ESTATE CAPITAL INVESTMENT PORTFOLIOS
OUTLOOK

EDITION 32 Winter & Spring 2020

In This Edition:

The Fed is now on board

A Brexit Bounce?

Wall St saved again

A Phase 1 cease fire?

Deteriorating US corporate profits

Falling yields but strong gains

ESTATE CAPITAL

The Fed is now much more supportive.

It is easy for investors to be concerned about the state of the world at the moment. Climate change is impacting our lives with increasing frequency. We have witnessed severe flooding in South Yorkshire and the intense forest fires in Queensland and New South Wales. We have also experienced civil unrest in Hong Kong, further fighting in Syria, economic crisis in Argentina, and our own Parliament in gridlock.

While all this unrest and disaster has been going on, the major central banks have been making life a little easier for business to combat the ongoing US-China trade tensions and reboot sluggish growth rates.

Despite this uncertainty, leading stock markets have been hitting new highs. The factors driving the rise in values are the cut in US interest rates, the restart of Quantitative Easing (QE) in America and Europe, an easing of the US-China trade dispute, and the likelihood that the Fed has put off a recession. If the outlook is one of a slowing economy with pressure on profits, then the release has been the Fed and the ECB turning on the money taps again.

The S&P 500 index started 2019 valued at 2506 and by mid-November was valued at 3090, a gain of 23%. The Euro Stoxx 50 index likewise gained 24%; the Nikkei 225 index was up 20%; and even the unloved FTSE 100, faced with unprecedented uncertainty, rose by 9.4%.

Markets have enjoyed a very good 2019 after a volatile end to 2018. This tailwind is a combination of factors mainly emulating from the USA. The yields on US government debt has returned to a more normal pattern since mid-October as investors returned to a 'risk on' mode. Markets have spent much of 2019 worrying that the US-China trade war would trigger a recession. While growth has slowed, it is at lease positive. Investors are feeling more optimistic as a recession looks to have been averted.

The US-China trade negotiations seem to be making progress. The two countries have a shared interest in defusing the two-year long dispute. A Phase 1 agreement looks to be likely but may not now be signed in December due to China's reaction to the Hong Kong protests. China has warned the US it

could take “firm counter-measures” if Washington continues to show support for pro-democracy protesters in Hong Kong. The warning came after President Trump signed the Human Rights and Democracy Act into law. The act mandates an annual review, to check if Hong Kong has enough autonomy to justify special status with the US. Among other things, Hong Kong’s special status means it is not affected by US sanctions or tariffs placed on the mainland. Analysts feel the move could complicate the negotiations between China and America.

The Federal Reserve has now cut US interest rates by a total of 0.75% this year. These rate cuts have not yet fully fed into the economy. In the coming months, US citizens will start to enjoy cheaper mortgages and businesses will have lower borrowing costs.

Despite a major strike by General Motors staff, the US economy added 128,000 new jobs in October, 136,000 in September and 130,000 in August. The US unemployment rate stands at 3.6%. This consistent increase in new jobs is a strong aspect to the American economy.

US companies delivered lower profits in the latest quarterly results season. These results were however better than expected. While earnings and growth are weak, they are expected to pick up as we head into 2020.

Safe haven assets such as gilts and gold have seen some changes in recent weeks. Bond yields have improved while the price of gold fallen. This is a reflection that markets are more optimistic. Central banks are in full loosening mode and there is more cash in the global economy through renewed QE. With weaker growth rates expected, we anticipate that investment returns will be modest but acceptable for the late stage in this long running economic expansion.

The end of 2019 is certainly more positive in outlook than at the very beginning of the year. In January, we were concerned that the Federal Reserve could make a grave policy error by putting up US interest rates at the wrong time for the economy. This could have sparked a major fall in equity market. This concern was the reason we were very cautious in Q1 2019 and held more in cash than we would normally. The Fed is now much more supportive.

