ESTATE CAPITAL INVESTMENT PORTFOLIOS

OUTLOOK

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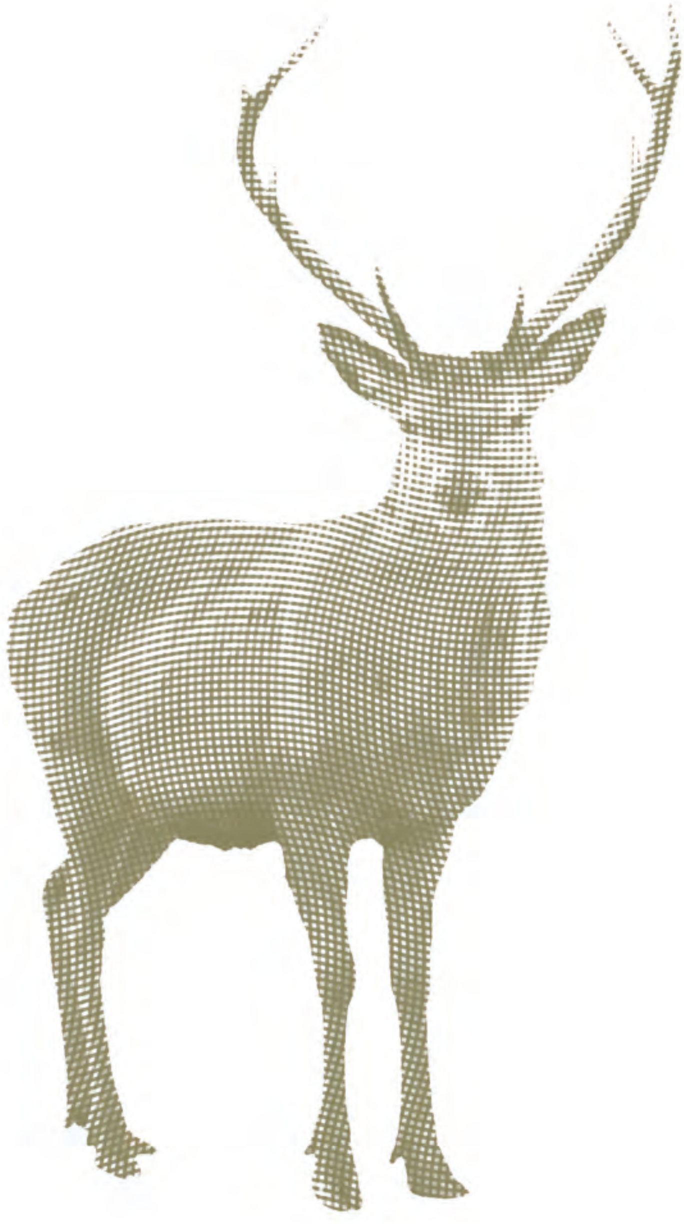

In This Edition:

Reasons Behind The China Crisis
The Federal Reserve Raise Interest Rates
The Improving Global Recovery
ECB Quantitative Easing Programme
The Growth Economies
Our New Portfolio Selections

ESTATE CAPITAL

The Market Falls of August and September Contributed to the Worst Quarter in Global Stock Markets

After the dramatic falls in equity markets in August, stock market volatility extended throughout September. These market falls contributed to the worst quarter in global stock markets since quarter 3 of 2011 and the Eurozone crisis. Confidence in the strength of a global recovery was hit by Chinese data that suggested that their economic activity had fallen. The subsequent official Chinese government intervention in both the foreign exchange and stock markets only exacerbated the situation.

August's devaluation of the Chinese renminbi was a major event and a significant departure by Chinese policy makers. This devaluation was part of a currency war aimed at supporting the competitiveness of Chinese exports.

Market anxiety almost reached a panic when the Shanghai Composite Index fell by 42% over a horrendous ten week period. Things look quite different now with the index recovering 17% from its August low and up 25% on its value twelve months ago.

The US Federal Reserve also contributed to the uncertainty by putting off its decision to raise the federal funds rate in September. Global jitters and some soft data on US job creation meant that dearer money was postponed. This caused investors to ask questions of whether the Fed knew something that they didn't, rather than being pleased that near zero rates had been maintained.

Notwithstanding the upturn in volatility in the past six months, the ending of quantitative easing (QE) in the US has been taken relatively well by markets. This reaction is encouraging as the withdrawal of loose money and the December rise in US interest rates further illustrate the growing confidence in the US recovery.

The US economy remains flexible and entrepreneurial with better demographics than many of its Asian and European counterparts. The low cost of oil and the development of domestic shale gas will provide low cost energy and a competitive advantage for many years to come. Countries that control their own energy costs, as Britain did during the industrial revolution, have built-in economic advantages.

Recent actions from the European Central Bank (ECB) as well as the Bank of Japan (BoJ) have provided massive monetary easing on an unprecedented scale for these areas. The respective QE programmes are aimed at currency devaluation to create greater export competitiveness. It remains to be seen if central banks in competing countries, adversely affected by these moves, will respond.

