ESTATE CAPITAL INVESTMENT PORTFOLIOS
OUTLOOK

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ESTATE CAPITAL

Several Events will Shape the Global Economy

Selecting an investment theme that encapsulates the year so far is not a simple task. Financial markets have reacted to the sharpest rise in the US $ for 50 years, the start of large scale quantitative easing (QE) in Europe and Japan, a first quarter slowdown in US growth, a sharp decline and then partial recovery in oil prices, spikes in Eurozone sovereign bond prices and the very real possibility of Greece leaving the Euro.

The magnitude of these market moving events might explain our prevailing tone of caution as we continue to expect volatility over the next 12 months on the assumption that tighter US monetary policy leads to a rise in bond market and in turn equity market volatility. Again, broad based asset allocation will remain key along with the identification of suitable markets.

Equity markets lead by China, India, Japan and Europe hit new highs in Q1. In the UK, the FTSE 100 index returned to levels last seen in the dot com boom of 1999. In the US the S&P 500 and NASDAQ hit new highs. Meanwhile high quality Eurozone sovereign bonds and corporate bonds moved into negative yield territory before responding to the reversal of deflationary pressure within the Eurozone that pushed yields up and prices down.

Generally we have faith that the world economy is improving aided by European and Japanese QE. For us, equities remain the growth asset along with commercial property. However, as we have witnessed in recent weeks, volatility remains a market feature as stocks have fallen back sharply from their earlier highs.

Several themes will shape the global economy over the next year or so. All of these are supportive of risk assets as economic growth improves, inflation stays low and liquidity remains strong. The challenges for markets will come when the US Federal Reserve raise interest rates, even if this tightening of monetary policy is tempered by ongoing liquidity provision from the European Central Bank (ECB) and Bank of Japan (BoJ).

We felt that at the end of 2014 that the combined impact of lower oil prices and lower interest rates would bring stronger growth and lower inflation in 2015. So far there has been evidence of this but it has been mixed. We have seen positive returns in Europe but so far disappointment in the US. Inflation has fallen in both the US and UK, in fact we have witnessed negative CPI numbers this year whilst Europe has seen an increase in inflation.

The slowdown in the energy sector is having a more immediate impact on the US economy than is the

boost to consumer spending due to lower energy costs. Very poor weather has also increased energy usage. Nonetheless the fundamentals are in place and with improving income and employment rising, consumption will soon pick up.

With the start of Quantitative Easing (QE) in the Eurozone and the expansion of QE in Japan, equity growth in these countries has risen in line with that recorded in the US and UK after the start of their respective QE programmes. Part of the current rise in capital values is down to QE but also due to lower energy costs, which have supported growth across the developed world. A stronger US$ and weaker € and ¥ have also skewed growth away from America towards Europe and Japan. It is likely that the Eurozone economy will outpace both the US and UK in the first half of this year. For example, European retail sales volumes are showing a 6% gain year on year.

Although US growth slowed in Q1, we still expect the Federal Reserve to start raising their interest rates in Q4 this year. This expectation is underpinned by the likelihood of US unemployment rates falling below 5% within the year given the current rate of job growth. There is evidence that wages and employment costs are increasing and while this will not yet translate into higher inflation rates, the Fed does wish to control inflation growth.

The Strengthening US dollar is becoming a significant factor for global growth. The US$ rose 12% in Q1 reflecting growing expectations of US interest rate rises this year. A growing US economy and a strong US$ is good news for exporting economies with US imports up 5% year on year.

‘The strengthening US dollar is becoming a significant factor for global growth’

This broad pattern of recovery in the advanced economies is not extending to emerging markets with the exception of India. The weakness of commodity prices, a downturn in construction and growth in China has influenced emerging markets. An upturn in China is needed to help support a broader emerging market recovery. We expect solid but not spectacular growth from China even though their stock market has had a remarkable year so far. The easing of Chinese monetary policy will cushion a slowdown rather than stimulate growth.

The energy importing emerging markets will benefit from lower oil prices, while the more manufacturing orientated countries in Asia are well placed to benefit from higher consumption in Europe and US. However with the likelihood of a Federal Reserve rate rise in the offering there will be increased pressure on emerging markets to finance US$ denominated debt. Therefore focusing on those economies that have strong balance sheets and low external debt like India would be worthwhile. Emerging markets GDP is expected to fall 3.7% this year, the lowest since 2009.

Sterling has Soared After the UK General Election

The UK general election was predicted to be the most uncertain in decades. In the event it was one of the most certain. The run up to the election did affect market outlook particularly with the realistic possibility of a UK government being heavily influenced by nationalist parties. Sterling has soared after the election on the outcome of a majority Conservative government. Sterling made its biggest gains against the US$ in six years breaking the $1.58 mark and its highest value against the euro in seven years reaching €1.40. This represents great value for British holiday makers this summer but also creates difficulties for UK exporters whose products have become more expensive to overseas buyers.

One of the most impressive aspects of the UK economic recovery has been the growth in jobs. Our economy has been a very effective job creator. In the past five years two million extra jobs have been filled while the number of unfilled positions stood at 750,000 at the end of May. Unemployment has fallen over the same period from 8% to 5.5%. Full time jobs account for 75% while those employed on flexible contracts, so called zero hour contracts, are around 700,000 in a workforce of over 31 million.

'Britain has become an impressive job creator'

There were 202,000 new jobs created in the UK in Q1. Our employment rate now stands at 73.5% the highest since records began, while the total number of people who are currently unemployed is 1.83 million, the lowest for 7 years. Regular pay awards are now growing at their fastest for 4 years. The annual rate of earnings in the private sector stood at 4.3% while the public sector rose by 0.9%.

