ESTATE CAPITAL INVESTMENT PORTFOLIOS
OUTLOOK

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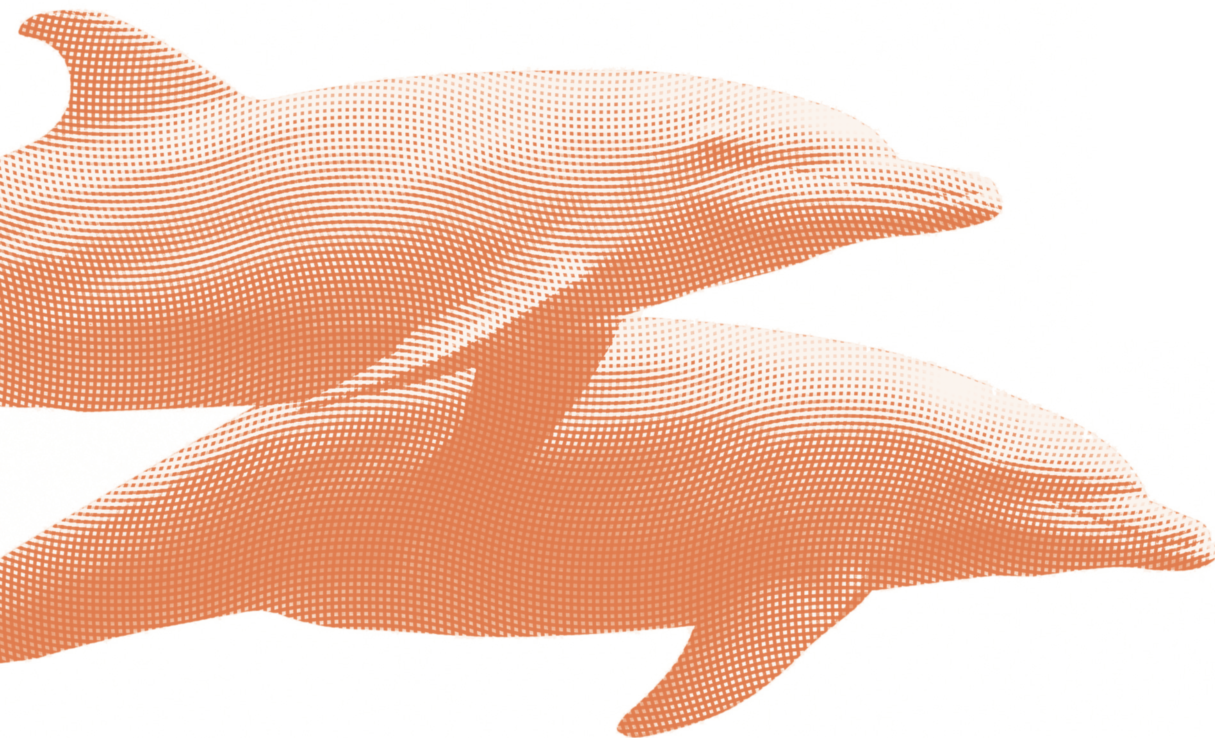

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ESTATE CAPITAL

The Impact of Brexit

Politically and economically the 23rd of June 2016 will go down as a momentous day in British history. Britain's narrow decision to leave the EU came as a major shock to markets, institutions and politicians; none were really prepared for the result.

The Brexit vote sent an immediate shock through financial markets particularly as a rally in UK assets occurred in the week leading up to the vote, as investors became more convinced of a remain outcome. The poor market positioning amplified the surge to sell off. This sell off continued in the aftermath until UK assets looked cheap and investors returned.

First to be hit was the value of GB£. Sterling fell sharply against major currencies, down to US$1.33 from US$1.49 a fall of 12% and now stands at US$1.29. This is GB£ lowest value since 1985.

The FTSE 100 index initially fell 7% to 5980 within minutes of the London Stock Exchange opening, a loss in value of £160bn. The index recovered by the end of trading to a 3% fall, which was better than many predicted. The FTSE 250 index fell 7% as UK mid cap companies are mainly UK focused and will be more impacted by Brexit as compared to the multi-national corporations in the FTSE 100.

Bank of England (BoE) Governor Mark Carney stepped in and made it clear to markets that the BoE stands behind the GB£ and assured markets with a promise of financial support. We are expecting an interest rate reduction to 0.25% in the summer along with, if needed, a further £125bn in quantitative easing (QE) to stimulate the economy. Markets recovered on the comments of the Governor. The FTSE rallied to 6527 close to its twelve month high of 6796. The outlook for business was further improved when Chancellor George Osborne announced a corporation tax rate reduction to 15% which will be one of the most competitive rates in the developed world.

Growth fears prompted the flow of capital to safe haven assets such as gilts and gold. This sent share values falling and gilt yields to record lows. Both UK gilts and US Treasury bonds saw massive inflows pushing US bond yields down by 0.25% to 1.45% while UK 10 year gilts fell to 0.98%. European 10 year bonds are trading on negative yields. The price of a safe haven is now extremely

high for the return on capital.

We expect short dated gilt yields to remain exceptionally low even if long duration bonds are now being impacted by a concern about future inflation. A weak GB£ may see gilt yield start to rise on expectations of inflation as the cost of imported goods rise.

Leading global credit ratings agencies have downgrade the UK following its vote in favour of exiting the European Union. For example, Standard & Poor's has downgraded the UK by two notches to AA as the period of uncertainty that is likely to now follow will impact economic activity. Moritz Kraemer, Standard and Poor's chief ratings officer, said: "In view of the vote, we think that an AAA rating is untenable under these circumstances. Any exit will likely be a drawn-out process while treaties or other arrangements are negotiated between the UK and the EU regarding their future dealings". The resulting cut in the UK AAA rating and the associated increase in government borrowing costs will impact negatively on an economy already weighed down by high fiscal and current account deficits.