A deal in January can give the UK a Brexit bounce.

There has been very little 'united' about the United Kingdom in recent months. The political temperature certainly increased as we got closer to the second Brexit deadline of October 31st with so much at stake and with so little compromise. The passing of the Benn Act, compelling the government to seek a further postponement to Brexit, brought to a head the inevitable necessity for a general election. When the extension to January 31st was granted by the EU, opposition parties could no longer refuse to back a poll on December 12th and to bring in a new parliament with a new mandate.

The threat of a no-deal Brexit has declined since the passing of the Benn Act and the success of Boris Johnson's renegotiated Withdrawal Agreement which received a majority in the House of Commons. As a result, sterling has risen from US$1.22 to US$1.29 over a period of 10 days from October 9th.

The election result, at the time of writing, looks to be going in Boris Johnson favour. The Conservatives are ahead in the polls and the Brexit Party is only standing against sitting Labour and Liberal Democrat MP's. The Leave Alliance seems to have realised the consequences. The Labour Party, still split on their preferred outcome for Brexit refused to join a Remain Alliance with the Liberal Democrats, the Greens and Plaid Cymru. If Boris Johnson is returned to Downing St with a working majority, then the passage of his Withdrawal Agreement will take place and Britain will leave the EU on January 31st 2020, if not earlier. However, if there is a hung parliament the passage of the Withdrawal Agreement will be harder and uncertainty will remain.

Against the back drop of Brexit uncertainty, it is not surprising that the UK economy remains in a low gear. According to the Office of National Statistics (ONS), the UK grew by 0.3% in Q3 equating to a year- on-year growth of just 1%, which is its slowest annual rate of growth for 10 years. The decline was put down to manufacturing and construction sectors contracting.

However, since the Referendum, the UK has grown in 13 of the 14 quarters with total accumulated growth of 4.9%. This compares well to Germany at 4.7%, Italy at 3.2%, but behind France at 5.8% who has comparatively outperformed. The ONS confirmed that UK employment stood at 32.74 million people in October, a fall of 58,000 due to the closure of several high street retailers. Interestingly, unemployment fell by 23,000 to 1.31 million as wages grew by 3.6%. UK inflation stood at 1.8% meaning that wages are again rising ahead of inflation.

The City of London Corporation views the Brexit extension to January as only a 'sticking plaster rather than a sustainable long-term solution'. The Corporation stated 'Continued uncertainty has left business without the clarity needed to make everyday decisions on investment, expansion and

recruitment. The three-and-a-half-year impasse needs to find a positive solution that enables business to get the certainty required in order to strive'.

Car production within the UK has fallen due to Brexit uncertainty and weaker overseas demand. Car imports for the year to the end of October fell 15.6%, making 2019 the weakest year for the car industry since 2011.

The Society of Motor Manufacturers and Traders (SMMT) cite the threat of a no-deal Brexit has caused international investment to stall and cost UK operators £500million on no-deal contingency planning. The SMMT welcome the general election with the hope that it will bring clarity and conclusion to a frustrating period for car manufacturers. The SMMT hope that the new government will agree and implement an ambitious relationship with the EU that safeguards free and frictionless trade.

There are many different scenarios and economic consequences depending upon the outcome of the general election. We have taken a view to plan for what is progressively emerging as the most likely outcome.

For the economy, a smooth Brexit with a transition period in which to negotiate our long-term future with the EU removes a great deal of downside risk to the UK and the EU. It would be expected that business investment would recover on the basis that business will know what it will be planning for. Overall household spending and the housing market should have a lift and bring about a gradual improvement in confidence and GDP growth.

However, if the UK were to leave without a deal for any reason, then it would do so without a transition period and all current EU trade deals would end. Custom checks would be installed at borders which would have a major impact on delivery times. In this scenario, it is thought that sterling could fall to around US$1.10. Inflation would rise due to the additional cost of imported goods which may hit consumer spending. As UK household spending is the biggest driver of GDP growth, we could see GDP fall further and remain low for some period of time.