Central banks now have far less ability to respond to adverse economic shocks when their interest rates are at near zero and having already implemented extensive QE programmes. A central bank "put" where monetary policy can underpin growth, is now less credible and less functional.

Since 2008 we have witnessed hundreds of interest rate cuts and trillions of US$ worth of QE. Still, it feels as though all we have to show for it is a fairly underwhelming stop-start recovery.

Since the great sell off in August markets have significantly picked up. It is becoming clear that Chinese growth is due to bounce back and markets are positive about the Federal Reserve interest rate rise in December. The postponement of a US interest rate rise in September and the continuation of BoJ and ECB QE have maintained the loose money conditions that have historically lifted stock prices.

'Global growth is holding up better than many commentators had expected'

A global manufacturing recovery has started to emerge in Europe, the US and Japan and is starting to shake off the recession scare of the summer. Chinese data has improved after a deep summer slump in industrial output. Fears in August of the world being dragged into a deflationary cycle, which prompted the heavy market falls, now seem overblown and panic driven as global growth is holding up better than many commentators had expected.

The Markit Purchasing Managers Index (PMI) of global factory output has risen to 51.4 in October fuelled by continuing monetary stimulus. The PMI results improved in the UK, Japan, India, Russia and Vietnam. Chinese PMI for October showed signs of bottoming the cyclical trough. The increase in Chinese PMI was the biggest jump for 15 months and the result of the recent fiscal stimulus and interest rate cuts at last feeding through to the real economy. This has also begun to spur on a Chinese housing market revival. The PMI index for the Eurozone rose to 52.3 again lifted by a weaker euro, cheap oil and ECB QE.

Senior Economists are now Predicting That the Global Recovery is About to Strengthen

This widespread opinion comes as government policies have turned to expansion in the US, China and Europe at the same time. In China, recent equity purchases by the Peoples Bank of China (PBC) and interest rate cuts are now filtering through the economy. The budget crunch effecting China is now over as the local government bond market has started to work more efficiently.

China's leaders are keeping their country on an economic stimulus. Whether or not this proves to be the correct course of action will be seen in the future, but for now a mini cycle of growth is welcome. China can expect "true" growth of around 5% this coming year and therefore is not an economy facing collapse.

In Europe, it is hoped that deflation has been held off. The combination of cheap money, cheap oil and a devalued euro are having a positive impact. This position is supported by the ECB continuing its QE programme beyond September 2016. The fiscal squeeze that undermined the Eurozone recovery four years ago is now a memory as Ireland, Spain and Italy are all growing out of austerity measures.

Studies in the US have indicated that the austerity policies of the US government from federal through to state and county have reduced national GDP growth by about 1% each year over the past five. US government at all levels is now adding net spending to the US economy having significantly raised their investment programmes.

In contrast to much of 2015, the growth outlook for 2016 looks good. Inflation will continue to be low and policy stimulus will be strong due to the combined efforts of Japan, China and Europe's central banks plus the delay to December of a US interest rate rise. The predictions for world GDP growth for 2015 are 3%, rising to 3.4% in 2016 and 3.7% in 2017.

The risks in the world have not however gone away. We still do not know how the emerging markets will cope with a US$ rate rise hitting their borrowing costs. There are concerns about a general emerging market decline. We also do not really know if the entire world's debt mountain is stable. Central banks may come to realise that they have over stimulated and reflated markets long after it was needed. This is an issue that both Janet Yellen and Mark Carney are currently wrestling with. The US Federal Reserve has started to return to normalised interest rates with a rate rise of 0.25% in December. The Bank of England (BoE) could then follow in November 2016.


SRCB

The Long Term Growth Appeal Remains Intact but on the Other Side of the Equity Market Correction

Chinese authorities have for some time been accused of manipulating their GDP figures. The latest Q3 figures for 2015 report a 6.9% year-on-year growth which does nothing to allay these suspicions. The unofficial alternative index covering electricity consumption, bank lending, rail and road cargo, which are all harder to fake than GDP, illustrate a growth of 5% pa. While the world knows that China is slowing, it is the speed at which it is slowing that is important. Industrial and manufacturing production fell 6% year-on-year in Q3 but retail sales grew 10.9%. Chinese consumers are clearly spending which is good news for the service sector which now makes up a much larger proportion of GDP than industry.

After the heavy fall in Chinese equities in August, economists and business leaders were calling for new fiscal spending and a reduction in interest rates. In response the PBC cut rates to 4.35% in October. This was the sixth rate cut this year and signalled to the markets that the government wants to support the economy. The reserve requirement on Chinese banks was reduced by 1% to 17.75% in order to free more capital for lending.

The Shanghai Composite Index has enjoyed a rollercoaster of a ride in 2015. It started 2015 at 3400 points, grew dramatically to a high of 5166 points in June, only to fall to 2950 by August and then recover to 3646 by November. This stock market volatility is a symptom of investors having to get used to slower growth. The falls were not the consequences of an economic boom on the way up so should not hamper growth now.

