporting adversely effected industries such as motor trade and aerospace. Supply chains would be affected or even broken and would need rebuilding within the UK. This may create a boost to indigenous business. The Treasury would likely cut corporation tax to 10% to increase Britain's attractiveness and competitiveness to international business.

If we leave on a no deal, the initial disruption would be massive. The current delays for exporting goods through British ports is up to 2 hours. This is projected to increase to 72 hours at ports on both sides of the channel. The impact on supply chains, imported goods such as food, medicines and materials for industry and construction would hit the economies of the UK and of Europe. The government and industry would need to stock pile while farmers will need to increase food production. Just in time delivery supply chains would come to an end in their current form and workers hours would be reduced or they could be made redundant. We remain wholly unprepared for this outcome.

The implications are clearly very painful but there are many economists, some business leaders, hard Brexit Conservatives and UKIP members who advocate such a move with the UK trading on World Trade Organisation (WTO) rules post Brexit.

One of the heralded dividends of Brexit is the self-control of borders, money, laws and trade. Having been through the torturous negotiations, it is clear to all that bilateral trade agreements take years not weeks to conclude. If we did leave on WTO rules and were free to enter into trade negotiations, it could be years before we conclude these deals.

The withdrawal agreement allows for a period of transition up until the 31st December 2020 or longer if agreed by both parties. During this period, the UK has to abide by EU rules but will lose our representation in EU institutions. The level playing field clauses lock the UK into EU law on labour, environmental protection, taxation, competition rules and state aid. The European Court of Justice will have the final say on matters of law. The withdrawal agreement does end the free movement of peoples so Britain can regain full control over immigration.

The withdrawal agreement sets out the legal framework for the divorce payment, thought to be around £39bn paid over several years, the rights of UK and EU citizens in each other's territories and the avoidance of a hard boarder between the Republic of Ireland and Ulster.

During this period, the UK and EU will negotiate a future trade agreement, the principles of which are laid out in the framework document. The so-called Irish backstop agreement only comes into play after a mutually extended transition period has failed to produce a trade agreement. In the transition, Britain will remain a member of the EU customs union so allowing smooth and free transfer of goods and services between the UK and EU.

During the transition, the UK can start trade negotiations with other countries that can then be implemented from the time we leave the customs union and start our new trade relationship with the EU. The withdrawal agreement leaves open the option for a Canada-style free trade agreement and allows the UK the time to get its act together and prepare for self-government.

Critics of the withdrawal agreement see the UK becoming a rule-taker and adopting the status of a 'colony' of the EU while in the transition period. Britain will still operate under EU trade rules which we will have no input over, having lost our MEP's and commissionaires. We will still be paying into the

EU for our membership of the customs union. Full membership cost £10.8bn this year. The withdrawal agreement does not offer the UK a unilateral exit mechanism over when the transitional period ends as this is determined by mutual agreement. This arrangement is disliked by many advocates of Brexit as this position could allow our rivals to undermine our competitive advantage in certain sectors or industries and hold us in the customs union longer than the UK government may want.

Several independent political commentators have stated that while the agreement does not satisfy everyone and is imperfect in many ways, it is an agreement that should have been expected given the EU position and its red lines of free movement of goods, services, capital and people. Many of the Prime Ministers critics and opponents have said that they would have done a better job of the negotiations but the outcome, whoever represented the UK would be little changed if the key parts of the referendum result was to be honoured.

The Labour opposition to the withdrawal agreement focuses upon the UK staying a permanent member of the customs union in order to maintain our existing trade with the EU. The UK imports £95bn more goods and services from Europe than exports to Europe. This permanent position of rule-taker while still paying into the EU is no more beneficial than staying a full member of the EU.

At the last general election both Labour and Conservative parties campaigned on manifestos to leave the EU single market and customs union.

The Treasury has now published its economic forecasts that compares staying in the EU to the various Brexit options. The forecast compares the likely impact of the proposals agreed by the Cabinet at Chequers in July with the alternative scenarios of Norway-style membership of the European Economic Area, a Canada-style free trade agreement with the EU and a no-deal Brexit. It finds that GDP will be lower in 15 years under all Brexit scenarios than it would be with EU membership.

The official figures indicate that while the UK economy is expected to grow, there was no version of leaving the EU that increased UK prosperity. The sought-after post Brexit free trade agreements only added a small addition to national growth. The forecasts suggest that the UK economy could be up to 3.9% smaller after 15 years under the PM's Brexit plan, compared with staying in the EU and that a no-deal Brexit could deliver a 9.3% reduction in GDP. The Treasury estimates do not put a cash figure on the potential impact on the economy, but independent experts have said that 3.9% of GDP would equate to around £100bn a year by the 2030s. Capital Economics expects GDP growth of 2% if the Withdrawal Agreement is ratified, compared to a 2% fall if a no deal exit occurs.