Business investment is likely to fall in some areas but rise in others; while government spending is expected to increase to limit the impact of a hard Brexit in the more effected parts of the economy. Interest rates are likely to be reduced from 0.75% to 0.25% with some additional QE implemented to encourage bank lending. These outcomes are likely to be equally replicated in the Republic of Ireland but to a lesser extent in the Eurozone.

If the UK were to leave with a deal, then we could see sterling rise to around US$1.30 given there is a trade deal still to negotiate by December 2020. Inflation may dip and then rise as households enjoy a boost to real income and

start spending. British investment that has been held up for some time would return and be supported by the government spending that was announced in the last budget. The economy should see a marked pickup in growth compared to the recent lacklustre performance. There will still be some uncertainty over the future relationship with the EU which would still need to be negotiated but the near-term risk of disruption could be is avoided. Sterling is currently valued at US$1.289 meaning that much of the rise in sterling due to a Brexit deal is already priced in.

If the UK were to revoke Article 50 and remain full members of the EU, which is the Liberal Democrats policy, we could see sterling rise above US$1.43, its level prior to the referendum. This would be the most positive scenario for immediate economic benefit.

The two barometers for Brexit uncertainty are foreign exchange rates and domestic investment. In areas such as employment levels, consumer spending and inflation the economy is doing well. If a deal is agreed in January then one expected benefit is an improvement in investment and capital expenditure from business at home and abroad.

Sterling has fallen in value from US$1.43, prior to the Referendum in June 2016, to a low of US$1.22 in October 2016, only to recover back to US$1.43 in April 2018 and now stands at US$1.28. The pound has fluctuated on the likelihood of UK securing a deal to leave the EU. The expectation of a Brexit deal has allowed sterling to strengthen recently. The long-term value of sterling against the dollar is US$1.45 so at US$1.28 it is 12% undervalued. If sterling regained this position, there would be a negative impact on the value of unhedged overseas assets when revalued back into sterling. We think this unlikely in the near term.

Most analysts consider that the UK stock market as undervalued compared to other developed markets. This undervaluation has been present since the June 2016 EU Referendum despite a relatively strong showing from the UK economy over that period. The FTSE 100 is heavy in commodity stock, but light in technology stock which is a particularly high value sector. International investors have been put off by Brexit uncertainty, while the potential threat of widespread nationalisation has put off utility sector investors, which makes up a significant proportion of the FTSE index.

Many commentators believe that getting a Brexit deal through parliament in January will give the UK a Brexit bounce. UK equity markets will be a beneficiary of this, particularly the UK focused FTSE 250 index of companies. The UK is seen as undervalued and with Brexit uncertainty lifted, foreign investors will be attracted to the UK. The strength of the UK economy, its flexibility and competitiveness should enable it to survive and prosper after the transition to a new relationship with the EU.

Wall St has shaken off concerns of an imminent recession.

It will not be a shock that the US economy is slowing down after 10 year of steady expansion. Despite this slowdown, most economists are not expecting a recession in the US, but instead are anticipating GDP growth of about 2% per annum. Recently published data has been more upbeat on the back of historically high employment levels, wage growth and strong consumer spending.

During the first half of 2019, the US economy grew on a year-to-year basis by 3.1% in Q1 and 2% in Q2. At the same time, the US labour market remained strong with new job growth averaging 131,000 per month between August to October, 154,000 per month between May and July and 159,000 per month between February and April. The unemployment rate remains at 3.6%, the second lowest rate since 1969.

Household balance sheets have improved through a general reduction in personal debt, wage growth and greater levels of employment. While consumer spending has risen, business investment and exports have weakened. The strength of consumer finance is an important factor for confidence that the business cycle can continue for another year.