China's unique brand of red capitalism and an enormous stockpile of foreign currency reserves provide it with both control and policy options. There are some very attractive companies geared into the rise of the Chinese consumer class. The so-called slowdown may have happened and therefore the long term growth appeal remains intact, but on the other side of the equity market correction.

China will be the first globally significant economy to grow old before it grows rich. The United Nations estimate that between now and 2025 the number aged between 15 to 29 will fall by 27% while those over 65 will rise by 52%. To grow their economy Chinese productivity needs to improve significantly.

China

However, the current levels of productivity are self-inflicted through policies to keep people employed. A far reaching programme of structural reform is needed. Commentators remain sceptical of Beijing's desire to push through any significant reform that is likely to lead to unemployment and bankruptcies. The transition to an open, liberal economy would weaken the financial controls of the politburo.

'To grow their economy Chinese productivity needs to improve significantly'

Asia

'While the outlook has improved, Asian stock markets are still subdued and are looking cheap'

Asia contains the majority of the world's population and is growing fast enough to produce an economy the size of Germany every 4 years.

The Asia Pacific ex Japan Index has fallen by 28% from its April 2015 peak taking it to a three year low in early September. These losses are the result of the fear of a hard economic landing for China, falling commodity prices and the prospect of higher interest rates in America which is expected to draw money away from emerging markets. Asian exports into China make up around 10% of the regional GDP so Asian growth is effected by China. The good news for the region is that it looks as if China has turned a corner. Any improvement in China will aid Asian exports. Capital Economics expect GDP growth in emerging Asia to rise to 5.6% in 2016 up from 4.3% in 2015.

While the outlook has improved, Asian stock markets are still subdued and are looking cheap. The MSCI Asia ex Japan Index has a price to earnings ratio of 11.4 which compares favourably with historical averages of 14.

Concerns Over the Global Market Overshadowed Evidence of a Resilient US Economy

The prospect of the Federal Reserve hiking interest rates coupled with slower growth in China unsettled the US equity markets in Q3. The S&P 500 fell from 2075 in early June to 1876 by the end of August. But, with the improvement in global economic outlook the index returned to 2079 in early December, fully recovering the summer losses.

All eyes were on the Fed in September as we waited on the first rate rise in a decade. In the end, interest rates were left on hold as concerns over the global market overshadowed evidence of a resilient US economy. Lower commodity prices and the strong US$ have given Janet Yellen more time to keep interest rates low.

Along with the announcement of record numbers of job vacancies, 200,000 new jobs were created in September and another 271,000 in October. Unemployment is historically low at 5% and expected to fall further. With good news on job creation it was a surprise that US wage growth fell slightly to 2.1% from 2.3% year-on-year.

US Federal Reserve officials are confident that the economic conditions needed to trigger an interest rates rise have been met. Fed officials saw the jobs market improving and inflation starting to move towards their 2% annual target. The US looks to have weathered turbulence in global markets without signs of stress.

Janet Yellen, the Chair of the Federal Reserve announced in December an interest rate rise of 0.25%. This is the first US rate rise in a decade and the first developed country to start returning its economy to 'normal' interest rates. The process of rising interest rates is likely to proceed gradually. The Fed believe an interest rate of 1.37% by the end of 2016 might be appropriate.

Some economists are expressing concern that the US recovery is now quite old and that declining growth is now inevitable. This may be the case but economic recoveries do not die of old age. This is often caused by central bankers raising interest rates too sharply to counter their concern over future inflation.

Economic growth in America was confirmed as 3.7% in Q3 while the economy is expected to finish the year on 2.5% growth. It is predicted to grow by 2.8% in both 2016 and 2017.

Earnings growth has been a strong driver of the bull market in US stocks that started in 2009. Recently, however, the momentum for earnings

'The US$ hit a currency twelve year high in March and it has remained strong since'

growth has started to slow. One factor affecting US companies is now the strength of the US$. The US$ hit a currency twelve year high in March and it has remained strong since. Companies within the S&P 500 index currently generate half of their profits abroad. Therefore, the strength of the US$ has squeezed US exports and company earnings. The other issue impacting earnings growth is falling oil prices. The energy sector accounts for 8% of the S&P 500 and within this sector, profits are expected to fall by as much as 65% this year.

The bull run has been assisted by much corporate cost cutting and share buy backs. Generally, it is now felt that American corporations have done all they can to cut costs and boost profit. The US economy is at a stage of the business cycle where companies can no longer maintain earnings growth through these activities. What they really need is sales growth.

Two of the strongest aspects of the US economy are consumer spending and corporate balance sheets. Both will continue to support economic activity in 2016. Companies are still holding onto record levels of cash and are deploying it in areas such as increased dividends, share buy backs, research and development as well as mergers and acquisitions.

The increase in M&A activity is expected to last well into 2016. M&A activity is a classic late cycle activity producing growth through acquisition rather than sales growth.

Fundamentally, dwindling profits and earnings growth do not justify the high price to earnings ratios that are common in large US companies. American large cap stock remains expensive and therefore we are inclined to migrate some capital to cheaper markets further away from 2016 monetary tightening.