The largest growth sectors have been professional; scientific and technical services, and the high technology sector. Manufacturing employment remains virtually unchanged while construction jobs are surprisingly slightly down. The modern British economy is very service orientated with overseas sales of service almost as big as manufacturing exports.

Britain has become an impressive job creator much like the US due to a flexible labour market that supports employment and business friendly economic policies. These features will now remain in place for at least the next five years.

As far as UK equity returns are concerned, the FTSE 100 index moved from a 12 month low of 6182 in mid-December to hit a new all-time high of 7103 in late April but has since given up a significant proportion of those gains returning to 6680 in mid-June. The UK index has underperformed many of its global counterparts over the last 9 months largely because the FTSE 100 contains a high proportion of poorly performing mining and energy companies. For example, BP and Royal Dutch Shell were hit by falling oil prices while Anglo American and Rio Tinto were hit by record low iron ore prices. It is for this reason that we remained underweight in the UK over the past six months.

The Bank of England (BoE) Monetary Policy Committee has voted again to keep interest rates on hold but has predicted that any pick-up in inflation at the back end of 2015 is likely to put a rate rise back on the agenda. The current rate of 0.5% has now been in place for six years. The last six years have seen real cuts to the incomes of savers. This has had a particular impact on retired savers living off their interest. Mortgage borrowers have benefited as buying a home has never been cheaper from a credit point of view.

This news was announced just before official figures showed that Britain fell into its first period of deflation for 55 years on the back of energy price reductions and an ongoing supermarket price war. The fact that inflation turned negative is not a cause for concern. We are unlikely to see damaging deflation as has haunted Japan over recent decades as inflation is likely to return quite quickly. Oil prices are now around 35% up on their January US$ 48pb low. Global oil supply has been squeezed so prices can now rise again. Q4 could see the combination of rising oil and commodity prices pushing inflation upwards enough to prompt the BoE Monetary Policy Committee into an early review of interest rates. Therefore enjoy the fall in prices while they last.

The BoE is somewhat less optimistic about recovery in Q2 as compared to Q1 and has revised downwards its projections for UK GDP growth. The new forecasts are 2.5% down from 2.9% in 2015 and 2.6% in 2016. The growth forecast has been reduced because of the rise in sterling and the impact that will have on exports, a fall in house construction, and because interest rates may have to rise a little earlier than previously thought. We still expect UK interest rates to stay as they are until Q3 2016 and even beyond.

The BoE is also concerned that many of the new jobs being created are lower skilled and therefore tax revenues may not yet match the rate of growth in job creation. The BoE is expecting workers to become more productive, higher paid resulting in increased tax revenue. We remain optimistic about UK growth.

Government borrowing fell to £6.8bn in April down from £9.3bn a year earlier. The Office of National Statistics (ONS) revised its estimate for a full years borrowing to £87.7bn which is below the government’s expectation of £90.3bn. While the deficit has been halved in the last parliament it is still one of the largest in the developed world.

George Osborne plans to hold a new Budget on 8th July. He is expected to outline his strategy to eliminate the deficit by the end of 2017 and achieve a budget surplus in 2018/19. Perhaps then we can then start to reduce the overall national debt that now stands at £1.487tr representing 80.4% of our annual GDP and costing us all around £52bn per year in interest payments.

There has been a noticeable increase in bank lending to small business. This is a strong signal that the shortfall of private investment is turning a corner and that credit conditions are improving. Also the number of mortgage approvals made to home buyers has increased amid wider signs of a broader confidence within the UK. In April £7bn of new lending was approved. There was a sharp increase in the amounts savers have deposited into their bank accounts as well as an increase in personal loans. The start of the new tax year in April saw £4.4bn invested in new ISA's and an annual 4.9% increase in personal loan applications. Borrowers are taking advantage of record low interest rates and the signs of economic improvement.

'It is predicted that property in the UK will rise by 22.8% over the next five years'

The recent Deloitte commercial property survey for central London revealed a 24% increase in the last six months of office space under construction. According to the report 9.5m sq. ft. of office space is being developed of which 4.4m sq. ft. is new construction. This is the second highest increase in the last twenty years. Some 37% of this space has already been pre-let. This increase in office construction is also being accompanied by a large number of private residential towers to satisfy the demand for accommodation.

There is also very good news outside London with several high profile businesses announcing their intentions to relocate out of expensive central London. While rental income improved at all levels, London still outpaced the rest of the UK.

The residential housing market was stagnant due to uncertainty over the outcome of the General Election. Values of expensive properties were hit by the threat of a Mansion Tax. City prices fell in the run up to May 7th but have risen significantly since. The election of a majority Conservative government seems to have released the hand break on buyer confidence and activity in the residential property market. According to Rightmove the number of new sellers on the market has risen by 20% since the election.

The house building industry has warned that if house prices surge again on the back of continuing low interest rates, insufficient supply, and a burgeoning population, it will become unaffordable for young people to live in parts of Britain. It is predicted that property prices in the UK will rise by 22.8% over the next five years, but London and South East prices are expected to rise by 29.4%.