In the short term, the UK is likely to go through a period of lower growth and increased inflation. A fall in GDP growth this year and next is probable. However this growth forecast may not affect UK stock values as much as many think. The fall in the value of GB£ will increase the competitiveness of UK companies in export markets. Lower interest rates and further fiscal stimulus are equity friendly.

HSBC estimates are that UK growth will slow from 1.8% down to 1.5% in the second half of 2016 with a 0.7% growth rate in 2017 down from 2.1%. Growth in the Eurozone will be dented, strengthening the case for the ECB to continue its expanded QE programme. If there is prolonged decline in market confidence the US Federal Reserve will find it difficult to raise US interest rates this year.

HSBC also believes that GB£ may fall even further as uncertainty of Brexit linger. They predict GB£ will fall to US$1.20 by the end of this year, leading to lower growth, higher inflation and a squeeze on living standards. They forecast inflation to climb to 1.5% by the end of 2016 and rise to 4% by the end of 2017.

In response, UBS are expecting the BoE to cut interest rates to 0.25% by August and to zero by early 2017. Barclays expect zero interest rates by September as well as a £125bn quantitative easing programme. This will support house values and mortgage take up.

The UK commercial property market has been hit

by the implications of Brexit, particularly the City of London office sector. Outflows have recently forced fund groups to move their fund pricing to a defensive spread of 5%. The majority of property funds have now also closed to new investment and withdrawals. We expect this pricing change to be reversed once inflows return. This could be aided by the fall in GB£ as UK assets are now 12% cheaper to overseas buyer but also hindered by the uncertainties of Brexit.

Certainly in the short term, the leave vote will be negative for both GB£ and the UK economy. However given that the FTSE 100 comprises of 70% overseas earnings the implications for the UK equity market may not be that depressing UK stocks are cushioned by equity dividend rates being 3 times higher than gilt yields.

Currency devaluation can be beneficial to an economy with low inflation, low interest rates and a trade deficit. Inevitably exports will start to rise while imports fall. Ironically we may find our exports to Europe increase after Brexit.

It was the devaluation of the GB£ that took the initial impact in the wake of the Brexit vote. As for as stock markets were concerned, the greatest damage was not in the City of London but in Madrid, Paris and Milan where stock markets fell twice as much as in the UK. The Madrid IBEX fell 12.5% while the Paris CAX fell 8%. Britain was able to stress relieve the pressure through our currency de-valuation. No such shock absorbers were available in Spain, France or Italy. If we needed evidence of the importance of control of your national currency then this was one.

Brexit has been a massive shock but not one that should poses an on-going threat to the overall global recovery. Most leading stock markets have recovered some of their initial losses while the US S&P 500 has recovered fully while the UK FTSE 100 has made gains. We would normally expect the reality of the situation to be reflected in the recovery of asset values firstly outside the UK, particularly the US and Asia, where the stock markets reacted sharply to the result but will have only modest direct consequences. In the UK and Europe it will inevitably take time for the dust to settle and in that period investors can expect plenty of volatility as UK and EU policy makers come to grips with the consequences of this historic vote.

‘In the short term, the UK is likely to go through a period of lower growth and increased inflation’

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What Next for the UK and EU?

The implications to British business over Brexit is that in the short term the uncertainty following the 'divorce' negotiations are likely to prompt companies to postpone or cancel investment and additional recruitment. Multinational companies located in the UK in order to access the single market could start to make plans to relocate depending upon the UK exit terms.

The longer term impact of Brexit will be governed by how much access to the tariff free single market the UK manages to retain, what savings are made on subscription costs and how future migration flows are managed as restrictions on EU immigration could cause the UK job market to be less flexible to demand and reduce tax revenue.

If our 'divorce' is prolonged and disorderly the prospects for a sharper slowdown in UK growth is greater as well as further declines in GB£ relative to other currencies. It would be expected that capital expenditure is delayed and overseas investment diverted to continental Europe to access the single market from within.

If the 'divorce' is friendly and efficient, which is in everyone's benefit and leads to a move to the Norwegian model in the European Economic Area (EEA) or a similar bespoke version. This will provide little loss in trade agreements and access to the single market. This would prompt a significant rally particularly in banking and financial services.

British banking stock were the worst hit post Brexit. The fear that the City of London could lose its 'passport' access to deliver financial services into the single market hit stock badly. Pulling financial institutions from London to Paris or Frankfurt and with them the vast jobs and tax revenue they provide. This would be a massive blow for British trade and a major prize for continental leaders.

Senior European Banking officials have already warned that the City of London will lose its access to the single market if it does not sign up to a deal that includes free movement of people, along the lines of the Norwegian settlement . The London Stock Exchange thinks Brexit could cost 100,000 highly paid jobs and risk the location of some clearing houses.

Government officials are deeply concerned about the implications of triggering Article 50 until a clear path for Brexit has been mapped out with their EU counterparts. The concerns lie in the reaction of multi-national companies seeking to migrate out of Britain to the European mainland to retain full access to the single market.

Triggering Article 50 without a clear road map

could see markets fall even further as banks and financial institutions start to plan to relocate. We can expect the European Banking Authority (EBA) currently based in London to relocate to within the EU.

The EEA model would allow Britain to keep access to the single market for goods, services and capital. However, this agreement also includes the unrestricted free movement of EU citizens. This will be the key negotiating point.

The EEA model could be one from which Britain could progressively repatriate controls over such things as migration, agriculture and fisheries. Adopting the EEA option or a variance close to it is the safest exit option and offers an olive branch to a disappointed and protection minded EU. Doing so would mean still paying in to the EU and accepting its rules. This arrangement could be adopted until all the bilateral trade deals with the rest of the world are in place. This process could take many years so a position of stability would be beneficial to all concerned.