The Withdrawal Agreement Bill will come before MP's from the 5th to 11th December. It is expected to be voted down as opposition parties and Brexiters join forces for different reasons to defeat the bill. The 100 Conservative MP's who are publicly opposed to the withdrawal agreement could with Labour support defeat the Bill and with no opportunity for success press Mrs May to change her policy or stand down so a new leader can take over.

We can expect markets to react negatively to the Bill being defeated. Sterling is likely to fall as would the FTSE 100 as it reacts to political events.

As it stands the only real option on the table to achieve Brexit is through the withdrawal agreement. A hard Brexit is not wanted and at this stage there is no second referendum on offer. MP's who want Brexit or wish at least to honour the referendum result and the opinions of their constituents will have on 11th December a stark and binary choice. It is this deal or no Brexit. Teresa May knows this as she has been through the negotiations.

The Bill is unlikely to get through on first attempt and may take a number of amendments to appease back benchers looking for a reason to support the bill such as a technological solution to import checks on the Irish boarder or a clearer and more UK focused exit agreement for the transitional period. If the Prime Minister loses the first vote, she may gain some additional traction with the EU for some concession over the framework agreement.

Without doubt this process will generate UK market volatility but this in itself will concentrate minds.

The choice in Parliament is either support an amended withdrawal agreement as a route to a soft Brexit or no Brexit at all. Even if Brexiteers do not like the deal, they run the risk of losing Brexit through a second referendum or a general election.

Another option is membership of the European Free Trade Area (EFTA) and European Economic Area (EEA) for a temporary period. This area includes countries such as Iceland, Norway, Lichtenstein and Switzerland. The so called 'Norway For Now' option is an existing 'off the shelf' alternative and is being discussed between Democratic Unionists and Conservative Brexiteers as an alternative to a voted down withdrawal agreement. The EEA option does have a unilateral exit mechanism and no backstop but does mean accepting during membership EU rules of freedom of movement of workers, labour and capital while also paying the EU about £2bn per year for single market access. Teresa May has avoided the option of EEA membership as it does not end freedom of movement.

If an amended version of the withdrawal agreement is defeated twice, which is quite possible, we will move into unchartered waters over Brexit. The country will need leadership at this time and in order to unite the Conservative Party and the DUP to create a majority in the House of Commons, Teresa May could signal a change of policy to seek temporary membership of the EEA. We think it unlikely that the Prime Minister will countenance the option of a second referendum and a delay to the Article 50 deadline or to call a snap general election on the basis she takes her withdrawal agreement directly to the people. But a week is a long time in politics. The Dominic Grieve amendment giving Parliament a greater say in the direction the country takes in the event of the failure of the withdrawal agreement increases the chances of a second referendum.

If we did end up holding a second referendum the choice will again need to be binary. The ballot should ask voters to either support leaving the EU or remain. With opinion polls showing the nation still divided over the issue of Brexit we may get the same result as last time and Teresa May will secure her withdrawal agreement, see it through and then step down or Britain could seek to remain an EU member state hopefully retaining our veto's and Margaret Thatcher's hard won £5.6bn annual rebate.

The main UK stock markets are offering good value to investors. Yields and PE ratios are internationally attractive. The FTSE 100 and FTSE 250 could certainly be hit by no agreement but could equally be boosted by any agreement to proceed with a soft Brexit in the form of the withdrawal agreement or EEA membership or even no Brexit at all. The passage of the Withdrawal Agreement Bill is likely to see sterling rally which may hit UK exporting manufacturers but generally there should be a relief lift, including greater investment that had been delayed and improved consumer confidence now that the cloud of Brexit is at last lifted. UK interest rates may rise in 2019 and sterling could strengthen further.

The pound jumped in value on the news that the EU and UK had agreed the draft text of the framework for the future relationship. The text does strike an ambitious tone stating that the EU and UK will aim to deliver trade in goods and services that goes well beyond WTO commitments and ensures an economic partnership without tariffs, fees and charges. The text confirms that UK financial services will obtain EU equivalence and therefore avoid disruption.

We have on this occasion not recommended the move out of UK equity to cash over the Brexit decision period as we are unsure of its time duration. While markets will be affected short term, we do not want to miss out on the likely relief lift when it occurs.

When the fog has lifted.

October's budget set out the conditions of the UK economy and public finances.

The UK is expecting 1.4% GDP growth this year and is projecting 1.5% in 2019 and 1.5% in 2020 according to the IMF. The UK achieved year-on-year growth of 2.5% at the end of August and 3.2% at the end of September according to the ONS, driven partly by UK household spending.

In the UK, 32.4 million people aged between 16 and 64 are in work. This is an employment rate of 75.5% which is up on last year's figure. At the same time the unemployment rate in September was 4.1% and wages are growing at their fastest rate for nearly a decade. The UK looks in good shape and with these high employment levels and subsequent higher tax receipts the Chancellor Phillip Hammond had an additional £13bn to spend.