Britain is Fortunately not Just Relying on Cheap Money for Growth

Reinvested dividends account for a significant part of overall long term returns from stocks. With this in mind it is good news that British stocks are paying out record levels of income according to Capita Registrars. UK dividends reached £27.2bn between July and September alone, up 6.8% on the corresponding quarter in 2014. A strong US$ also assisted investor returns. Half the value of dividends from Britain's twenty largest companies are declared in US$ providing shareholders with a currency windfall of £600m. The FTSE 250 Mid Cap index also saw its dividend pay-outs increase by 11% on last year. It is predicted that the largest 350 companies in the UK will pay out a new annual record of £84.8bn in dividends in 2015.

The FTSE 100 hit a 15 year high in April of 7103. Throughout the summer, the index followed other world indices into heavy falls before recovering lost value. The FTSE 100 started June at 6600; fell to a low of 5895 in late August, recovering to 6401 in December. The FTSE 100 has a high component of energy and commodity companies and therefore was affected by the global sentiment to those sectors. The FTSE 250 was not as impacted.

The UK has dipped in and out of deflation this year, firstly in April and then again in September. This fall into negative inflation was put down to lower petrol prices. Core inflation (which does not include volatile food and energy prices) held steady at 1%. Lower prices have put more money into people's pockets particularly when accompanied by wage growth. This increase in household earnings is supporting consumer confidence.

The International Monetary Fund (IMF) is expecting continued steady growth from the UK. It has predicted that output will grow by 2.5% for 2015 and 2.8% in 2016. Britain is fortunately not just relying on cheap money for this growth. There is plenty of organic momentum. Consumer's real income is rising with wage growth of 2.9%, the fastest rise in six years.

The Confederation of British Industry (CBI) has, however, struck a more cautious note and downgraded its forecasts for the UK economy due to uncertain trading conditions. It is predicting now a 2.4% growth in 2015 and 2.6% for 2016. They expect wage inflation to rise to 3.2% next year.

The CBI has taken into consideration that the strong £ has made exports expensive and more difficult. The UK economy continues to have a strong service sector but weak manufacturing. We are as

'Renewed economic optimism has raised expectations over a Bank of England interest rate rise'

a nation particularly reliant on financial services and consumption. Manufacturing accounts for about 10% of UK output while energy and utilities account for 5%, construction 6% and the service sector the remaining 79%.

Figures from the Office for National Statistics (ONS) show that the UK unemployment rate fell to a seven-year low of 5.3% in the three months to September. It was the lowest jobless rate since the second quarter of 2008. The number of people out of work fell by 103,000 between July and September to 1.75 million. There were 31.21 million people in work, 177,000 more than for the April-to-June quarter and 419,000 more than in the same period a year earlier. The ONS confirmed that 74% of the UK working ages are employed.

It has been a tough few months for the UK manufacturing sector. SSI Steel closed its blast furnace and coke ovens in Redcar, while Tata Steel cut jobs in Scunthorpe and Lanarkshire. The Q3 figures for UK manufacturing showed further contraction as it was hit by a summer slowdown in global consumption. The UK steel industry has been affected by global overcapacity, high electricity costs and EU limits on state aid to iron and steel companies.

Foreign investment plays a big part in UK manufacturing with global businesses wanting access to Europe through a country with low corporation tax and flexible labour laws. Unfortunately, the strength of the British pound has made foreign investment more expensive for overseas companies as well as making UK made products more expensive to export.

There has been some recent promising news for Britain's manufacturers with Q4 bringing in rising levels of orders. The Manufacturing Purchase Managers Index (PMI) jumped to 55.5 in October up from 51.8 in September. This indicated a significant rise in confidence and orders. The 3.7% rise was the steepest recorded in 24 years.

Renewed economic optimism has raised expectations over a Bank of England interest rate rise. Most commentators are expecting a modest increase in November 2016. We believe there is little need yet for a rate rise as inflation is far below the BoE target of 2%.

The London Housing Market has Formed the World's Biggest House Price Bubble

Investment Bank UBS has recently confirmed that the ratio of property prices to wages and property prices to rent has reached an all-time high and that London property has become more de-coupled from household earnings than anywhere else in the world. Real house prices after adjustment for inflation has soared by almost 40% since the beginning of 2013. Since the peak of 2007 London is up 6% while the UK national average is still down 18%.

The demand for London properties is largely driven by foreign investment and global uncertainty. The market has a high risk of correction but there remains little evidence of a slowdown.

This is supported by official figures. Mortgage lending rose to £21.8bn in October, up nearly 20% from a year earlier, according to the Council of Mortgage Lenders. The total was the highest since 2008, and growth in mortgage lending was also at a seven-year high. The CML said that total mortgage lending in 2015 was likely to beat its initial forecast of £209bn.

'The UK commercial property index has shown some strong growth this year'

UK commercial property has had a strong year with capital growth around 10.5%. The latest Investment Property Forum forecast is predicting a consistent 5.4% rise each year throughout 2016, 2017 and 2018.

The UK commercial property index has shown some strong growth this year as compared to heavy falls in equities. Investor demand continues to outstrip supply as good underlying fundamentals are supported by both rental growth in all retail markets and low interest rates.