Significant Signs of Distress in European Sovereign Bonds

Interest rates in the Eurozone have reached extraordinary low levels. The highly unusual phenomenon of negative bond yields is now common. For example, the 5 year German bunds have been offering a coupon rate below zero. This situation is intensifying the search for income and consequently driving down yields. Investors, including ourselves, bought European corporate bonds in late 2014 in the belief that the start of the ECB €60bn monthly bond purchasing programme in January would eat up bond supply in Europe leading to scarcity and rising values. The situation was suddenly changed when the ECB QE programme reversed the deflationary pressures in the Eurozone far sooner than expected. The new expectations of inflation forced European bond issuers to respond to the change by offering more attractive higher yields. With rising bond yields come a corresponding fall in bond prices. We have therefore witnessed the early but significant signs of distress in European sovereign bonds.

Britain is still borrowing heavily and servicing an ever-growing debt pile. If the UK gilt market starts to spike, with yields forced to rise as investors demand higher returns to combat eventual inflation and interest rate rises, this could seriously hit the cost of borrowing and impact the economic recovery.

Prior to the election, the 10 year Treasury Gilt gross redemption yields stood at just under 1.9%. Two weeks later, they broke above 2% for the first time in six months with bond values subsequently falling. This was partly due to the recent rebound in oil prices fuelling inflationary expectations, together with a broad sell-off of Eurozone bonds.

Foreign investors have been selling their UK bonds. Non-residents sold a total of £14bn between January and February. This is part of a wider trend as prices of Western sovereign debt have been inflated by printed money, causing a bond bubble that could burst with inflation and interest rate rises. This is why some bond investors have been leaving the market ahead of a potential loss occurring exit and explains why the European bond market has witnessed significant rises and falls recently.

The threat of rising bond yields will have a major impact on western governments not least in the UK. Our public finances remain fragile with borrowing of £87bn in 2014/15 and a national debt of £1.5tr, which nearly doubled over the term of the last parliament. Financing the rising cost of this debt will be challenging.

'After a miserable 2014, the Eurozone is growing'

After a miserable 2014, the Eurozone is growing. European data has been improving prompting economists to review upwards their growth forecasts. The ECB QE monetary stimulus, lower energy prices and improved bank lending levels have already created inflationary pressure. A big turning point for Europe was the end of the European banking asset quality review. European banks have been under pressure to improve Tier 1 capital ratios. By shoring up capital reserves they cut back on lending to the economy. Now, European banks have been given the all clear and therefore have resumed normal lending and are competing for new business which is leading to falling commercial lending rates.

The combination of better lending conditions, lower oil prices, and the depreciation of the Euro by 8% since January has increased European output and exports.

Retail sales and new car registrations rose at a healthy pace suggesting that energy related savings are being spent not saved. With employment rising and wage growth picking up, we expect further solid spending growth this year and next. Lower borrowing costs will also encourage business investment. It is expected that Eurozone GDP will grow 1.6% in 2015 and 1.8% in 2016. In fact, Europe may be in better shape than is reflected by current markets as monetary policy takes time to filter through into the real economy. After three years of policy easing and now full QE, Europe may well see stronger economic growth and higher inflation than may be currently expected.

Deflationary fears have moved to inflation expectations, credit is flowing more freely and demand from households and companies are on the rise. Consumer confidence is strong despite concerns over Greece.

Over the past five years European company earnings have lagged behind those of the US as America's growth has powered ahead. This is starting to change which bodes well for European equities. Perhaps the most dramatic transformation is that of the Spanish economy. Recent headlines have been about bailouts, crushing unemployment, high bond yields and bank crisis. Now, it is a growing economy with 2.6% GDP growth this year. Spain will grow almost as fast as the UK and a lot faster than France or Germany. Unemployment, thankfully, is starting to fall as manufacturing and exports are up. There is also good news in Italy. The Eurozone's third largest economy is benefiting from the ECB stimulus package, falling oil prices, and at last the easing of austerity measures. The Italians can expect 0.7% growth this year.

'Mario Draghi must be very pleased with the early results of his QE programme'

Mario Draghi, the ECB President, must be very pleased with the early results of his QE programme. He has confirmed, irrespective of the initial impact, the ECB bond buying programme will be implemented in full. This will mean a €1.1tn capital injection into the Eurozone economy through to September 2016. Mr Draghi believes it will take time for the full benefits to spread to the wider economy and return inflation to its target of 2%.

Critics of QE have warned that the ECB's monetary policy lets national politicians off the hook on essential reform and that ultimately political inaction will raise pressure to maintain emergency low levels of interest for longer. While Mr Draghi accepts these points, he currently considers them the price to pay to help countries with huge debt burdens reduce their borrowing costs and start a recovery. He considers the implementation of the full QE programme as vital to boosting confidence, growing investment, and creating higher consumption and stable inflation.

German investors were buying up gold bars and coins as a hedge against the QE programme in Europe and the threat of a Greek default. Gold is seen as a safe haven to protect against inflation and economic crisis. While overall gold demand fell across the world, it significantly increased in Germany. Generally with the absence of strong inflationary pressure and a raising US$, gold is unlikely to record any significant price movement.

Financial market reaction to the developments in Greece has been relatively muted up until early June when markets started to become very nervous. With the absence of an agreement, the risk of bond rate rising as an upward adjustment of the risk premium and losses on equity markets could materialise. While it is generally believed that the European Banks can withstand a Greek default, it would be unwise to consider that the default could be contained without global loses and some peripheral contagion.

The ECB's bigger concern in some respect is what happens to the world economy when the US Federal Reserve begins to raise interest rates. This will further raise US$ values and start changing the cost of long-term credit, consequently changing the forecasts for GDP growth and debt costs.