However, corporate investment levels remain uncertain and fell 1.2% between Q2 and Q3 due to the lack of clarity over Brexit. Many companies have put investment plans on hold while the uncertainty persists. This uncertainty is expected to be resolved over the winter months and investment levels may then increase as businesses plan for the agreed outcome. Once the form of Brexit is clear then business investment is expected to rise.

The UK stock market has suffered like all others recently but with all asset reductions comes value opportunities. The UK's two big oil companies have been benefiting from higher oil prices and offer investors a dividend yield of 5%. Some FTSE 100 companies are offering post correction yields of over 6%, and 40% of all FTSE 100 companies are offering investors dividends of over 4% which is very attractive given that CPI inflation is 2.4% and base rates are 0.75%.

With all corrections there is value and once the fog of Brexit has lifted the UK it is likely to be viewed as an attractive place to invest.

Too big to fail and too big to bail?

In terms of the scale of public debt, Italy has been the elephant in Europe's room for a long time. The Italian national debt is now €2.5tn which is 132% of Italy's GDP and making Italy highly vulnerable to economic shocks and loss of investor confidence. While Greece still holds the title of the most indebted nation in the Eurozone, Italy is not far behind. But it is Italy's economic size that makes it both too big to fail and too big to bail.

Despite this fragility, past governments have kept the show on the road and contained the problem. Now, the newly elected populist coalition government of the Northern League, 'Lega', and the Five Star Movement (M5S) are threatening to follow through on their manifesto promises to cut taxes and increase spending on unemployment benefits, introducing a guaranteed basic income to poor families of €780, lower retirement ages and scrap VAT increases.

The government's budget was published in late September with a target deficit of 2.4% of GDP in order to pay for their campaign promises. The EU wants a deficit target of under 2% and has told Rome to revise their budget. This is an unprecedented move from the EU to a member state. The EU has the right to reject a Eurozone member's budget and impose fines if ignored. The proposed budget deficit of 2.4% falls short of the 3% default limit currently allowed under EU rules but it is Italy's high level of debt at €2.5tn that alarms the EU.

Italy now pays €93bn per year in interest payments which is more than they invest into education.

Economic forecasts are predicting that the Italian deficit will hit 2.9% of GDP in 2019 and 3.1% in 2020. The Italian economy is flat lining and the stand-off between Rome and Brussels is having dangerous implications for bond yields and credit. The northern block of EU countries are seeking debt restructuring and structural reforms prior to any further assistance.

For Italy to service this debt it must sell government bonds to investors. The interest rates on Italian 10-year bonds rose to 3.78%, as compared to 0.44% yields on German 10-year bonds, indicating that investors are concerned by the political risks and fragile public finances. Higher bond yields mean that Italy will be paying higher rates of interest to service its public finances as they are renewed. Fortunately, the average renewal rate for Italian debt is seven years. Bond yields have risen in other Eurozone countries with high public finance debt such as Spain, Portugal and France. The Italian situation is one of the pressures the ECB has in rising interest rates.

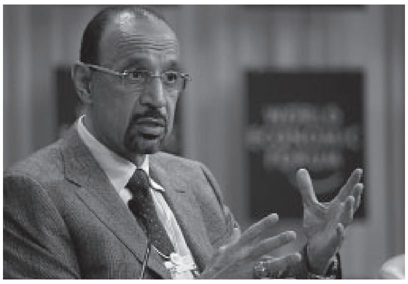
Markets were relieved that the M5S Lega coalition has only partially followed through on its full manifesto pledges. The cost of which would have taken the deficit to 5.5% of GDP. For this reason, investors are likely to see Italian bond prices as attractive at the current yield of 3.25%. Analysts are expecting Italian debt as a percentage of GDP to fall in 2019 and spreads are likely to narrow. For now, the issues of debt, structural reform, and productivity can be deferred but no one should underestimate the determination of the M5S Lega government desire to implement their budget. If the difference between German and Italian bond rates rises over 4%, this could cause a credit squeeze that hits the balance sheets of European banks and requires state intervention. The exposure that French banks alone have to Italian debt amounts to 11% of French GDP. The stakes are high for all involved and the markets will discipline weakness.

If the M5S Lega sticks to their tax and spending plans the EU may then activate its 'excessive deficit procedure'. They will find this difficult as the political impact of the EU fining a net contributor member nation would be historic. However, the standoff has been defused when the Deputy Prime Minister Luigi Di Maio stated that Rome may be willing to reduce the deficit target to 2.2% or even down to the EU target of 2%. This news prompted European stock markets to rise and bond spreads to fall from 3.34% to 2.91%. Italian 10-year bond yields stand at 3.25% while the exact German equivalent offers 0.34%.

ECB's €30bn per month QE programme is due to come to an end in December but as Eurozone economies are slowing the programme may continue into 2019. We shall wait to see but what is clear is that the Eurozone still needs the support of QE to depress the cost of borrowing.

It is Italy's economic size that makes it both too big to fail and too big to bail.