There is fear across European political institutions that Brexit will give confidence to the many populist movements in other EU counties calling for their own referendums. Politicians in France, Holland and Italy have already called for membership referendums. European leaders now need to channel these concerns and frustration into reform and accountability not self-preservation. Over the months ahead we can expect a campaign for further European integration as a way of protecting the EU and single currency against further 'insubordination' by member states.

The two biggest factors that has driven EU migration to the UK is the growth in the UK economy and the resulting job opportunities but also the high levels of unemployment in the southern European counties. These levels of unemployment are not aided by the single currency that is valued to the advantage of Germany. The € for the southern European counties is overvalued by 20%-25%. It is the general lack of growth, high unemployment and the bureaucratic remoteness of Brussels that creates frustrations, something that Donald Tusk recognises but stubbornly Jean-Claude Junker does not.

For Britain, it is going to be very difficult to leave the EU. But as a country that retains its own currency, Brexit will be easier for the UK than for example Italy or Spain. Political risk on the continent carries far greater uncertainty. For Britain, we must be clear on what we want rather than what we don't want.

Financial Markets have had a roller coaster ride in 2016

Financial markets have had a roller coaster of a ride so far in 2016 with deep falls in January being followed by a rebound rally which has left investors back to where they started the year. Global equity markets have closely tracked the oil price as it fell due to oversupply and perceived lack of demand. The catalyst for January's sharp declines were a threat of global slowdown, a devaluation of the Chinese renminbi and some weak data from the USA soon after the rise in US interest rates last December.

It soon became apparent that such fears were overplayed and the world economy would avoid a further setback. However it did take action by several major central banks to kick start the recovery. This came in the form of the US Federal Reserve signalling a deferment to further rate rises. In doing so it brought a partial decline in the ongoing appreciation of the US$. This decline in US$ values certainly aided China as well as commodity prices and commodity producing economies.

The European Central Bank (ECB) extended its asset purchasing programme from €60bn per month to €80bn per month and introduced negative overnight interest rates to incentivise savers to spend and banks to lend. These actions created economic activity and the inflation the continent so desires. Negative interest rates put a charge on deposits encouraging banks to lend or buy assets increasing consumption and demand, but can also be counterproductive as they hit bank earnings and risk a restriction on credit.

Further market relief was provided by Zhou Xiaochuan, the Governor of the Peoples Bank of China (PBC), when he made it clear that he did not wish to devalue the renminbi in trade weighted terms. His comments signalled that Chinese policy makers were comfortable with growth forecasts. The hard data from China indicates that growth continues and with the heavy outflow of foreign currency reserves reversing, China looks to have got a grip on capital outflows and its currency. These developments have helped towards a stronger renminbi, a stable but softer US$ and a rise in oil prices. This has in turn supported global equity values.

Even though markets have recovered from January's falls the outlook remains difficult as the prospect for global GDP growth looks at times to be nervous. Consequently, corporate earnings growth could be stronger. The UK GDP growth in Q2 has been effected by the EU referendum with much investment activity postponed. Both business and consumer confidence have been affected as the economy slowed. The fact that Britain has voted to leave the EU has send shock

waves around global markets. It will take time to evaluate the economic and business impact of the result.

Oil prices have had an influence on the behaviour of equity and bond markets and a critical role in the determining the path of interest rates in the US. It is clear that the supply and demand equilibrium in oil is coming back into balance and the continued recovery in oil is significant. However, what has been surprising is the muted impact this oil price recovery has had on asset prices. This may be explained by markets responding to the Federal Reserve pausing on further interest rate rises this year.

The Federal Reserve has to some degree allowed inflation to rise, weakening the US$ and in turn boosting trade and commodity prices. A weaker US$ means a weaker renminbi as their relative values are loosely tied. The weakening US$ is a gift to China and may not be enough to start a bull market but it has put off any bears.

Inflationary pressure is building in the US and UK with both economies effectively fully employed and skill shortages emerging. When the oil price growth is priced into the annual figures it will become a positive contributor to inflation. In the US, if oil and food were removed from the basket of goods measured for RPI then US inflation is already above the Feds 2% target. Prior to the Brexit result it felt inevitable that Dr Yellen would announce US interest rate rises in the fall but that now looks unlikely.

In China, there has been a decisive improvement in economic activity in the last few months particularly for industries involved in major infrastructure projects. There has been a material improvement in industries such as cement, steel and construction. This is also evident in the iron ore market where prices have risen by 25%. The Chinese authorities have accelerated infrastructure spending, some of which was previously delayed by two years due to a corruption clampdown.

Asia and China have been out of favour in global equity portfolios with the market over-reacting to the falls of August 15 and January 16. Asian equities are trading below the 15 year average for price earnings and at a 25% discount to other global developed markets.

The Chinese economy has stabilised and showing signs of an upturn

In January, the coming together of an inevitable slowing China and the weakness in oil and commodity prices suggested a recession that spilled out into the rest of the world. However, since the resulting heavy falls in Chinese equity values in January, there has been a steady recovery in the Chinese economy that has stabilised and is showing signs of an upturn.

In April, China reported that official GDP growth for Q1 2016 was 6.7% year on year, slightly lower than the 6.8% for the previous quarter. These days hardly anyone believes the official Chinese growth figures and for good reason as they are manipulated to satisfy growth targets. Analysts expect the real growth in China to be more in line with 4-5% rather than 6.7%. Many independent observers think that the Chinese economy underwent a sharp slowdown in 2015 but has since largely stabilised. The tentative signs of growth should not be unexpected given the monetary and fiscal stimulus being applied by Beijing.

Soon after the January stock market falls, Beijing invested nearly US$1.15 trillion in new credit into the Chinese economy. This is equivalent to 46% of the total GDP of Q1 and is a massive increase in extra credit and a boost to liquidity. This level of credit resorts to the old model of debt fuelled growth rather than a concerted move to a service and consumption economy. China's debt to GDP is now 270% well above the debt burdens of most developing economies.