The Real Greek Tragedy

'The people of Greece are withdrawing their savings from their own banks at a phenomenal pace'

The Greek government continues to hold out for a better bail-out deal. Greece's bargaining position has deteriorated dramatically in recent months. As the Syriza lead coalition took power in January, Greece was actually starting to enjoy its strongest period of growth since 2008. The economy despite the lack of reform had bottomed and recovery was in progress. It is disappointing to see how quickly that position has been lost. Soon after Alexis Tsipras became Prime Minister, the ECB surprised many by announcing that it would no longer accept Greek bonds as collateral for cheap loans. Greek banks could therefore no longer borrow new money from the ECB, limiting the ECB exposure to Greece.

Greece's debt mountain stands at €320bn. The cash strapped government has been struggling since February over the further release of €7.2bn. In June it is due to repay €6.75bn to its principle creditors (ECB, IMF and bond holders), in July €5.95bn and in August €4.38bn. It is the repayment of these loans that are being negotiated without success as yet.

Figures show that private sector bank deposits shrank by €4.6bn in April down to €133bn the lowest since 2004. The people of Greece are withdrawing their savings from their own banks at a phenomenal pace. Since January's general election, €30bn has been withdrawn. So far what has happened is not a full scale run on the banks but it is a fast jog and big enough to cause concern. If Greek citizens take enough money out and banks cannot replace the liquidity with loans from the Bank of Greece then their banks will fail. The ECB are in control of the emergency liquidity assistance (ELA). Greek banks have been told that as long as they remain solvent and have adequate collateral they will continue to receive funding. However, with the realistic possibility of Greece leaving the Euro and reinstating the Drachma at a 40%-50% devaluation rate, who would hold their money in Greece?

The likelihood of a forced Greek exit from the Eurozone is higher than ever. It seems clear that Germany in particular is warning Greece "enough is enough". This raises the question of a potential spill over effect into other markets. The risk of default contagion is greatly reduced as compared to the last Grexit threat back in August 2011; Greece is a relatively smaller economy and has greatly reduced its banking sector exposure. The greater risk is a loss of investor confidence but even this has been minimised by the ECB QE programme buying up European corporate bonds. If Greece does exit from the Euro it will be expected that equity and bond markets will see greater global volatility and initial significant losses. However banking contagion should be limited to other peripheral European markets. We do however ultimately expect a classic European and IMF deal to be reached to keep Greece in the Euro, but the chances are reducing by the day as each side becoming more entrenched.

The US is Historically Overpriced but Enjoying Significant Momentum

The brutal weather in January and February across North East America has once again hit GDP growth. The combination of freezing conditions, a prolonged dock workers strike and a very strong US$ has led to the world's largest economy contracting by –0.7% in Q1 compared to an expected 0.2% expansion. On the back of a high US$, American exports fell by 14% while imports increased by 5.6%. The trade deficit widened in March by US$15.5bn to US$51.4bn much to do with delayed imports.

Wall St stock value dropped after a weaker than expected US consumer confidence report, flat retail sales in April and May, and lower than expected industrial production.

With the slowing of output and GDP, some of the shine has come off US stocks that have enjoyed a terrific run of growth for the past few years. Some economists believe the US economy is running a little hot but consider the recent relapse in Q1 as a temporary blip. Goldman Sachs expects that a surge in delayed imports, low oil prices, low interest rates, high employment and rising wages will see the world's superpower generate further growth. They are predicting a GDP growth figure of 2.9% in Q2.

The US Department of Labor has confirmed that US unemployment is now 5.5%. This represents a seven year low. Employers in the US created 280,000 new jobs in May on top of the 223,000 new jobs created in April. The March figures were 85,000 which were disappointing, and below expectation, but can be attributed to the seasonally poor weather in the North East. These figures did lead to a fall in US stock values, but the improved April and May figures reversed that decline. While employment growth continues at the current pace, Janet Yellan, the Head of the Federal Reserve, remains on course to raise the federal funds interest rates towards the end of 2015.

In an unusual move, the International Monetary Fund (IMF) has urged the Federal Reserve to delay any rises in interest rates until 2016 as they believe pockets of vulnerability in the US economy have emerged. Some fund managers are expecting a 2016 start to US interest rate rises. In which case emerging markets will take some comfort.

Despite these signs of growth in the US, we are conscious that American stock markets are currently trading on a price to earnings ratio (P/E) of 27, when the long term mean is 16. We are also mindful that with the wave of cheap money available, equity growth in US corporations is disproportionately being achieved through borrowing, share buy backs, and mergers and acquisitions (M&A) rather than from strong and rising profits. The US is therefore historically overpriced but is enjoying significant momentum due to its status as the first developed economy to emerge from recession.

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Domestic Consumption is the Core Investment Case

Investors have spent many years wondering why fast economic growth in China was not reflected in strong investment returns. Now, they are wondering how slower economic growth can generate such attractive investment returns.

President Xi Jinping is reforming the economy and turning away from debt funded infrastructure investment to boost growth. A continuation of the 2014 objectives of reform and deleverage will be continued in 2015. We expect China's leaders to manage a slower rate of growth persisting in the future.

Lower growth makes the operating environment more competitive for many businesses. The best companies, those with higher margins, bigger cash flows, stronger balance sheets and superior management, are using these tighter times to gain a competitive advantage. Businesses with low debt and better operating efficiencies are investing in new products and efficiency gains offering investors attractive growth.

The rise in domestic consumption is the core investment case. With wages and incomes rising, social change and urbanisation is driving a multi-year increase in consumer activity. China is the world's largest importer of oil and therefore should be a net beneficiary of lower energy prices.