Inflation at the end of October was 1.8% with expectation of little change in the months ahead. This outlook has allowed the Fed to cut interest rates on three occasions this year. Interest rates now stand at 1.50% to 1.75%. These rate cuts have increased the availability of money but not yet enough to see a meaningful increase in US inflation. The housing market should further improve on the back of these three interest rate reductions. An expanding housing market has a positive knock-on effect to other sectors, not least the market for raw materials.

The Federal reserve's rate cut has resulted in a new high in November for the S&P 500 index and the Nasdaq Index. This recent lift in the S&P 500 comes after corporate profits had fallen throughout the first half of the year and brokers were warning of further declines in corporate earnings. There had been concerns that the record US bull market was coming to an end only to be saved again by the Fed.

These peaks mean that Wall St has shaken off concerns of an imminent recession which were

prompted by a US yield curve inversion and resulted in a heavy sell-off in the summer. Since the end of Q2, most S&P 500 companies have beaten their earnings expectations. This uplift in equity comes at a time when bond yields are exceptionally low. It is quite clear that the message that the bond market is giving is the opposite to that of the equity market with bond yields indicating negative growth ahead.

It would normally cost less to borrow money over a shorter period than a longer one and therefore a yield curve would normally slope upwards with longer dated bonds having higher yields than shorter dated ones. This natural yield slope inverted, or reversed, in both May and again in August suggesting that the US economy may be heading for a recession. The US bond market has a good track record at predicting a recession in the US economy. With only one exception in 1966, each time the US yield curve has inverted, the US has entered recession within 18 months. Analysts have been predicting a 40% likelihood of a recession as they also take into account other factors such as consumer spending, interest rates and employment rates.

Household balance sheets have improved through a general reduction in personal debt, wage growth and greater levels of employment.

A mistake by the Fed affects everyone.

In late November, US stock markets hit new highs, buoyed by the Federal Reserve cutting interest rates, trade deal optimism, improved Q3 earnings and positive job growth numbers. The rise in stock values was a result of the Fed cutting interest rates for the third time this year. We have now seen a 0.75% reduction in US interest in 2019.

Many investors interpreted the first Fed rate cut of 0.25% back in July as a warning of an increasing risk of a recession. July's rate cut pushed 10-year yields in developed markets' government bonds to all-time lows, including UK gilts. The Fed's September rate cut gave analysts far greater confidence that the Fed would act ahead of markets and be willing to take supportive action early.

On October 31st, the Federal Reserve Chairman Jerome Powell announced an earlier than expected further 0.25% cut in US interest rates. He also indicated that any future rate reduction would require a 'material re-assessment' of the economic outlook. This was interpreted to mean that the Fed had done what it needed to cover the risk of a serious downturn in the US economy. There is still pressure on corporate profit margins and any impact this may have on future job growth numbers will be watched by the Fed.

Jerome Powell was optimistic over a Phase 1 trade deal with China and felt that other risks were also subsiding. The previous two rate cuts this year have already helped certain sections in the economy sensitive to borrowing costs such as housing. This latest rate cut will take some time to be felt.

There is an expectation that the Fed may cut rates twice more in the first half of 2020. This is a complete reversal of Jerome Powell's position in October 2018 when he predicted three rate rises in 2019. This was taken as a policy miscalculation as markets subsequently sold-off. The actions taken by the Fed since show that market expectations were correct.

Stock markets have also responded positively to the Fed returning to its quantitative easing (QE) policy. The Fed has re-started buying US$60bn per month of US short-dated treasury bills to pump cash into the US economy. This QE programme is aimed at the repurchase market used by banks and corporations to trade bonds for cash overnight.

The cut in interest rates and the restarting of QE is likely to result in a weaker US$. President Trump wants to lower the value of the US$ to support US exports and US$ denominated debt holders. But the consequences are that both equity values and bond values are not rising on the basis of economic fundamentals and strong earnings but because of lower interest rates. The continued action of central banks has resulted in around US$14tn of bonds now paying negative yields. One third of new issues are sold with a guaranteed loss built into the coupon.