Oil Wars.



The US administration's sanctions against Iranian oil exports came into force on the 4th November. This includes sanctions on corporations buying Iranian oil or trading with their central bank. Without a waiver agreement, foreign oil firms will face the risk of being excluded from the US market including being banned from accessing US capital markets and SWIFT, the dollarized world payment system.

These sanctions are being implemented after the US pulled out of the Iranian Nuclear Accord as a tactic to prevent the advancement of Iran's nuclear capacity. Britain, Germany and France were against the US actions.

At the start of the embargo, eight countries had agreed a temporary waiver with US authorities to allow their oil companies to continue purchasing oil from Iran on the condition that they stop or significantly reduce purchases by at least 50% by March 2019. Amongst the eight countries granted a temporary waiver were India, Japan, Italy, Taiwan, Greece, Turkey, South Korea and China. The Trump administration allowed these waivers so that Iran's eight largest export markets had time to source new oil importers and in order to avoid a significant hike in oil prices.

While the EU is trying to maintain and preserve the Iranian Nuclear deal, Europe's multinational oil companies have dropped their business ties with Iran due to the threat of US sanctions on their businesses in the USA. Total, for example has suspended all activity in Iran.

India is Iran's second biggest oil export market and has agreed with the US to reduce its current import volumes by two thirds. While Indian oil refineries have cut down on Iranian imports, China's main oil refineries have stopped importing Iranian oil. It is expected that unless Iran ends its nuclear programme then all the temporary waivers will end with heavily reduced levels of oil being exported from Iran. The country will then inevitably feel the full economic consequences on not being able to export its main asset.

In the run up to the sanctions Iran's fleet of gigantic crude carriers, which is the second largest fleet in the world, started switching off their GPS devices to make it harder to monitor their movements. Iranian backed militia have retaliated by attacking and sinking Saudi Arabian tankers in the Red Sea. Iran's leader Hassan Rohani has threatened to shut the Strait of Hormuz to restrict the shipment of a fifth of the world's crude.

This embargo on all oil exports from Iran could see the supply of oil reduced by as much as 1.7 million barrels per day and potentially lead to shortages. World oil prices peaked at US$86pb at the beginning of October as concern grew over how existing oil producers would fill the expected loss. However, the number of waivers granted to foreign countries and the general slowdown in demand has initially take the pressure off oil prices. Initially traders were concerned about too little supply but OPEC and Russia have boosted production by 1m barrels per day. The US has used the murder of journalist Jamal Khashoggi to pressure the Saudi Crown Prince to increase production to over 11m barrels per day. US oil companies are also opening an increased number of rigs to boost production. US crude oil production is expected to hit 12m barrels per day in 2019 which will take the pressure off the price post waivers.

Since the sanctions were introduced oil prices have actually fallen by 27% to US$63pb as increased oil production has offset initial concerns. Demand for oil has fallen due to the slowing of China and fear over the outcomes of a prolonged US - China trade war may have on the global economy. This slowdown has eased concerns over the impact of initially losing the supply of 1 million barrels of oil per day.

As Saudi Arabia, OPEC and Russia are currently producing oil at near their maximum extraction rates, additional supply could come from oil producing countries like Libya, Canada, Kazakhstan, Nigeria, Mexico and Venezuela but unfortunately these counties are less reliable producers. How OPEC, American shale oil and Russia respond to the Iranian exile will be key to ensuring a stable oil market.

While oil dependency is reducing, particularly in recent years with oil alternatives being developed, oil supply and the oil price still has a major impact on global economics.

Demand for oil has fallen due to the slowing of China and fear over the outcomes of a prolonged US - China trade war may have on the global economy.

China

China introduces targeted stimulus.

The Shanghai Composite Index of the largest 300 companies (CSI 300) has had a very poor 2018 having fallen 24% up until November including an 8% drop in October. These equity losses can be accounted for by the impact of tariffs on Chinese goods arriving in America and the slowing of the Chinese economy.

However, the CSI300 has rebounded and there is some stability in valuations over an improvement in trade relations with the USA and the fact that Beijing is taking measures to introduce further stimulus in response to the weaknesses in the economy. The Chinese authorities have cut the bank reserve requirements to support additional lending and have reduced taxes, fees and market trading costs. These actions are targeted to keep credit and business activity flowing without adding to its massive national debt. They are also aimed at improving consumption which now accounts for 78% of Chinese GDP growth, well up from the 50% range of the past ten years. The companies that will benefit are those that are focused upon the consumer.

Japan

Japan looks good value.

Since October's heavy correction, it is becoming clear that while investors realise the world is slowing and expectations for growth are diminished, there are still opportunities for growth. In fact, some markets seem to be good value because of the correction. One such example is Japan. The main Japanese stock market suffered some of the steepest declines. The Nikkei 225 was down 12% in October and is now looking cheap. Price to earnings ratios are around 13 and dividend yields are around 2.2%

Japanese economics figures are improving with the tightening of the labour market. The relaxation over immigration should also help address the problem of an aging work force. Cheap stock and an improving economy make Japan a market we are happy to support.