The People's Bank of China has reduced its interest rate by 0.25% to a lending rate of 5.1% and a deposit rate of 2.25%. This is the third such reduction in six months following some disappointing results showing weaker than expected exports and foreign trade. Foreign trade fell by 10.9% on a year on year basis as rising labour costs and a relatively strong currency squeezed manufacturing and exports. These rate reductions are therefore aimed at incentivising spending by making it less attractive to leave money in the bank and encouraging business to invest by cutting lending costs.

The data reinforced expectations that China will see its worst annual performance in 25 years. The IMF predict that China's GDP will grow this year at "only" 6.8%, down from 7.4% last year and greatly reduced from 14.2% in 2007. But, this is a different China and one starting to steer a different course. Government reforms are helping the country transfer itself from an investment and export lead economy to one focused on sustainable but slower domestic consumption lead growth. Economists will agree that 6.8% is still, in global terms, a very attractive growth rate.

'The volume of trading on China's major exchange has some days reached US$140bn'

Since the start of the year the Chinese stock market, the Shanghai Index, has risen 37% and its sister

index, the Shenzhen is up 53%. Over the past two years the two markets have risen by 122% and 96% respectively. The volume of trading on China's main stock exchange has reached US$140bn on a number of days this year. This is four times greater than Wall St. There are 100 million investment accounts in Shanghai as rapid economic growth over the past decade has created a burgeoning middle class wishing to enter equity markets.

From 2011 to 2014 the Chinese stock market hardly moved in value compared to China's economic growth. The main reason being the difficulty foreign investment used to have in participating in China's semi-closed stock market and the preference Chinese people had for investing in homes and property. This sector is now in decline as an asset class due to oversupply and higher credit controls on mortgages. The Chinese stock market took off when the property bubble burst.

It would be natural to be concerned that with these growth rates the Chinese equity market itself may be heading for a bubble. P/E ratios are currently up to 20 times earnings which is internationally high but still well below the 40 times earnings of 2007. Some sections of the Chinese stock market do qualify for the generally accepted definition of a bubble and are being driven by herd instincts and momentum. We are therefore cautious.

The prices of new homes in China fell for the ninth consecutive month in May showing that the property sector continues to be a major drag on the world's second largest economy. Average house prices in China's 70 major cities fell by 6.1% so far this year with a very large inventory of unsold property weighing on the market. The property sector accounts for about 20% of China's economy and is now considered one of China's biggest risks to economic growth. The recent rate reductions may help stimulate demand but some economists are calling for a much bigger rate reduction to at least 2% in order to recover demand.

There have been reports that China is about to start its own QE programme but in reality this amounts to the People's Bank of China buying local government bonds only. This is targeted financial assistance to revenue squeezed local government. The property turn down has affected local government bond take up rates. China does not need Western style QE as overall monetary policy is fairly tight with interest rates at 2.25%. There is still plenty of room to cut rates before QE.

China plans to establish a US$166bn gold fund in order to stock pile the precious metal. The news of the fund made up of bullion, Gold ETF's and investments in gold mining companies could restore some impetus to the gold market that has been struggling to offset the strength of the US$. Gold has fallen below the psychologically important US$ 1200 per ounce as traders took note of the Federal Reserve's intention to increase the Fed Funds rate later this year.

A Positive Outlook for Japan

We are positive about the outlook for Japan both this year and next. Several factors should allow GDP to rise to 0.9% this year and 1.8% next year before the next sales tax increase hits consumption in 2017. Lower energy bills will provide much needed relief to household finances and a boost to consumption. The external trade picture is improving with exports up 15% year-on-year. The BoJ QE programme will hold down interest rates, boost money supply, support asset prices and push down the ¥. While the BoJ is unlikely to hit its 2% inflation target this year, it should at least succeed in creating inflation.

Japanese equities have had a great start to the year. The Nikkei 225 is up more than 12% year on year and has reached a 15 year high in May of 20570. Unlike past rallies, this one has not been followed by significant further depreciation in the ¥. The Japanese market looks well supported by QE and is cheap compared to other markets. The Nikkei, even after significant gains, is still trading below its ten year average P/E ratio. Japan has been cheap on most trade measures for some time and for good reason. There are several forces that now should lead to positive long-term growth.

Government policy demands that the Japanese government's pension fund need's to invest tens of billions of ¥ into the Japanese stock market to comply with revised mandates. A quarter of the government's pension fund must now be invested into the domestic equity market. Also the BoJ is expected to invest another US$25bn in QE programmes. The combined impact should be significant.

Given the lack of domestic energy resources, Japan's energy imports are one of the highest amongst advanced economies. The reduced cost of oil to industry and manufacturing, as well as the domestic consumer, should drive down costs and increase consumption. Cheaper oil is therefore a tail wind behind Japanese equity growth.

There has been far too many past false dawns in Japan and this is the reason that for many years, we have not invested into a Japanese single country equity fund. Given the depth of the country's structural reform that still has to be addressed, it is yet too early to call Abernomics a success. However, attractive valuations, earnings momentum and lose money provide a flexible environment for future growth in this market.

Emerging Markets

Emerging markets (EM) have been going through a general slowdown over the past 12 months. A falling income stream automatically raises questions over debt repayment. The growth in emerging markets post economic crisis was supported by US QE. This debt fuelled growth causes problems when borrowing grows faster than income and will be a major concern if the Federal Reserve increases its interest rates later in the year.

Emerging markets are in a much healthier position since the previous "Taper Tantrum" of May 2013. While overall debt may be higher, the proportion of foreign exchange is far less. Emerging market economies do now hold greater stockpiles of reserves. This may be some comfort to sovereign governments, but does not protect corporations from high borrowing and falling revenue. The countries that concern us are Turkey, Chile, Brazil, Columbia and South Africa.