A restricted supply and improved tenant demand across the majority of the office and industrial sectors is the principle contributor to rising demand. Office rental values particularly in London and the South East continue to be the best performers.


Liverpool Street
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Europe's Anaemic Inflation has Pushed the ECB Into Extending its Monetary Stimulus Programme

Like all other markets, Europe was impacted by the China crisis in August and September particularly as Germany is a major exporter to China.

German car manufacturer Volkswagen was a major distraction to markets as it has been involved in one of the biggest corporate scandals in recent years. Volkswagen share price lost 43% in September alone, following news that the company had fitted its diesel cars with defeat device software that cheat emissions tests.

Despite the uncertainties over global demand and a Chinese slowdown, economic data from Europe proved that the recent outlook was improving. Industrial production rose by 1.9% in Q3, twice the rate economists had expected. The PMI index continues to post positive indications with manufacturing orders rising.

In October, Eurozone inflation returned to a positive 0.1% after recent deflation. The drop in energy costs is held responsible for the -0.1% deflation rate across the Eurozone in September. Fortunately, core inflation remained stable at 0.9% over the second half of the year.

This ongoing level of anaemic inflation has pushed the ECB into extending its monetary stimulus programme beyond September 2016 for a further six months to March 2017. Mario Draghi stated "we have always said that our bond purchases would run beyond September 2016 in case we do not see a sustained adjustment in the path of inflation"

The demand and supply of credit across the Eurozone was limited because of bank re-capitalisation and restrictions to lending between 2011 and 2014. This lack of credit created a second credit crunch in Europe which caused a drag on growth compared to other economies. This situation has now ended with European banks having the full support of the ECB to fulfil their lending capacity.

Ireland has Become the Eurozone's Star Performer

In 2010, Ireland almost went bust after the state was forced to prop up a bankrupt banking sector. Now two years after exiting an IMF and EU bailout package, it has become the Eurozone's star performer. Along with a rejuvenated Spain, Ireland has outstripped all other members of the Eurozone. GDP is predicted to grow by 6% this year and 4.3% in 2016. This growth has allowed Ireland to reduce its debt burden from a peak of 125% of GDP to 108% now.

Enda Kenny's latest budget is aimed at keeping the recovery going. The budget contained measures including a cut in corporation tax from 12.5% to 6.25%. To qualify for this 50% cut, companies must demonstrate that their earnings are dependent upon intellectual property created in Ireland.

Interestingly bottlenecks are already developing in the Irish economy. For example, the demand for housing is outstripping supply particularly in Dublin. It will soon become clear whether Ireland is overheating. After only a few years since near bankruptcy, this is not such a bad problem to have.

'GDP is predicted to grow by 6% this year and 4.3% in 2016'

It is Thought That This Year will see the Economic Plans of Shinzo Abe Paying off

Recently, the Japanese economy has struggled due to weaker industrial production and a fall in exports to both the US and China. The economy officially fell back into recession after it shrank by 0.8% in Q3. However, it is thought that this coming year will see the economic plans of Japanese Prime Minister Shinzo Abe starting to really pay off. Japanese monetary policy is very supportive through The Bank of Japan's ongoing ¥80tn QE programme and 0% interest rates. Mr Abe has also announced plans to reduce Japan's corporation tax rate of 33% by 3.3% from April 2016.

Like all other stock markets, Tokyo's Nikkei 225 index has seen dramatic highs and lows in the past six months. In mid-July, it hit a high of 20868 only to dramatically fall to 16755 by mid-September. It has, like other markets, recovered and sits at 20012 in early December. The predictions for GDP growth in Japan for 2015 are around 0.8% but rising to 1.8% in 2016.

The case for Japanese equities has been aided by improved corporate governance rules and a shift in favour of equities by the massive Japanese government pension fund. We expect other pension schemes and insurance companies to also shift to equities. There has been greater pressure on companies to increase their dividend raise wages and increase capital spending. Some estimates put the amount of cash that could be deployed by Japanese companies as high as 34% of their market capitalisation compared to a current distributed yield of just under 2%.

The Japanese market offers the prospects of attractive valuations with average price-to-earnings ratios of 13 (which is cheaper than other developed markets), rising profitability and improved dividends.

India

'India is on course to overtake China as the world's fastest growing large economy'

India's economy is moving in the right direction and Indian equities should remain relatively resilient compared to other regional economies. This is particularly true as emerging markets come under pressure from the US interest rate rise. India is also less exposed to the fortunes of China.

India grew at a faster than expected pace in Q3, keeping the country on course to overtake China as the world's fastest growing large economy. The Indian economy expanded by 7.4% in the three months to September. The IMF is expecting India to grow by 7.3% this fiscal year and 7.5% in 2016-17.

The great investment appeal for India remains its huge and growing consumer class plus its abundance of well managed globally competitive companies. The opportunity for growth over the long term is significant.

Markets were surprised by the recent cut in interest rates in India from 7.25% to 6.75%. The Indian central bank, The Reserve Bank of India, stated that strong domestic demand would be needed to counter the recent weaker global growth.