The Chinese economy is growing again particularly in housing, construction and infrastructure. There is however concerns about the sustainability of spending boosts as they are financed by increases in credit from already highly indebted state owned banks. Without doubt, China's continued reliance on credit growth and state backed infrastructure investment is adding to longer term risks. Nonetheless, China is growing and this growth is supporting price improvements in emerging economies and commodities.

The indicators for Q2 show a stronger than expected rise. This suggests that the recent fiscal stimulus and looser monetary policy are starting to be reflected in economic activity. A rebound in property and construction investment has been reflected in increased industrial production. The Q1 growth figures were down on the preceding quarter but there was evidence of growth in industrial production up 6.8% and retail sales up 10.5%.

The Chinese authorities now track the renminbi to a trade weighted basket of currencies. US$ weaknesses have recently helped the renminbi stabilise and has relieved some of the currency pressures seen in August 2015 and January 2016.

China

China is going through a decade or more of transition. The 13th five year plan abolished the one child policy, invested in health care and pensions encouraging a shift to consumerism. Ongoing urbanisation and the continued rise in the country's service sector will provide the next phase of growth.

China is now the world's biggest car market. China's e-commerce companies have seen significant jumps in revenue. The demand for smart phones is beginning to slow as has the luxury goods market. However the march to consumerism is set to increase and is a trend worth profiting from.

China is growing and this growth is supporting price improvements in emerging economies and commodities.

United States

After a nasty slide in US stock values in January, US markets have bounced back sharply erasing their losses and regaining record levels. For example, the S&P 500 index fell to 1829 in January to recover to 2098 by early July. Unlike other countries around the world the oil price falls and China growth scare of January did not push the S&P into a bear market (as defined by a 20% fall from a previous high). This means that the US bull market that began in March 2009 is still running. This is now the second longest running bull market without a 20% correction in US stock market history. Therefore, how long can it go on for?

The US recovery remains solid but relatively lacklustre. Many US companies have been affected by the oil price slump and the high value of the US$. Both of these factors have improved recently.

Q1 2016 saw the US economy grow by 0.5% which for a quarter's growth is a two year low. Some suggest this and the reduction in new job numbers as a sign of an economy slowing. The Fed believes that rising employment and inflation will result in higher GDP growth during the second half of 2016.

Valuations on US stock are historically high. The S&P 500 cyclically adjusted price earnings ratio

The US is getting close to full employment

(CAPE) is around 27 which is close to the 27.5 peak at the top of the credit bubble. A high price to earnings ratio is associated with confidence in growth but also can be expensive to buy. Interestingly, the trailing CAPE is 19.4, suggesting that long term returns from US large cap stock are likely to reduce.

The USA's economic fundamentals are being assisted by the US Federal Reserve (Fed). Since the end of its Quantitative Easing (QE) programme, the Fed has stopped increasing the money supply used to invest into the bond markets. The Fed has signalled it will only raise interest rates when the fundamentals require it to do so and thus provide a tail wind to equities. For the month of May, analysts were expecting an increase of160,000 new jobs, instead US payrolls only grew by 38,000 which was the lowest monthly increase in job growth since 2010. Interestingly however the unemployment rate fell from 5% to 4.7% as the available labour market shrank. The job market is a lagging indicator and it may be reflecting a slowdown starting at the end of 2015. The average payroll growth in the three months to June was 116,000 which is a step down from the 200,000 + of the past few years.

At their June meeting, this new data influenced the Federal Reserve Open Markets Committee (FOMC) to retain the US Fed rate at 0.25% due to an uncertain jobs market and the concerns over the 'Leave' result in the UK Referendum hitting global markets.

Some analysts have taken the view that the Fed should not be worried about the slowdown in new job numbers as it is a result of the US getting close to full employment. Employers may be finding it difficult to hire suitable workers. If this is the case, we can expect wage inflation. The Employer Cost Index has grown by 2.4% year on year.

Where next for the UK?

The FTSE 100 index like many other developed stock markets has had a turbulent ride this year. It started January at 6100 and fell to 5536 by mid-February after the fall in oil price and the devaluation of the renminbi only to rally to 6400 in mid-April. The FTSE 100 is heavily influenced by oil, energy and mining prices so as oil and commodity prices recovered so did the index.

Since April the markets have traded sideways until the impact of Brexit hit markets in mid-June. The FTSE 100 fell from 6340 to 6022 in the days after Britain voted to leave the EU. The next day fall of 3.5% was far less than expected and far less than other Eurozone stock markets. It has by 1st July recovered and grown to 6521 on the prospect of a deflated GB£, interest rate cuts and reduced corporation tax rates.

The UK economy grew by 0.4% in Q1 2016 down from 0.6% in Q4 2015 but in line with forecasts. Certainly economic momentum will slow in the wake of Brexit as it had been before with investment and development postponed. The Manufacturing Purchase Managers Index (PMI) fell below 50, the mark that separates expansion from contraction for the first time since March 2013, but has recovered to 52.1 in June. The construction PMI was above 50 but at a four year low.

There is some very good news about employment rates. The Office of National statistics (ONS) reported the UK has the lowest unemployment rate since October 2005. Unemployment is now 5% after 55,000 new jobs were created in Q1. The employment rate remains at 74.2% the joint highest level since records began in 1971.

The only down side of this news is that the number of new jobs created in Q1 was 55,000 as compared to 116,000 in Q4 2015. This reduction in the number of new jobs was evidence of the economy cooling.

Wages grew by 2.3% in the past twelve months with firms reporting higher labour costs due to the new national living wage. The weakness in £GBP and the recovery in oil, could also see inflation climb faster than expected.