India is still a growth story.

2018 has not been a good year for emerging markets. The Indian rupee slipped 15% against the strengthening US dollar and Indian stocks have endured a period of significant volatility. The BSE Sensex Index hit 39,000 points in August only to fall to 33,300 by October only to recover to 36,134 by early December.

Indian Prime Minister Modi seeks re-election next May and his reforms in this Parliament have aided India's development. The economy is supported by a vast cheap labour force, strong demographics, an excellent education system, solvent new banks and advancing technology.

Recently, the Reserve Bank of India has risen interest rates to 6.5%. This has stabilised the rupee and helped to control inflation but may curtail lending and credit.

In the past, India's economy has been restricted by weak government finances, high fiscal deficits, endemic corruption, heavy red tape and regulation. Modi has implemented policies that address these problems. He brought in a nationwide VAT tax system and removed two large denomination notes to restrict the shadow economy. More Indians are moving to online banking to bypass the backward banking bureaucracy. The private banking system is vibrant but the public sector banks are held back by bad debt.

India is heavily investing in infrastructure. The country is laying 133km of motorway per day in order to improve its economy and business efficiencies. The Indian economy has great growth potential which is not lost on major international companies all setting up business in India. Amazon, Apple, Google, Walmart, Microsoft and Facebook are all investing significantly in India due to the size of the business potential.

Technology

The growth of tech deals.

Mergers and acquisitions activity in 2018 are set to be the highest on record with US$3.3tn of deals conducted by October 2018. A series of mega deals have contributed to this record. This level of M&A is fuelled by high levels of disruption occurring across almost every industry sector driven by the internet, smart phones, block chain and AI. This is being increasingly felt by incumbents everywhere who are fighting against diminishing demand. There is now a growing divergence between incumbents and next generation companies.

One prime example is advertising. Online advertising agents are seeing companies raise their spending on social and digital media. Digital advertising is expected to account for more than half of the total of US advertising sales for the first time this year.

Analysts are expecting compelling productivity gains from new technology to drive innovation in the digitalisation of business with automated decision making through AI over the next decade.

Property

The impact of online shopping.

There are up to 200 UK shopping centres that are under threat of falling into administration due to the demise of traditional large anchor stores such as BHS and Toys R Us. The failure of BHS in 2016 left empty units in 200 shopping centres of which only 95 have been re-let.

Many smaller towns have out of town shopping centres that offer a similar range of stores and merchandise. Many are becoming less attractive as compared to online purchasing. The UK online retail growth has been faster than any other retail market in the world.

The University of Nottingham Business School suggests that £2.5bn of shopping centre real estate is up for sale in towns and cities all across the UK. Many leading national retailers are finding business hard, closing stores and hit with rent and rate rises. Shopping centres are therefore under pressure to cut rents to keep tenants or run the risk of a void.

UK shopping centres will need to look at their business model and move to more of an experience theme. The successful centres will combine retail with entertainment, café, bars restaurants, leisure such as ice rinks, ski slopes, or sea life centres and services like libraries, health centres, GP surgeries and chemists. All this adds to the range of services and experiences people cannot get online.

Defending portfolios.

At certain points in a market cycle, usually when a down turn is looming, investors consider the defensiveness of their portfolio. We still feel that equities have an opportunity to make some additional end of cycle growth but this is expected to become a diminishing virtue. The question now is how to protect capital and reduce volatility while still making positive returns. In a low-yield slow growth economy this is challenging.

Defensive investing tends to work best as a tactical strategy. One that is temporarily helping a portfolio to weather a period of unfavourable conditions at a particular point in an economic cycle as the growth phase ends. However, if a defensive strategy is maintained for too long a period due to over caution, it will weigh on a portfolios long term growth potential.

With this in mind, we are reducing portfolio risk across our portfolio range in order to defend capital from the growing number of global uncertainties and challenges. We are also still holding meaningful levels of equity in the desire of capturing capital growth.

Cash is the ultimate defensive asset but it does come at a cost, particularly if inflation is rising, and purchasing power and capital growth is lost. It therefore does not pay to be in too much cash for too long. Capital is best put back to work as soon as the outlook improves and catches the new upward momentum.

Short duration corporate bonds are a level of risk up from cash but can add a defensive layer. They are less effected by rising interest rates as compared to longer duration bonds and offer fixed interest returns.

The correlation between bonds and equity has been challenged by the financial crisis and quantitative easing programmes. Both fell during the financial crisis and both rose in the recovery. The traditional bond to equity splits do not offer the same negative correlation protection as they once did. It would still be expected that gilts should provide non-correlated diversification from a falling equity market.