Vietnam

'One country that has stood out for growth is Vietnam'

Since 2008, Vietnamese productivity has improved more rapidly than for any of its other Asian neighbours. Over this period modern factories and abundant cheap labour has led to dramatic productivity gains.

With the wage rate a quarter of that of China, the productivity upside that global companies can achieve through relocation is obvious. Foreign investment, particularly in the electronics industry from the likes of Samsung and LG, has been significant. Free land and deferred corporation tax have also helped.

With a population of 90 million, Vietnam has an abundance of labour and a demographic make-up that will see the growth in its labour force outstrip overall population growth. Vietnam also has a middle class of approximately 12 million which is predicted to rise to 33 million by 2020.

A significant general boost to the whole area has been the recent Trans Pacific Partnership (TPP) trade agreement. Vietnam is the single largest beneficiary giving it easy access to the US and Japanese markets without trade tariffs.

The Vietnamese stock market trades at an average price-to-earnings ratio of 12 and has average dividend yields of 3.6%.

Latin America

'A poor performer in Q3'

Latin America was a poor performer in Q3. The combination of weak Chinese data and inaction over US interest rates unsettled markets. Falling GDP provided a negative backdrop for Latin America, but the credit downgrade of Brazil to BBB+ was particularly significant. This will make it more expensive for Brazil to borrow as lenders demanded higher interest rates to compensate for a greater default risk.

Foreign exchange movement was another feature with emerging market currencies hitting new lows against the ever strengthening US$. Almost 70% of the decline in the Sao Paulo Bovespa Index can be attributed to the depreciation of the Real.

By contrast, however, Mexico has enjoyed real sales growth up 5.8% on last year. Mexican unemployment has also fallen to 4.68% as the Mexican economy becomes more and more competitive.

Gold

'Without the fear of inflation or financial crisis gold has declined in value'

Continued strong economic data from the US and the US interest rate rise suggests that the prospects for the US$ are very good. The backdrop of a strong US$ has historically been a challenging one for gold. Without the fear of inflation or a financial crisis, gold has declined in value. Asian retail demand and central bank purchases along with the return of post QE inflation are potential sources of support for gold prices.

The Forex Gold Index stands at US$1053 per oz. having progressively fallen from a January high of US$1300 per oz. Gold is currently trading at a six year low after increased speculation that the US Federal Reserve will raise interest rates. This speculation has triggered a recent selloff in the precious metal.

Oil

The principle target of Saudi Arabia's high oil output policy, which has led to a global oversupply of oil, has been the US shale industry. The resultant fall in oil prices has seen the number of shale rigs halved this year suggesting that Saudi has been successful. However, as a consequence Saudi Arabia's own budget position has deteriorated considerably and as a consequence; they may have to control oil output once again. Since the summer, the Brent Crude oil price has consistently stayed below US$50pb.

Market analysts are not predicting any short term rise in oil prices. In October the World Bank released its Commodity Forecast predicting that world crude oil prices will fall slightly in 2016. The ongoing glut in oil will also maintain downward pressure on prices. In November the global stock piles stood at 3bn barrels.

'Saudi Arabia's own budget position has deteriorated considerably'

The ECB has Bought €538bn of Bonds since Eurozone QE was Implemented in March

The Federal Reserve's decision to keep interest rates on hold in September prompted government bonds to rally.

Whilst the gilt market benefited from the Fed's decision, corporate bonds and high yield bonds came under pressure as the sense of delay merely prolonged the uncertainty. On-going concerns about China and the fall in commodity prices has weighed on corporate bond returns.

The average return from UK gilt funds over the last quarter has been 0.5% as compared to the average of UK corporate bond funds of -0.7% and high yield bond funds of -0.9% over the same three month period.

European Central Bank (ECB) president, Mario Draghi, has made comments that have highlighted a policy divergence between the ECB and other central bankers. Mr Draghi stressed the ECB's willingness to increase the size, composition and duration of its bond purchasing programme to boost Eurozone growth.

The ECB has bought €538bn of bonds since Eurozone QE was implemented in March. The programme has maintained its monthly goal of buying €60bn-worth of public and private sector debt, amounting so far to about 5% of the Eurozone GDP. The Bank of England (BoE) has in comparison, purchased £375bn of fixed interest securities, which represents 19% of UK GDP. By this measure, the ECB could increase its asset purchasing programme. Any move to extend Eurozone QE will likely support asset prices particularly European equities and bonds as well as result in a weaker Euro.

Investors, sensing a summer slowdown, started to seek higher interest rates from bond issuers amid a raised risk of default. The credit spread is the measure of the additional yield provided to bond investors above that offered by safer, government gilts and is seen as a risk indicator. There has been a substantial rise in investment grade and high yield grade credit spreads over the past year. Analysts put this down to additional credit risk. With high yield bonds now offering 8% prices have fallen to compensate for these enhanced yields.

The default rate for non-investment grade high yield bonds is well below the historical average and as yet there has not been an investment grade default. But as a measure of risk, the number of high yield bonds with credit spreads of 10% above government bonds is at a four year high and at the highest of this business cycle. Rising credit spreads are often associated with a sign of economic problems.