The Fed's policy on rate cuts or rate rises has a major impact on the rest of the world as any mistake by the Fed affects everyone. The Fed's policy influences currency exchange rates, interest rates and international flows of investment capital throughout financial markets. Some analysts think that Jerome has used up some of the ammunition that he may need later.

Tax rate cuts have masked an underlying deterioration in US corporate profits.

The S&P 500 index has gained 23% since the beginning of 2019 driven mostly by the on-going easing of monetary policy by the Fed. This easing has supported the rise in the price-to-earnings ratio (P/E) as earnings per share over the same period has hardly moved.

Markets have, over the past 15 months, experienced some sharp reductions. Unless the Fed can implement a successful 'end of cycle' policy this tailwind of growth is not likely to be sustained. Earnings will have an important role in determining equity returns as stock markets are driven by such fundamentals.

Data from the US Bureau of Economic Analysis shows that US corporations have been far less profitable than previously thought. The share of national GDP provided by pre-tax profits has fallen from 12.27% in 2014 to 9.9% in 2019. President Trump's Tax Cuts and Jobs Act in December 2017 brought US corporation tax rates down from 35% to 21% masking an underlying deterioration in US corporate profits. The stimulus from these tax cuts is now beginning to fade.

Analysts are predicting that there will be a profit squeeze on US corporations due to increases in wages and that retail price rises are not likely to be high enough to offset rising labour costs. Therefore, earnings and profits are likely to suffer. Some fund managers are predicting a 3.7% drop in profits for 2019 and a 2.4% fall in 2020. Corporate profits will suffer further should the global economy fall into recession. However, it is possible that profits would improve if the US and China where to agree a trade deal and remove all tariffs. This would boost confidence, investment and trade volumes. Sadly, a comprehensive lifting of tariffs looks unlikely at this point in the negotiations but a start could be made soon.

Phase 1 will be a cease fire and reduction in hostilities.

The effects of US trade tariffs upon Chinese imports are starting to have an impact upon both USA and Chinese GDP growth. US imports from China have been falling and were down 16.2% year-on-year in October according to Trading Economics. Some of the smaller East Asian economies such as South Korea, Taiwan and Vietnam have seen production and trade gains as parts of the international supply chains have shifted towards those economies not targeted by tariffs.

In less than two years, the average tariff rate on US imports from China has risen from only 3% to 26%. President Trump has also called upon US corporations to seek alternatives to Chinese products.

There is clear evidence that the trade war is affecting both economies. US manufacturing and agricultural sectors have experienced a significant fall in income. This will affect President Trump's re-election chances as these sectors are important to his base. China is also concerned about the slowing state of their economy. Some economists have suggested that 25% of the global slowdown can be attributed to this trade dispute.

The People's Bank of China (PBoC) has been spending its US$ foreign currency reserves to prop up the renminbi, but stopped their purchased on the two occasions that Donald Trump tweeted to announce either new or higher tariff rates. The devaluation of the renminbi seems an obvious counter to increased tariffs. With tariff rates averaging 25% on all Chinese goods entering the US, the Chinese authorities could devalue their currency to match the tariff so removing the impact on American consumers. However, any devaluation of the renminbi against the US$, would increase the value of any US denominated foreign currency debt within China and prompt the flight of foreign capital from its domestic banking system.

If China devalued the renminbi by 25%, it could cost them 2% of GDP in increased interest payments and higher interest rates. While this may be manageable for a period, the flight of capital is a more serious concern. The last time Beijing implemented a currency devaluation was in May 2015. This unexpected action triggered a three-month period of stock market losses and large capital outflows that hit China's foreign currency reserves. The inflation impact would also be significant as a 25% fall in the renminbi would imply a 5-7% additional rate of inflation. This would hit Chinese consumers directly.