The UK residential housing market continued to rise in value with house prices up on average 8.2% in the past year. Unsurprisingly, London prices climbed by 14.5%. The average UK property is now valued at £209,054. Some areas of the UK saw house price falls, this included Wales with a reduction of 1.9% taking the average house value to £139,445. The effects of Brexit on house prices are yet to come through. New builds will be effected by higher imported material costs due to the devaluation of GB£.

The great opportunity facing British business is the export opportunity available with a 12% reduction in GB£ values. British goods in foreign markets will now be very well priced. The challenge will be the impact of inflation from more expensive foreign goods due to currency devaluation. This provides an asset allocation call towards large cap UK multi-nationals, index linked gilts and corporate bonds.

The ECB is spending €80 billion per month to create growth and inflation

European equities have advanced since the start of March as the ECB released further details of its asset purchasing programme covering both government and corporate bonds. The new programme raised the monthly purchase value from €60bn to €80bn and will run until March 2017.

GDP data for Q1 showed the Eurozone economy expanded by 0.6% up from a 0.4% forecast. This was mainly driven by French and Spanish companies. Particularly pleasing was that the Eurozone unemployment rates fell to 10.2% in Q1. This is the lowest level of unemployment since August 2011. This GDP growth is the strongest since 2008 and is better than both the US and UK for the same period.

The positive GDP figures were accompanied by a drop in inflation. This highlights the challenge facing Europe. The continent can really do with both growth in the economy and inflation, but inflation fell to -0.2% in April mainly due to lower oil prices. The improving domestic demand, supportive ECB policies and now rising oil prices are likely to put upward pressure on inflation going forward.

'This GDP growth is the strongest since 2008 and is better than both the US and UK for the same period'

Investors are now waiting to see what steps the Japanese government takes

The Japanese economy grew faster than expected in Q1 hitting an annualised growth of 1.7%. This growth was a result of higher government spending. This turnaround from Q4 2015 was important to Japan as each of the past four quarters have alternated between growth and contraction.

In January, The Bank of Japan (BoJ) pushed interest rates into negative territory in order to combat deflation by lowering the value of the ¥, get consumers spending and corporations borrowing. Instead, the ¥ jumped in value and had strengthened by 13.2% against the US$ by February. This had the impact of reducing the earnings of Japans heavy weight exporters.

Lifting Japan out of its seemingly endless slump has turned out to be much harder than expected when Prime Minister Shinzo Abe came to office in 2012. The Japanese economy needs to reverse the current deflationary pressure as inflation was -0.4% in May. Monetary stimulus is now having less of an effect so a new round of quantitative easing (QE) and government spending is being suggested. Before this occurs, the BOJ will want to see what impact negative interest rates will have on consumption and savings rates.

Prime Minister Abe has postponed the anticipated increase in VAT in a move to support consumer spending but will do little to reduce Japan's public debt of around 230% of GDP.

The Nikkei 225 index has been falling for most of 2016 and in May was down 16.2% on the year. Fortunately for overseas investors, the strengthening of the ¥ offset much of these falls. These equity losses have been a result of delayed government action and the high value ¥.

Huge amounts of money have flowed out of Japanese equity funds with foreign investors responsible for half the outflow. Despite this it is anticipated that new fiscal stimulus by the BoJ will help equity values. Analysts are expecting more monetary stimulus on top of the move to negative interest rates and the ongoing QE programme. It is the expectation of further measures that have influenced us to stay invested in Japan as without it we would have removed our holdings, instead we have just reduced them..

Brexit caused international markets to fall between -2.4% and -6%. Particularly badly hit was Japan's Nikkei 225 Index, which fell -8%. The heavy falls were due to the strengthening of the ¥ as currency capital moved from £ to ¥. The main losers were the Japanese government who are desperately trying to deflate the ¥ in order to aid Japan's export competitiveness and those very companies who's goods are now more expensive in world markets. The ¥ has fallen 16.2% so far this year against the US$ but remains historically high.

India

Reform failure could damage the potential of India.

The election of Narendra Modi prompted fresh hopes for India and this was reflected strongly in equity markets. However reform momentum in India has suffered a series of blows and investors are losing patience. Some of the hopes for reform in the business community such as land acquisition and labour reform appear to have been abandoned or watered down. Reform failure could prove damaging to the potential of India.

Mr Raghuram Rajan, Governor of the Reserve Bank of India (RBI) has resigned under pressure as Prime Minister Modi seeks a central banker that is more aligned to his policies. His resignation led to a fall in the rupee.

Analysts expect the government to largely deliver on its infrastructure plans and the encouragement of private sector involvement. Infrastructure investment will deliver growth, lower inflation through reduced logistic costs and has the potential for direct foreign investment because of improved distribution.

The Indian economy grew by 7.9% in Q1 and remains the fastest growing major economy. Oil prices have helped cool inflation and as a result the Reserve Bank of India cut interest rates to a six year low. The government also wishes to harmonise state taxes and reduce corporation tax.

Emerging Markets

Our general opinion is that emerging markets offer good long term value but have until recently faced heavy headwinds with a strong US$, higher US interest rates, and low oil and commodity prices. However, the first half of 2016 has witness an improving environment with the temporary weakening of the US$, a delay in US interest rate rises and commodity prices stabilising and even rallying.

As a result emerging market assets have rebounded. The MSCI emerging markets index has so far enjoyed a good 2016. The chief beneficiaries of this recovery are Brazil, Turkey, Russia and South Africa. On a valuations basis the sector looks good value with price earnings ratios of 13.27% as compared to an average of 13.7.

What happens next will depend upon US interest rates and emerging markets corporate earnings as the current improvement in economic conditions may not filter through into company profits until 2017. The concern that emerging markets still hold for us is the amount of distressed assets held in these markets that would be affected by further US interest rate rises.