Investment funds are now quietly switching out of government bonds as they are a much overpriced asset. In November, as much as US$6tn of government debt was trading on negative interest rates. The worst of these was two year Swiss bonds at -1.046% pa and two year German Bunds at -0.4% pa. Bank of America has suggested that US$17tn of bonds are trading at below 1% pa interest. These rates are remarkable as the global average core inflation rate is at a seven year high of 2.7%.

If the ECB continues to increase its QE programme, interest rates and bond yields in Europe will fall further, which in turn will increase prices. In the short term this will be attractive to European bond holders, but we are concerned over the impact future inflation and interest rates rises will have on bond prices. Starting with the US, the likely increase in employment and wage growth will push up real interest rates and consequently push down prices. As bond holders rush to exit there could be a significant liquidity problem.

We remain cautious and underweight in both high yield bonds and government gilts. The general strategy for 2016 is to position the fixed interest sections of the portfolio to negate the US interest rate rise. Thus, we continue to hold some short dated strategic bond funds.

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

4th December 2015


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PORTFOLIO SELECTIONS

Portfolio Selections – January 2015

We have witnessed a remarkable period of both stock and bond market volatility throughout 2015. These events are, perhaps part of a new lesson that recovery from a great recession by way of quantitative easing and loose money policies provides us. QE is an untried economic experiment that is without previous experience.

With this in mind and in order to provide investors with consistent and as attractive returns as possible for any given risk profile, we have diversified portfolio assets in order to spread both opportunity as well as risk.

On the whole, we believe that global markets are poised to benefit in 2016 from economic expansion in the major economies of the US, Europe and Japan; economic stability in China; low oil prices and an abundance of liquidity from the ECB and the BoJ. The picture for 2016 is an improving one, as compared to a disappointing 2015, mainly due to the end of austerity measures in advanced economies. In the developed world, only the UK will be pursuing fiscal cutbacks next year as our government seeks to further reduce government spending. However after November's Autumn statements many of the proposed cutbacks have been either slowed or cancelled.

The fortunes of the emerging markets will be boosted by the fact that China, while continuing to see a deceleration, will still maintain a reasonable rate of GDP growth at around a "real" 5% pa.

International companies have robust balance sheets and generally improving trade conditions. The developing opportunities for these companies to sell their goods and services will ultimately translate into investor returns.

As of 1st December 2015, our best performing funds held within our portfolios over the last 12 months have been;

Old Mutual UK Mid Cap	24.86%
Old Mutual UK Smaller Companies	20.77%
Jupiter European	17.75%
Aberdeen Property Shares	17.50%
Baring Europe Select	16.15%
Axa Framlington Biotech	13.72%
Fundsmith Equity	12.68%

The main reasons behind these positive returns have been the significant growth in the US, European and UK, particularly in mid and small cap markets.

While our poorest performing funds were;

Blackrock Pacific ex Japan Index	-5.74%
Aberdeen Indian Equity	-2.88%
Schroder Asian Income	-2.20%

The main reasons for these disappointing performances were the general sell off in Asia and emerging markets as a result of the China crisis.

'Collectively our eight portfolios outperformed their respective benchmarks on 39 out of 41 occasions'

As far as the 24th Edition of our portfolios is concerned, seven of the funds from the 23rd 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 which we feel offer better prospects going forward. We continue to hold meaningful levels of cash and property across the portfolios to help dampen volatility.

In general, we hold a positive outlook for equities particularly for the UK, Europe and Japan for 2016 as both European and Japanese equities have earnings growth potential.

We remain neutral over US equities. We are concerned about a potential lack of earnings growth as price-to-earnings ratios in US large corporations are over 20. We have therefore in most portfolios marginally reduced our holdings. We see the US as a growth economy and are happy to remain invested.

We believe that China is over the worst of its troubles giving a boost to Asia and emerging markets as the region is generally heavily dependent upon China. We will retain our current holdings in Asia, India and China. Profits are returning to those markets and prospects look favourable in 2016. We remain negative over the majority of smaller emerging markets until the impact of US interest rate rise has been assessed as well as a return to commodity demand.

In the short term we expect returns on government bonds to be reasonable, particularly if further ECB QE suppresses yields and supports prices. Credit risk and liquidity has improved in Europe. There is some concern over high yield defaults in the US and reduced liquidity in this asset class in general. For this reason, we remain cautious and underweight in corporate bonds and high yield bonds. With inflation expectations still some way off, we prefer fixed rate over index linked gilts.

The general strategy for 2016 is to hold some short dated corporate bond funds to negate the US interest rate rise.

We remain negative on commodities and commodity producing countries such as Russia and Brazil mainly due to an ongoing lack of demand and their overall dependence upon China. The level of oil production is starting to be controlled by the major OPEC countries which should put support behind the current oil price. Since the summer, the Brent Crude oil price has consistently stayed below US$50pb. This low oil price does however continue to support consumer spending.