Gold traditionally outperforms in inflationary conditions and is a safe haven asset in times of equity losses. The overheating US economy is fuelling the need for inflation protection. The fact that gold produced no return and has been falling in value as the US dollar has strengthened in value has meant we have avoided holding the metal until the end of the growth cycle when its characteristics become more attractive.

When markets are rising, no one wants to forgo upside gain to protect against an event that may not occur, but if it does investors will be grateful. The balance of probability weighs more heavily on further market volatility until the main issues of interest rates, trade wars, Brexit, quantitative tightening and stable oil pricing are resolved.

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

4th December 2018.

PORTFOLIO SELECTIONS

We have been saying for the past six months that the blending and selection of investments for our Investment Portfolios has been challenging with so many global factors conspiring to impact both stock and bond markets. The US tax cuts and infrastructure spending has provided significant end of cycle stimulus to the US economy and stock market this year. These factors are set to continue through to the summer of 2019 when the stimulus is expected to start to fade. Both the IMF and OECD are predicting global GDP growth to hit 3.7% in 2019. They have reduced their forecasts down from 3.9% due to the slowing of many developed countries and China.

The rate of economic slowdown will be affected by the pace of the US Federal Reserve's asset selling programme, tightening of US$ liquidity, the rate of increase in US interest rates and the resulting yields on 10-year US treasury bonds, the ending of the ECB quantitative easing programme and the extent and duration of a trade war between the world's two largest economies, China and the USA.

We think that investors should have a lower expectation of investment growth in the year ahead. Most analysts are expecting a slowdown in 2019 and a recession in 2020.

We wish to maintain an acceptable equity exposure in all our risk related portfolios even if funds are feeling bruised after the falls in October and November. We do want to access the IMF and OECD forecasted growth but at the same time take a pro-active defensive stance to protect capital from the growing number of negative events that could potentially hit portfolios next year.

US interest rates are currently standing at 2.00% - 2.25% while the current rate of inflation for the 12 months to the end of October was 2.3%. Core inflation (prices excluding food and energy) which is the measure the Fed used to asses inflation was 2.1%. We are expecting the Fed to raise US interest rates by 0.25% either three or four more times between now and the end of 2019, including a rate rise this December.

We can expect these rate rises to be implemented unless there is a shock to the system or markets react badly to higher than predicted rises in inflation, interest rates and bond yields. If inflation remains relatively modest and behaves as expected, then markets may well have already priced in the expectations for 2019. A policy error by the Fed at this late phase of the cycle will be damaging to equity markets.

We are nearing the end of a magnificent bull run that started back in 2009. Asset values have risen on the high tide of quantitative easing, but now that QE is in reverse and progressively being withdrawn, we cannot be certain the impact this will have on asset values.

Opinion does differ on the prospects for 2019. There are analysts who see strong economic fundamentals such as good corporate earnings, high employment, low inflation and interest rates all supporting global growth for at least the next year. Others see the impact of the raising cost of borrowing, the strong US$, slowing economic growth and protectionism through tariff wars as being issues that could tip the global economy into an early recession.

In January 2018, we first started underweighting bonds and introduced an overweight in cash. Then in June 2018, we progressed this position further. Through the year we harvested the growth in funds when available but also protected portfolios from the worst of the stock market losses. Our portfolios were far more robust in limiting losses as compared to the national benchmarks we measure our performance by.

In our new 30th Edition, we have taken into consideration the key issues impacting performance when deciding both our asset allocation and fund selections, namely, US interest rate rises, US wage and core price inflation, tariff disputes and world trade, Brexit Withdrawal Agreement success, post waivers oil prices, Italian budget standoff and China's debt and economy management.

We are therefore taking our defensive stance a stage further as we progressively reduce asset risk. We have reduced equity exposure in emerging markets, Japan, Asia and Europe and increased our holdings in short duration high yield bonds, inflation linked bonds and a small exposure to gold funds. We have removed our holdings in target return funds having concluded from both the performance of our holdings and on-going research that this sector has not delivered the returns expected and that these funds are generally more expensive than non-hedged alternatives.

We have however maintained our positions in US equity markets and the equity specialist sectors we like. The US tech sector has been hit by heavy reversals recently so we see this as a bad time to bail and instead will retain for recovery as the US remains the growth economy of the world.

We are very conscience that the Brexit withdrawal agreement may yet have a difficult path ahead but despite this uncertainty, UK stocks look attractive as they are undervalued and offer good longer-term prospects particularly the high dividend paying UK multi-nationals with global reach.

We have limited our exposure to gold and gold mining stocks to no more than 2% in any one portfolio. Gold remains a volatile asset. While the US$ is strong, inflation growth is at acceptable levels and there are no near-term serious stock market corrections expected, then it is not worth holding more at this stage.

There is some opinion that the ECB may continue its QE bond purchasing programme into 2019 due to the weak economic outlook for the Eurozone. The forecast for European growth is not at all strong and we have therefore halved our positions. The slowdown in China is having a meaningful impact on Eurozone GDP growth. We have however retained our holdings in European high yield bonds as we see them as offering relatively good value and think that they will retain their prices.