For investors to really feel things are good for emerging markets, several events need to come together. China needs to stabilise and grow, oil and other commodity prices need to rally further and the US$ needs to not rise significantly. If these conditions remain then emerging markets could continue to progress through 2016 and 2017.

The emerging market middle class consumer comprises almost 2 billion people. They now spend US$7tn per annum. This market is expecting to double in size by 2030. Companies that exploit this 15 year growth curve can create consistent equity growth.

‘Emerging markets have enjoyed a very good 2016’

Oil

'Oil has acted as a real time indicator of investment sentiment'

This year oil has acted as a real time indicator of investment sentiment. The perception is that oil reflects global growth conditions. January's oil price collapse was a supply rather than demand induced issue and since then the correlation between oil and stocks has been significant.

Brent Crude climbed to a 2016 high of US$50pb which was an 80% increase from January's US$27pb.This rise in price has been aided by supply disruption around the world and has reduced the oversupply glut. Events like wild fires in Canada, military action in Nigeria, power cuts in Venezuela and reduced shale production in the USA have all hit output.

While there has been a reduction in supply, oil demand in both China and India has risen. India is now the world's fourth largest consumer of oil behind the US, China and Japan. It is predicted that this summer crude oil demand will exceed production. This will support the oil price and return inflation to economies. In the future, one should not overlook the development of new technologies and alternative sources of energy as well as the advancement of electrical cars potentially effecting oil demand.

Gold

'Gold's lack of income is now less of a disadvantage'

Gold and gold equity prices have rallied sharply this year spurred on by safe haven buying as doubts over global growth surfaced in January and June. Gold has been one of the top performing commodities this year rising from US$1065 per ounce to US$1340 po currently. This rise is on the back of poor equity markets in Q1, the deferment of US interest rate rises and the economic and political uncertainty in Europe.

The value of gold is sensitive to the value of the US$, the strength of the world economy and the extent of currency devaluations due to quantitative easing. In December, we decided against investing in gold on the expectation of a strengthening US$ due to ongoing Fed rate rises throughout 2016. The general consensus is that the Fed FOMC will delay interest rates this year which will aid the growth of gold.

The physical buying of gold in India, China and Russia has been very strong. Gold imports into China hit record levels in Q1 with concerns over the devaluation of the renminbi. Gold was a safe haven for fears over the solvency of China's regional banks.

Gold is priced more as a currency for its intrinsic value rather than a balance of supply and demand as for a commodity. In the current environment of low real yields and negative interest rates, gold as a safehaven for value is attractive. Golds lack of income is now less of a disadvantage.

Steel

'The uncertainty over Tata Steel is a stark reminder of the structural over capacity in world steel market'

In 2015, China exported over 100 million metric tonnes (MMT) of steel into world markets. This is greater than the annual domestic usage of steel in the US. On the back of this steel prices were driven to a very low level. Anti-dumping duties have been introduced in the US but not yet in the EU. Prices this year are already recovering particularly with the announcement of plans to remove 150 MMT of annual capacity from China's steel industry and the pick-up in demand. The current uncertainty over Tata Steel is a stark reminder of the structural over capacity that exists in the world steel market. However, improving steel market conditions should create optimism for the future of the plants. Unfortunately, the Brexit vote has impacted on the outlook for a potential takeover.

Property

'UK commercial property market has delivered excellent returns over the past few years'

The UK commercial property market has delivered excellent returns over the past few years through record level of investment particularly in London office space. However there are signs that the market has peaked. The IPS Capital All Property Index shows a slight decline in prices in Q1, while the Royal Institute of Chartered Surveyors (RICS) index also dipped. RICS confirmed there was a steady easing in demand for commercial property since the referendum was announced.

Real estate in the City of London has been the most impacted with offices being the hardest hit by any negative fallout from Brexit. This year's EU referendum has brought much uncertainty to the commercial property sector with rents and capital values coming under pressure.

The City has been the base for non EU financial institutions aiming to serve the broader EU market. London would likely retain its position in Europe as a world leading financial centre in the event of Brexit but some activity could be lost and occupier demand may fall. Some US and Swiss banks may relocate to Europe as the right to passport services across the single market could be lost.

The majority of property funds, after a period of growth, saw profit taking and outflows from the sector. This resulted in fund managers moving the price of their funds from an offer to bid basis and in doing so temporarily reduced values by around 5%. This reduction is aimed at reducing outflows by making them expensive and protecting the remaining investors.

There is evidence that developers have postponed some speculative schemes and banks held off lending until the referendum was over. Once confidence is restored and inflow returns the funds will revert to an offer basis for pricing, however this may take some time. For this reason we have reduced our property holdings.

UK government bond yields have fallen to record lows

The returns on UK government bonds has fallen to a record low as investors move to safer assets over concerns about the global economy and the impact of the UK leaving the EU. The yields on UK 10 year gilts have dropped to 0.86% while the yields on German 10 year Bunds are now -0.13% and Japanese 10 year bonds -0.25%. This means that investors are paying the German government to hold their money. More than US$10tr of global sovereign debt is yielding less than zero.

The low yields on government bonds paints a pretty pessimistic picture of the global economy and suggests we are still set for an extended period of low inflation, something central bankers are trying their best to counter.

Investors buy bonds for the predictable and secure income stream they offer. Even so, yields have been falling for months. This time last year UK 10 year gilt yields were 2%.

With concerns over equity volatility investors will seek safe havens so gilt yields could fall further. Europe currently has ultra-low interest rates as well as the ECB pumping €80bn per month into the European bond markets. Both are driving yields down and correspondingly prices up.

Yields on US bonds are in global terms relatively attractive. The June US bond auction reported record demand from investment funds and foreign central banks. As far as government bonds are concerned US and UK bonds still pay modest yields.