We remain positive and overweight in UK commercial property which has contributed well to overall portfolio returns this year. We are confident this sector can continue to provide meaningful returns to investors.

We are once again pleased to report that the gross performance of our portfolios in each of our current eight portfolios up until 1st December 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 eight portfolios outperformed their respective benchmarks on 39 out of 41 occasions. This is one of our highest outperformances in the twelve years we have been running them.

The portfolios were tested during the equity falls of August. Our defensive, cautious and balanced portfolios held up well, protecting investors from the worst of the volatility. The post China crisis returns have also been robust and ahead of the relevant national averages in all cases.

Our performance is reported on the next page of this Outlook and online at **www.estatecapital.co.uk**

PORTFOLIO PERFORMANCE

The Estate Capital Investment Portfolios

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

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

There are 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.

Cumulative Portfolio Performance from 4th December 2015

Below are the past five year's gross investment returns for each of our portfolios from 4th December 2015

Portfolio	*6 months*	*1 year*	*2 years*	*3 years*	*4 years*	*5 years*
Defensive	0.20%	3.22%	9.80%	13.17%	23.53%	25.32%
Conservative	0.91%	5.12%	13.45%	20.11%	34.16%	33.92%
Balanced Income	0.46%	5.05%	13.55%	25.07%	40.92%	43.27%
Balanced Beta	-1.82%	2.68%	13.24%	22.34%	38.41%	38.97%
Balanced Higher Income	-0.85%	4.52%	-	-	-	-
Balanced Alpha	0.07%	6.60%	17.20%	26.31%	39.21%	38.54%
Speculative Beta	-2.94%	2.15%	13.19%	27.93%	43.66%	-
Speculative Alpha	-1.09%	6.79%	19.45%	44.83%	-	-

Discrete Portfolio Performance from 4th December 2015

Below are the gross investment returns for each of our portfolios for each 12 month period over the last five years from 4th December 2015

Portfolio	*2014*	*2013*	*2012*	*2011*	*2010*
Defensive	2.94%	6.26%	3.38%	9.62%	1.37%
Conservative	4.56%	7.52%	6.42%	13.35%	-0.37%
Balanced Income	4.58%	7.39%	11.06%	14.24%	1.45%
Balanced Beta	2.02%	9.72%	9.01%	14.63%	0.41%
Balanced Higher Income	4.20%	-	-	-	-
Balanced Alpha	5.56%	9.29%	8.78%	11.23%	0.82%
Speculative Beta	1.43%	9.90%	14.46%	15.11%	-
Speculative Alpha	5.51%	11.02%	23.01%	-	-

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 4th December 2010 to 3rd December 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 eight portfolios.

Rates of Risk Related Returns

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

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

Asset Allocation January 2016 - Edition 24

Portfolio	*Risk*	*Money Markets*	*Fixed Interest*	*Property*	*UK Equity*	*US Equity*	*Europe Equity*	*Asian Equity*	*Japan Equity*	*Global Equity*	*Other Assets*
Defensive	2	44%	13%	20%	11%	7%	3%	1%	0%	0%	0%
Conservative	3	28%	17%	23%	12%	8%	6%	3%	4%	0%	0%
Balanced Income	4	15%	20%	21%	25%	7%	7%	4%	0%	0%	0%
Balanced Beta	5	12%	23%	15%	18%	11%	7%	12%	0%	0%	2%
Balanced Higher Income	6	10%	19%	13%	38%	8%	7%	5%	0%	1%	0%
Balanced Alpha	6	11%	15%	14%	21%	16%	9%	10%	4%	0%	0%
Speculative Beta	7	2%	14%	15%	21%	16%	12%	14%	5%	0%	1%
Speculative Alpha	8	6%	3%	16%	20%	22%	13%	15%	4%	1%	0%

Perspective Range of Return & Volatility

Portfolio	*Risk*	*Return*	*High*	*Low*
Defensive	2	3.48%	11.87%	-4.91%
Conservative	3	4.39%	18.39%	-9.61%
Balanced Income	4	4.93%	22.33%	-12.47%
Balanced Beta	5	5.53%	26.33%	-15.28%
Balanced Higher Income	6	6.08%	30.29%	-18.13%
Balanced Alpha	6	6.08%	30.29%	-18.13%
Speculative Beta	7	6.57%	34.18%	-21.04%
Speculative Alpha	8	7.08%	38.09%	-23.94%

Investment Ratios

Portfolio	*Risk*	*Beta*	*Alpha*	*Sharpe Ratio*	*Info Ratio*
Defensive	2	0.65%	1.82%	0.23%	0.33%
Conservative	3	1.01%	2.47%	0.60%	2.61%
Balanced Income	4	0.89%	2.68%	0.81%	1.24%
Balanced Beta	5	1.11%	0.77%	0.53%	0.68%
Balanced Higher Income	6	0.77%	2.47%	0.11%	0.88%
Balanced Alpha	6	0.91%	1.19%	0.64%	0.21%
Speculative Beta	7	1.15%	0.08%	0.58%	0.36%
Speculative Alpha	8	1.24%	3.66%	1.00%	1.38%

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

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