We remain attracted to both Asia and Japan but have eased back on holdings as part of our overall de-risking strategy.

China is caught between a slowing economy and a fight with the US over tariff levels on traded goods. China is taking the pain with the main Beijing stock market falling 18% this year. We can however see an outcome where stock values recover with additional targeted stimulus and a negotiated settlement over trade. We have retained our positions in both China and India as they are the dominant growth economies in the emerging markets. We have, however, removed our other emerging market exposure. This is mainly a reaction to US interest rate rises, bond prices, the global cost of US$ denominated debt and the regional impact of a slowing China.

We have maintained our full geographic and sector diversification by retaining holdings in healthcare, infrastructure, technology, insurance, gold, financials, and commercial property. This diversification along with a style move to some value focused funds will aid portfolio stability and growth.

Our fixed interest securities are primarily focused upon short dated high yield credit, strategic bonds, longer-dated corporate bonds, inflation linked bonds and gilts. This blend is less affected by interest rate rises and protects against inflation.

We have further increased our cash holdings. While this is costly to performance, it is there as an asset class to underpin portfolios at a time of market volatility.

We have taken the decision to retain all our current risk rating on our nine portfolios but in reality, each portfolio's underlying assets have had their risk content reduced. For example, our Speculative Alpha Risk 8 portfolio is now a risk 5. Balanced Alpha Risk 6 portfolio is now risk 4. This de-risking strategy is temporary until the outlook for equity returns improves. We hope you are in agreement and comfortable with our actions.

As of 22th November 2018, the best performing funds held in our portfolios over the past 12 months have been;

Baillie Gifford America	23.07%
Schroder Global Healthcare	15.57%
Lindsell Train Global Equity	15.36%
HSBC American Index	10.84%
Fundsmith Equity	9.59%
Polar Capital Global Technology	8.61%

All of these funds have a common theme and that is investment into the US economy this year either in full or in the majority.

As of 22th November 2018, the poorest performing funds held within our portfolios over the past 12 months have been;

Janus Henderson China Opportunities	-13.14%
Somerset Emerging Markets Dividend Growth	-13.11%
GS India Equity	-10.32%
Veritas Asian	-10.92%
Vanguard Emerging Markets Index	-8.72%
FP Crux European Special Situations	-8.45%

These funds have performed badly due to the decline in economic activity in China, the impact of trade wars, high US$ value and borrowing costs and the heavy correction in asset values in October.

As far as the 30th Edition of our portfolios are concerned, twelve new funds have entered our selections while twelve funds have either been dropped or substituted.

The funds removed are: -	TER
Blackrock European Dynamic	1.76%
Fidelity Emerging Asia	1.20%
Fidelity Special Situations	0.93%
FP Crux European Special Situations	0.99%
GAM Star Credit Opportunities	1.30%
GS India Equity	1.38%
M&G Global High Yield Bond	0.86%
Merian Global Equity Absolute Return	1.68%
Somerset Emerging Markets Dividend Growth	1.37%
Miton UK Multi-Cap Income	0.975
Merian North American	1.01%
Fidelity Global Financial Services	1.24%

The funds added are: -	TER
First State Asian Focus	0.99%
Royal London Sterling Credit	0.35%
Aberdeen European High Yield Bond	0.96%
IShares Index Linked Gilts Index	0.22%
Twenty-Four Dynamic Bond	0.82%
Blackrock Gold and General	2.04%
Jupiter European	1.11%
Merian Gold and Silver	0.91%
Newton Global Income	0.82%
Baillie Gifford Japanese Smaller Companies	0.81%
Stewart Investors Indian Subcontinent	1.41%
Fidelity China Focus	1.04%

Our asset allocation for all portfolios has been moved to a more defensive position. We have generally reduced equity and increased bonds and cash. We are underweighted in equities other than US and UK. Our high level of equity diversity is maintained across asset, sector and region. We have increased fixed interest securities but still remain underweight. We have introduced small percentages of gold funds to most but not all portfolios.

We are pleased to report that at the time of writing, even with the heavy market falls in October and November, our nine portfolios have performed well as compared against the relevant national Investment Association (IA) benchmarks. The relative performance is measured over six time periods, 6 months, 1 year, 2 years, 3 years, 4 years and % years. Collectively our portfolios outperformed their respective benchmarks on 50 out of 52 occasions which is a 96% competency.

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

PORTFOLIO PERFORMANCE

The Estate Capital Investment Portfolios

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

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 and both the quality and consistency of past performance.