'Falling income automatically raises questions over debt repayment'

BRIC (Brazil, Russia, India & China)

'The fortunes of the BRIC economies are diverging'

The fortunes of the BRIC economies (Brazil, Russia, India and China) are diverging. Slower growth in China appears to be both planned and inevitable. As the economy decelerated further, interest rate cuts look likely. According to the IMF and OECD, overall, Chinese growth looks set to slow to 6.8% in 2015 and 6.3% in 2016. India's interest rate cuts in March and May reflect, on the other hand, an improving confidence in the country's economic prospects. An expansionary budget, falling inflation, and an improvement in industrial output are signalling a strengthening outlook. Indian growth rate looks set to exceed China at 7.5% this year and next. The fortunes of Russia and Brazil are markedly weaker as their economies are expected to contract by -6.3% and -1.1% respectively, this year as a result of lower commodity prices and poor economic management.

Latin America

'Under pressure'

Latin American markets have come under pressure due to concerns over the timing of US interest rate rises, a rising US$ value, and disappointing economic data from Brazil. Weakness in the Brazilian equity market was accentuated by a sharp drop in the value of the Brazilian Real versus the US$. Brazil's Central Bank raised interest rates by another 0.5% up to 12.75%, a move that is expected to improve exchange rates.

India

The Mumbai Sensex Index hit 29681 to reach an all-time high at the end of January but has since given up some of these gains. As at writing it stands at 26768, a 10% decline, but still up on the yearly growth figures. The market seems to have fallen off the boil on the back of a new fund manager tax and because the reforms expected from Narendra Modi's government have progressed more slowly than investors had hoped. This is India though.

'India can boast one of the world's fastest growing economies'

The bigger picture remains more encouraging. Foreign investment limits have been raised, costly subsidies have ended, infrastructure spending is growing, and employment laws are being liberalised. The Modi government intends to sell off the countries mineral rights. The coal sector, for so long a monopoly, will be open to competition, thus helping to end the electricity shortages and blackouts. Reduced energy costs have helped with inflation which for a long time has been a problem within the Indian economy. This allowed the Reserve Bank of India to cut interest rates twice in Q1.

The position of India as a good investment is currently aided by low oil prices, sound demographics and global service economy. India can boast one of the world's fastest growing economies over the next year. The IMF expects GDP growth of 7.5% this year.

'Russia has done well to avoid a real collapse'

The Russian economy not surprisingly contracted by 1.9% in Q1 because of low oil prices, weaker domestic spending and the heavy trade sanctions imposed from the West. The ECG expects Russia to contract by 4.5% this year and by 1.8% in 2016. However, Russia has done well to avoid a real collapse under the economic and political circumstances. Further contracting seems inevitable given the lagging effect of monetary policy and fiscal tightening underway.

The Central Bank of Russia has extended its anti-crisis measures aimed at supporting their domestic banks as they have suffered as the rouble has fallen in value. The rouble fell 39% against the US$ over the last 12 months although it has rallied since February. The weak currency and high inflation due to the lack of Western imports has hit spending. The Central Bank has reversed its sharp interest rate hike of last December reducing rates back to 14% from 17%. Wages have fallen 8.4% this year which only adds to the downward spiral.

The Organisation of Petroleum Exporting Countries (OPEC) is expecting to leave oil production levels unchanged at 30 million barrels per day despite concern, in some quarters, that the oil price is well below US$100 per barrel. Saudi Arabia wishes to preserve the low oil price in order to undermine the US shale industry. Oil currently stands at US$64pb. A level OPEC member such as Iran, Iraq and Venezuela are put under financial strain due to their lack of foreign currency reserves to buffer their economy from falling revenue.

'US shale oil industry has yet to capitulate'

OPEC, which controls 1/3rd of world oil production, effectively triggered a price war last November aimed at winning back market share from shale drillers in the US. Oil production from shale in the US has fallen due to the decline in the number of oil rigs. Since November, 784 oil rigs have stopped pumping. However, contrary to expectations, the highly indebted and price sensitive US shale oil industry has yet to capitulate. The rig count may have halved but output has held up despite Saudi Arabia's actions. Around the world, established oil reserves are being used up signalling that demand will soon start to rise. On the basis of falling supply and higher consumption in Europe, OPEC has revised upwards it forecast for world oil demand.

Oil prices have rallied from their low point of under US$50pb in November to around US$64pb in mid-June. The main reason for this six month rise is the positive growth in Europe. However, this mini-rally in oil prices and other industrial commodities is seen by leading investment banks as running ahead of the economic reality. Oil is up 31% and copper up 60% but world growth is only just rising.

'The End of a 30 Year Bond Bull Market?'

Government bonds are supposed to be risk-free assets. UK gilts and German bunds being perhaps the most secure. With the ECB starting their €60bn pm QE programme in March, this prompted investors to rush to bonds. The general consensus was that the QE programme would buy up the Eurozone bonds on offer and the resultant scarcity would push up prices even if yields fell to zero. Buyers crowded the small market. Within weeks of the start of Mr Draghi QE programme, the spectre of deflation was removed with low borrowing costs, rising oil prices, and economic growth. Future inflation was back on the agenda and with this yields soared to compensate investors for the risk of future inflation. With rising yields came falling prices. Government bonds have been on a bull market since the early 1980's on the back of low interest rates. Yields have been exceptionally low and hence bond values have been expensive. This is particularly true if yields are less than inflation or near zero.