With yields on government bonds so low, investors with a need for income are increasing their risk by moving to higher yielding non-investment grade bonds. For this reason, high yield bonds have done well. With inflation expectations in the USA improving US inflation linked treasuries have also risen.

The positive economic sentiment that began in February has continued with generally positive returns from corporate bonds. Further weakening of the US$ and improvements in the commodity markets has assisted US high yield bonds. US high yield bonds are at the riskier end of the market but are amongst the best performing major asset this year with an average return of 7%.

However, default rates on high yield bonds have hit 3.9% due to deteriorating credit quality. Non-investment grade rated American companies have debt equal to 48% of their assets. Fortunately, QE and low interest rates have spared the most highly indebted firms.

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

7th July 2016

JUBILEE WALKWAY

PORTFOLIO SELECTIONS

Portfolio Selections - July 2016

Over the past year, every time the Fed thought that the world was strong enough to cope with a rise in the Fed Funds rate, China has countered by devaluing the renminbi. Each time has provoked a very negative reaction in financial markets. However, we may have broken out of that cycle, as the last few months have seen evidence of a recovery in global growth. Business surveys have improved considerably in the US while data from China suggests the stimulus applied after the stock market falls of August 2015 are taking effect.

It feels like markets have been down the hill and back up so far this year. The question is what will happen next? It is still difficult to make a case for accelerating growth other than a catch up for the lost ground in the first half of 2016. However growth will be aided by a reduction in risks such as rising oil prices, low US interest rates, a stable China and on-going quantitative easing (QE) programmes. Indicators are pointing to steady growth in the US but slowing in Japan. The case for European growth is good but is now clouded by the UK Brexit decision which will hit European stock markets as much as if not more than the UK.

For much of this year, the concerns over a Chinese hard landing have abated. There has been a sharp upward movement in a range of economic indicators, including industrial production, monetary growth and Purchasing Manager Index (PMI). On the expenditure side, fixed asset investment in property and infrastructure has increased. We now expect a China recovery to be a significant theme for the remainder of 2016.

The rise in oil prices are likely to result in inflation later in the year. US wage growth is yet to significantly rise, but once it does, we can expect an increase to US interest rates.

As growth resumes and inflation moves towards the 2% target, the US Federal Reserve will feel pressure to raise rates and as a consequence market volatility may return. Higher US interest rates strengthens the US$ which puts pressure on the renminbi and commodity prices. US$ denominated debt will become more expensive hitting emerging markets. Forecasters now think that will not occur until late 2017.

Recent easing by the ECB and the BoJ has been followed by significant appreciation in the ¥ and €, which is the exact opposite of the intended consequences. While this may not persist, it counters the whole action of rate reduction and asset purchase. Therefore, the US remains a less volatile growth region.

The Eurozone continues to be a major beneficiary of the low oil price. Domestic demand in Germany has been the major cause of Eurozone growth with rising real incomes and additional government spending. Austerity cut backs are no longer a significant drag on Eurozone growth. With the Fed wishing to tighten money supply and while the ECB remains in easing mode, a weaker Euro remains a key driver for European equities.

We are conscience that a delayed Fed rate rise will temporarily put off a return of capital to the US. This will boost Asia and the Emerging Markets. Emerging markets will be sensitive to any strengthening US$ hitting commodity prices. However the upswing in global growth may also stabilise commodity prices that have had a good year already. We have

maintained our positions in China and India but added a general emerging markets dividend fund to broaden diversity.

As of 1st July 2016, our best performing funds held within our portfolios over the last 12 months have been;

Fundsmith	29.42%
Jupiter India	17.72%
HSBC American Index	17.22%
Schroder US Mid Cap	16.21%
Old Mutual North America	15.44%
Barings European Select	12.27%

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

While our poorest performing funds were;

Axa Framlington Biotech	-25.19%
HSBC FTSE 250 Index	-12.78%
Aberdeen Property Shares	-12.52%
Old Mutual UK Mid Cap	-10.07%
Fidelity China Focus	-8.99%

The main reasons for these disappointing performances were the volatility in the health care and pharmaceutical sector in the US, the recent heavy fall off in UK mid cap stock and commercial property as a result of Brexit and the past years volatility in China.

As far as the 25th Edition of our portfolios is concerned, seven of the funds from the 24rd 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 security and growth prospects going forward adding such assets as infrastructure funds, UK and global corporate bonds and index linked gilts that were not present in the last edition. We continue to hold meaningful levels of cash, bonds and property across the portfolios to help dampen volatility although we have reduced our property exposure. Our general strategy is to remain well diversified across all portfolios.

In general, despite the volatility of the past twelve months, we still hold a positive outlook for equities particularly for the US and Asia which are less affected by the Brexit fall out and for UK large cap multi nationals who will benefit from a devalued GB£. Despite the political negativity both UK and European stocks can recover their current depressed values, particularly with low interest rates, an ongoing QE programme and low oil prices.

While we remain positive over US equities. We are concerned about a potential lack of earnings growth as price-to-earnings ratios in America's large corporations are over 25. We still see the US as a growth economy and are happy to remain invested. US$ valuations are likely to hold as the Fed has postponed further rate rises and will aid America's exporters.

'Collectively our eight portfolios outperformed their respective benchmarks on 37 out of 44 occasions'

We believe that China is over the worse 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 more favourable in the second half of 2016. We are less concerned about the smaller emerging markets as it looks as if the Federal Reserve will delay further interest rate rises this year and commodity prices are improving.

We see returns on government bonds to be exceptionally low value as the only gain is on capital returns because yields are so low. The massive move of capital to safe haven assets after the Brexit vote and the ongoing ECB QE programme will continue to suppress bond yields. Inflation caused through the devaluation of GB£ is likely to result in rising bond yields and a corresponding fall in bond prices. We therefor consider index linked gilts as attractive. Equally, while demand for income remains, corporate bonds and high yield corporate bonds are also attractive. Due to the low yields in the UK and in Europe, we have increased our exposure to global bonds.