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 nine 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 22nd November 2018

Below are the past five year's gross investment returns for each of our portfolios from 22nd November 2018

Portfolio	*6 months*	*1 year*	*2 years*	*3 years*	*4 years*	*5 years*
Defensive	-1.54%	-0.16%	7.32%	10.22%	13.42%	20.22%
Cautious	-1.83%	-0.15%	9.61%	16.79%	21.67%	31.20%
Conservative Income	-3.05%	-0.78%	8.44%	14.13%	18.06%	26.17%
Conservative Alpha	-2.78%	0.19%	12.90%	21.14%	27.66%	37.56%
Balanced Beta	-2.69%	-1.43%	11.24%	23.46%	25.55%	36.67%
Balanced Income	-3.27%	-0.90%	9.46%	16.75%		
Balanced Alpha	-3.72%	-1.10%	14.23%	29.33%	34.72%	46.36%
Speculative Beta	-3.35%	-1.34%	12.24%	29.81%	30.53%	42.22%
Speculative Alpha	-4.02%	-0.92%	16.33%	33.60%	39.55%	54.14%

Discrete Portfolio Performance from 22nd November 2018

Below are the gross investment returns for each of our portfolios for each 12 month period over the last five years from 22nd November 2018

Portfolio	*2018*	*2017*	*2016*	*2015*	*2014*
Defensive	0.76%	5.88%	4.02%	3.54%	4.65%
Cautious	0.95%	8.05%	8.07%	5.18%	5.61%
Conservative Income	-0.49%	8.31%	7.03%	4.35%	5.21%
Conservative Alpha	1.24%	10.96%	9.05%	6.02%	
Balanced Beta	-0.45%	10.21%	13.49%	3.06%	5.65%
Balanced Income	-0.62%	8.99%	8.91%		
Balanced Alpha	0.59%	12.25%	15.65%	5.92%	5.22%
Speculative Beta	-0.20%	10.89%	18.59%	2.23%	5.23%
Speculative Alpha	0.93%	14.54%	16.85%	7.10%	5.79%

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

Asset Allocation January 2019 - Edition 30

Portfolio	*Risk*	*Money Markets*	*Fixed Interest*	*Property*	*UK Equity*	*US Equity*	*Europe Equity*	*Asian Equity*	*Japan Equity*	*Global Equity*	*Other Assets*
Defensive	2	43%	28%	8%	5%	8%	2%	3%	2%	1%	0%
Cautious	3	36%	27%	8%	6%	12%	3%	5%	2%	1%	0%
Conservative Income	4	25%	26%	8%	21%	7%	3%	6%	3%	1%	0%
Conservative Alpha	4	30%	27%	8%	7%	13%	3%	7%	3%	2%	0%
Balanced Beta	5	27%	24%	9%	6%	16%	4%	9%	3%	2%	0%
Balanced Income	6	25%	27%	7%	22%	7%	3%	5%	3%	1%	0%
Balanced Alpha	6	26%	26%	7%	9%	16%	4%	8%	2%	2%	0%
Speculative Beta	7	21%	24%	8%	9%	17%	5%	10%	5%	1%	0%
Speculative Alpha	8	21%	18%	8%	10%	22%	5%	11%	4%	1%	

Perspective Range of Return & Volatility

Portfolio	*Risk*	*Return*	*High*	*Low*
Defensive	2	3.08%	11.25%	-5.09%
Cautious	3	4.21%	18.21%	-9.79%
Conservative Income	4	4.79%	22.24%	-12.66%
Conservative Alpha	4	4.79%	22.24%	-12.66%
Balanced Beta	5	4.79%	22.24%	-12.66%
Balanced Income	6	4.79%	22.24%	-12.66%
Balanced Alpha	6	4.79%	22.24%	-12.66%
Speculative Beta	7	5.44%	26.33%	-15.46%
Speculative Alpha	8	5.44%	26.33%	-15.46%

Investment Ratios

Portfolio	*Risk*	*Beta*	*Alpha*	*Sharpe Ratio*	*Info Ratio*
Defensive	2	0.72	0.91	0.01	0.06
Cautious	3	0.90	2.31	0.60	1.15
Conservative Income	4	0.85	0.77	0.33	0.04
Conservative Alpha	4	0.75	3.30	0.88	0.99
Balanced Beta	5	1.02	2.55	0.76	1.27
Balanced Income	6	1.03	0.67	0.42	0.68
Balanced Alpha	6	0.88	3.14	0.93	1.01
Speculative Beta	7	0.92	3.02	0.90	0.97
Speculative Alpha	8	1.04	3.27	0.95	1.36

Estate Capital makes FT Financial Adviser Top 100 financial advisers list for 2018.

We are delighted to announce that Estate Capital has made the FT Adviser Top 100 Financial Advisers list for 2018. This list sets out to showcase some of the best financial advisers in the UK. The list is, as expected dominated by large national corporations including stockbrokers, wealth management divisions of banks and insurance companies. Estate Capital making the list is quite an achievement.

The list takes into consideration the range of investment strategies, new business levels, client satisfaction and how highly qualified the advisers are. Estate Capital was the only Welsh business to make the list.

We have worked a long time and put a great deal of effort into gaining this level of national recognition. We must thank our loyal clients and staff for all their support.

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

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