The recent uplift in oil prices and business growth in the Eurozone particularly in Spain eased fears of deflation which Mr Draghi's programme was designed to prevent. If inflation is to return to Europe, zero bond yields are not acceptable and therefore will have to rise. The normally safe and secure government bond market saw ultra-low yields rising by 20% or more with a corresponding fall-off in value. German Bunds, for example, lost 15% in value in early May. Across Europe, sovereign bonds have seen dramatic rises in yields and resulting falls in capital values representing big losses. The sell-off was described by Goldman Sachs as "large and vicious".

This bond market re-adjustment could signal the end of a 30- year bond bull market as capital values have kept growing on the back of progressively declining yields due to lowering inflation and interest rates.

There are some good reasons to believe that a bear market in bonds may be premature. Investors have not moved out of fixed interest securities and the Eurozone recovery is only just starting. Recent good news in Spain, France and Italy was offset by disappointing news elsewhere. With unemployment still very high we are not likely to see inflation become a problem in Europe for some time. Therefore the ECB are most likely to keep printing money as they have stated, until September 2016 at the earliest. Central Banks are also in no hurry to raise interest rates. This should, going forward, keep the lid on sovereign bond yields and support bond prices. Either way, government bonds remain an unattractive investment.

A major question for bond holders is what will happen once central banks do begin to raise interest rates? The government bonds from countries such as the US, the UK, Germany and Japan all have high credit ratings and therefore yields are determined by the outlook for interest rates. Short duration bonds (less than 10 years) are influenced by current interest rates, while long term bonds are affected by how investors expect rates to change in the years ahead. This is equally true of corporate bonds.

The rout in government bond values in May intensified fears amongst analysts over the lack of liquidity in bond markets. A big sell-off in gilts, corporate bonds and high-yield bonds perhaps triggered by the start of potential US interest rate rises in October 2015; ECB tapering QE after September 2016; or the emerging markets struggling with rising US$ values, would create major liquidity problems as sellers crowd the exits. Bonds by their nature tend to be attractive to cautious and often retired investors, those least wanting to tolerate losses. For this reason, we have sought to reduce our bond exposure and create greater diversification within our portfolios.

Against this background we have set out our portfolio recommendations.

17th June 2015


JUBILEE WALKWAY

PORTFOLIO SELECTIONS

Portfolio Selections – July 2015

Our last Investment Outlook Report in December 2014 was cautiously optimistic about global growth. We felt that if Mario Draghi could press on with a European QE programme, opportunities within Europe would develop aided by falling oil prices and low borrowing costs. We have, I am pleased to say benefited from these events.

Since the start of 2015, equity markets have responded well to the loose money supply, low interest rates, and low energy costs. After a strong start to the year, global equity markets have now been affected by the uncertainty over Greece and the impact of a potential US Federal Reserve rate rise. As a result much of the early Q1 2015 equity gains have been given up, if only temporally. Investors in markets such as Europe, Japan, China and India will have overall enjoyed significantly higher rewards than other economies; however, prospects going forward may be less attractive. Generally, global corporate earnings estimates, with the exception of Japan, have taken a step backwards and valuations are less attractive particularly in the US. Average US P/E ratios are the highest recorded in the post- war period and are broadly based across sectors leaving little in the way of undervalued assets. Principle drivers of equity markets are central bank stimulus and the hunt for attractive yields. Along with our concerns over the highly valued US market, equity and now bond markets are vulnerable to any unexpected bad news and with it act disproportionally.

As of 17th June, our best performing funds held within our portfolios over the last 12 months have been;

Henderson China Opportunities	30.78%
Old Mutual UK Mid Cap	29.38%
Schroder US Mid Cap	24.75%
Aberdeen Property Shares	24.08%
Old Mutual North American Equity	23.87%
Schroder US Smaller Companies	21.67%
Fundsmith Equity	20.80%

The main reasons behind these positive returns have been the significant growth in the US, China and UK Mid Cap markets.

While our poorest performing funds were;

Templeton Global Total Return Fund	-1.81%
Kames High Yield Bond	2.37%
JP Morgan Emerging Markets	2.62%

The main reasons for these disappointing performances were the general sell off in bonds and emerging markets. We were particularly disappointed at Kames High Yield Bond as this fund has served us very well for many years.

'Collectively the seven portfolios outperformed their respective benchmarks on 36 of 39 occasions'

As far as the 23rd Edition of our portfolios is concerned, 15 of the funds in the 22nd Edition have been substituted. Our asset allocation remains broadly in line with that of previous editions in order to retain the portfolios risk profile. However, they have been tilted towards sectors we feel offer better prospects going forward. We are holding greater levels of cash and property across the portfolios in order to help dampen volatility.

Despite concerns, we still believe that the general economic and monetary environment remains supportive of risk assets relative to both fixed interest and cash. Our strategy is to remain overweight in equity and UK property. We have increased our exposure in the UK, Japan and Europe as well as specialist areas such as infrastructure, financials, biotech and healthcare. We have maintained our holdings in India and China but reduced our exposure to the USA. We have significantly reduced our equity holding in emerging markets in general. While geographic uncertainties prevail, we have extended our exposure to specialist sectors, particularly UK property, listed infrastructure, financial institutions and healthcare research and provision. As far as fixed interest securities are concerned, we are cautious of the potential rise in US interest rates and while not imminent, the return of inflation. We have maintained our holdings in UK corporate bonds and high yield bonds as they represent reasonable value. However we have reduced our overall fixed interest holdings and transferred a proportion of the portfolios to UK property funds that are offering both better yields and growth prospects. We are negative about Brazil, Russia, gold, commodities and European sovereign bonds and so do not hold any direct holdings in our portfolios.