We remain overweight in UK commercial property which has contributed to overall portfolio returns this year. We are conscious that the pricing of commercial property funds has had a negative impact on valuations but this enforced pricing will be a temporary measure until confidence is restored and the Brexit implications settle. We are confident this sector will continue to provide meaningful longer tern returns to investors but after it has gone through a significant short term downturn. We have however reduced our commercial property holdings.

We are reasonably pleased to report that the gross performance of our portfolios in each of our eight portfolios up until 1st July 2016, as measured against the associated national benchmark, has been quite satisfying. The relative performance is measured over six time periods from 6 months, 1 year, 2 years, 3 years, 4 years and 5 years. Seven of our portfolios showed up well only the Defensive portfolio did not due to its high cash and low equity content. It did however achieve its objective. Collectively the eight portfolios outperformed their respective benchmarks on 37 out of 44 occasions (84% competency). However, I am disappointed to report that this success factor is one of our lowest outperformances in the twelve years we have been running them mainly due to the Defensive Portfolio's relative underperformance.

The portfolios were tested during the equity falls of last August, January and June. Our portfolios held up well, protecting investors from the worst of the volatility. The post Oil crisis returns since February has been robust. We fortunately moved those clients who followed our recommendation to switch out of UK and European equity to cash ahead of the Brexit vote. This action protected the UK and European asset allocation from the subsequent falls. We will return to risk assets at this rebalance in line with our asset allocation.

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

PORTFOLIO PERFORMANCE

The Estate Capital Investment Portfolios

The 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 4th July 2016

Below are the past five year's gross investment returns for each of our portfolios from 4th July 2016

Portfolio	*6 months*	*1 year*	*2 years*	*3 years*	*4 years*	*5 years*
Defensive	1.49%	2.67%	6.98%	12.98%	19.19%	22.24%
Conservative	2.48%	5.01%	11.52%	19.04%	31.25%	31.39%
Balanced Income	1.88%	3.68%	8.01%	17.19%	32.45%	35.38%
Balanced Beta	5.57%	5.49%	13.66%	21.63%	37.45%	38.42%
Balanced Higher Income	2.74%	2.97%	-	-	-	-
Balanced Alpha	5.73%	8.53%	17.61%	25.84%	41.87%	41.66%
Speculative Beta	6.95%	6.98%	14.64%	23.80%	45.15%	40.32%
Speculative Alpha	4.93%	7.22%	19.42%	31.35%	64.48%	53.54%

Discrete Portfolio Performance from 4th July 2016

Below are the gross investment returns for each of our portfolios for each 12 month period over the last five years from 4th July 2016

Portfolio	*2016*	*2015*	*2014*	*2013*	*2012*
Defensive	2.25%	3.98%	5.38%	5.78%	2.91%
Conservative	4.32%	5.82%	6.66%	10.45%	0.26%
Balanced Income	3.13%	3.79%	8.61%	12.92%	2.91%
Balanced Beta	4.92%	7.21%	7.02%	13.09%	0.88%
Balanced Higher Income	2.25%	-	-	-	-
Balanced Alpha	7.40%	7.66%	7.27%	12.54%	0.49%
Speculative Beta	6.41%	6.38%	8.21%	17.00%	-2.88%
Speculative Alpha	6.14%	10.48%	10.40%	24.74%	-5.91%

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 July 2016 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 July 2016 - Edition 25

Portfolio	*Risk*	*Money Markets*	*Fixed Interest*	*Property*	*UK Equity*	*US Equity*	*Europe Equity*	*Asian Equity*	*Japan Equity*	*Global Equity*	*Other Assets*
Defensive	2	46%	30%	9%	7%	5%	1%	1%	0%	1%	0%
Conservative	3	32%	24%	14%	10%	11%	3%	6%	0%	0%	0%
Balanced Income	4	13%	32%	13%	21%	8%	6%	6%	0%	1%	0%
Balanced Beta	5	9%	27%	14%	20%	9%	7%	12%	2%	0%	0%
Balanced Higher Income	6	3%	26%	12%	24%	11%	8%	9%	0%	7%	0%
Balanced Alpha	6	5%	23%	12%	21%	19%	7%	10%	2%	1%	0%
Speculative Beta	7	1%	18%	12%	20%	19%	7%	20%	3%	0%	0%
Speculative Alpha	8	3%	8%	12%	17%	30%	12%	13%	3%	2%	0%

Perspective Range of Return & Volatility

Portfolio	*Risk*	*Return*	*High*	*Low*
Defensive	2	3.50%	11.93%	-4.93%
Conservative	3	4.35%	18.35%	-9.65%
Balanced Income	4	4.97%	22.37%	-12.44%
Balanced Beta	5	5.60%	26.41%	-15.21%
Balanced Higher Income	6	6.04%	30.26%	-18.18%
Balanced Alpha	6	6.04%	30.26%	-18.18%
Speculative Beta	7	6.55%	34.17%	-21.07%
Speculative Alpha	8	7.04%	38.07%	-23.98%

Investment Ratios

Portfolio	*Risk*	*Beta*	*Alpha*	*Sharpe Ratio*	*Info Ratio*
Defensive	2	0.65%	1.39%	0.13%	0.05%
Conservative	3	1.03%	1.65%	0.50%	1.43%
Balanced Income	4	0.89%	1.12%	0.34%	0.37%
Balanced Beta	5	1.17%	1.11%	0.45%	0.75%
Balanced Higher Income	6	0.76%	0.71%	0.00%	0.12%
Balanced Alpha	6	0.94%	2.36%	0.60%	0.85%
Speculative Beta	7	1.18%	0.71%	0.41%	0.46%
Speculative Alpha	8	1.30%	2.02%	0.60%	0.90%

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

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