We are once more pleased to report that the gross performance of our portfolios in each of our current seven portfolios up until 17th June 2015 as measured against the associated national 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 and all of our portfolios showed up well. Collectively the seven portfolios outperformed their respective benchmarks on 36 of 39 occasions

Our performance is reported on page 24 of this Outlook Report as well as on our website **www.estatecapital.co.uk**

A New Balanced High Income Portfolio

We have launched a new Balanced High Income Portfolio. This is in response to a growing requirement for higher income producing investments. The new pension freedoms are leading to more retirement income coming from pension drawdown plans and from general investment. The Balanced High Income Portfolio has an expected gross yield of 4.48% pa while the Balanced Income Portfolio is 4.1% pa. The risk profile of the new portfolio is set at 5/10, reflecting the higher equity content compared to the Balance Income Portfolio.

PORTFOLIO PERFORMANCE

The Estate Capital Investment Portfolios

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

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 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'

Cumulative Portfolio Performance from 17th June 2015

Below are the past five year's gross investment returns for each of our portfolios from 17th June 2015

Portfolio	*6 months*	*1 year*	*2 years*	*3 years*	*4 years*	*5 years*
Defensive	2.99%	5.46%	9.42%	17.07%	20.56%	29.69%
Conservative	3.77%	6.80%	12.19%	25.10%	27.77%	40.40%
Balanced Income	4.68%	5.66%	13.82%	30.00%	33.52%	49.44%
Balanced High Income	5.67%	6.77%	-	-	-	-
Balanced Beta	3.89%	8.57%	15.09%	31.72%	34.93%	-
Balanced Alpha	6.94%	9.72%	16.49%	31.67%	33.54%	48.50%
Speculative Beta	5.41%	8.16%	16.69%	38.27%	36.73%	-
Speculative Alpha	8.85%	12.32%	24.68%	-	-	-

Discrete Portfolio Performance from 17th June 2015

Below are the gross investment returns for each of our portfolios for each 12 month period over the last five years from 17th June 2015

Portfolio	*2014*	*2013*	*2012*	*2011*	*2010*
Defensive	6.71%	2.77%	8.82%	1.31%	8.88%
Conservative	8.78%	2.99%	14.87%	-0.31%	12.49%
Balanced Income	7.88%	6.05%	17.72%	-0.34%	15.87%
Balanced High Income	New	-	-	-	-
Balanced Beta	11.12%	3.51%	19.45%	-0.51%	-
Balanced Alpha	12.66%	3.19%	18.16%	-1.55%	14.30%
Speculative Beta	11.64%	4.54%	25.10%	-4.94%	-
Speculative Alpha	15.90%	7.85%	-	-	-

The value of investments can fall as well as rise. Past performance is not a guide to future performance. Cumulative and discrete performance charts show % growth from 29th March 2010 to 17th June 2015 calculated using bid prices with income re-invested into the fund net of tax.

PORTFOLIO PERFORMANCE

Asset Allocation

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

Rates of Risk Related Returns

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

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

Asset Allocation June 2015 - Edition 23

Portfolio	*Risk*	*Money Markets*	*Fixed Interest*	*Property*	*UK Equity*	*US Equity*	*Europe Equity*	*Asian Equity*	*Japan Equity*	*Global Equity*	*Other Assets*
Defensive	2	47%	13%	22%	7%	5%	3%	3%	0%	0%	0%
Conservative	3	28%	16%	21%	14%	8%	5%	7%	0%	1%	0%
Balanced Income	4	12%	24%	19%	27%	7%	6%	5%	0%	0%	0%
Balanced High Income	5	10%	25%	13%	29%	9%	8%	6%	0%	0%	0%
Balanced Beta	5	11%	21%	14%	18%	11%	8%	15%	2%	0%	0%
Balanced Alpha	6	7%	15%	13%	22%	16%	8%	16%	3%	0%	0%
Speculative Beta	7	5%	9%	14%	21%	17%	11%	20%	3%	0%	0%
Speculative Alpha	8	6%	3%	15%	20%	21%	11%	21%	3%	0%	0%

Perspective Range of Returns & Volatility

Portfolio	*Risk*	*Return*	*High*	*Low*
Defensive	2	3.82%	12.28%	-4.64%
Conservative	3	4.75%	18.75%	-9.25%
Balanced Income	4	5.16%	22.57%	-12.24%
Balanced High Income	5	5.68%	26.50%	-15.14%
Balanced Beta	5	5.68%	26.50%	-15.14%
Balanced Alpha	6	6.34%	30.57%	-17.88%
Speculative Beta	7	6.91%	34.55%	-20.72%
Speculative Alpha	8	7.49%	38.53%	-23.56%

Investment Ratios

Portfolio	*Risk*	*Beta*	*Alpha*	*Sharpe Ratio*	*Info Ratio*
Defensive	2	0.69%	1.89%	0.94%	0.05%
Conservative	3	1.04%	2.39%	1.31%	2.08%
Balanced Income	4	0.93%	2.22%	1.57%	1.04%
Balanced High Income	5	New	-	-	-
Balanced Beta	5	1.15%	1.08%	1.40%	1.09%
Balanced Alpha	6	0.96%	0.53%	1.30%	0.01%
Speculative Beta	7	1.19%	0.18%	1.36%	0.68%
Speculative Alpha	8	1.26%	3.07%	1.84%	1.33%

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

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