If China did devalue Washington could increase tariffs further and it may also encourage other

economies, such as Japan and EU, to retaliate against any devaluation by imposing their own tariffs on China. As it is, the PBoC has used its US$3tn of foreign currency reserves to defend the renminbi.

The 13th round of negotiations was conducted in October and since then there has been a cooling of tensions over a trade agreement. The areas of dispute have been separated so that a Phase 1 agreement can focus on the less contentious issues that are easiest to resolve. Washington is looking for a US$40-50bn increase in Chinese procurement of US agricultural goods such as soya in order to shore up Donald Trump's rural support.

On December 15th, a 25% tariff on the import of US$156bn worth of Chinese electronic goods is planned to come into force. This tariff will impact US consumers more than previous actions. Therefore, if a Phase 1 agreement is reached and signed off by both President Trump and President Jinping, both sides can simultaneously roll back on past and future tariffs.

There has been uplift in stock market valuations after encouraging announcements in both Washington and Beijing. This has now been priced into stock markets meaning there is a lot of room for disappointment.

The more difficult issues will be put back to future negotiations. Given the range of issues that the Trump Administration has with China – state espionage, intellectual property theft, subsidies to state-owned businesses and the closed nature of China's domestic market to foreign companies, it seems unlikely that a full and sustainable trade agreement will occur soon. Phase 1 will be a cease fire and reduction in hostilities. The timing of the US Presidential elections next November may encourage President Trump's team to agree a settlement sooner rather than later.

Economic strains caused by the trade war have weighed on global growth this year. The International Monetary Fund estimates that the US-China trade war will shave almost 1% off global growth in 2019.

A period of unprecedented growth and improvements in living standards.

Last October marked the 70th anniversary of when the Mao lead Communist Party took power in China in 1949. The past four decades particularly have been a period of unprecedented growth and improvements in living standards of millions upon millions of Chinese. In 1981, 90% of Chinese citizens lived in extreme poverty. In the past 38 years, that figure has fallen to 2%. Due to this wonderful expansion, China is now servicing a national debt level of 300% of the country's annual income and official figures have confirmed that GDP growth is at its slowest rate for 27 years.

The great turnaround in fortunes in China started in the 1980's by then Premier Deng Xiaoping who started free-market reforms with the beginning of red capitalism and massive investment in infrastructure and manufacturing. GDP per head has risen from US$200pa in 1945 to over US$10,000pa today. This is considered the fastest sustained expansion by a major economy in history with growth averaging 9.6% per year.

China used to deliver cheap labour on a massive scale, but as the county has grown wealthier so have wages. The country is now losing its competitive advantage to countries like Vietnam. China is also challenged by its ageing population which is a consequence of its one child policy. China's working age population has been falling since 2015.

China's year-on-year growth has fallen from 6.7% in 2018 to an expected 6.3% for 2019. Analysts believe the real figures are lower than the official figures and that the slowdown has not yet ended.

The Chinese authorities will be faced with difficult decisions if they wish to stimulate a growth recovery with the national debt standing at 300% of GDP. So far, Beijing has used tax cuts as an incentive to get the economy moving during the trade war with the US.

The protracted trade dispute with the USA, slowing growth, greater international competition and an aging population are all challenges that Beijing will have to address in the years ahead.

The long running unrest has hit business confidence.

Tourists are avoiding Hong Kong and retailers are feeling the heavy consequences of the five months of protests that have dealt a devastating blow for business in Hong Kong. The violent unrest has pushed the economy to the edge of a recession with two quarters of negative growth.

The recession is not just about the riots and protests against Carrie Lam's now withdrawn extradition bill between the territory and mainland China, but also a reflection of the impact of the US-China trade war and a weaker renminbi which has hit consumer spending and confidence. Holiday makers have fallen by 50% in October 2019 as compared to October 2018 with hotel vacancy rates as high as 60%, leaving hotels slashing prices and making staff cuts. Qantas, the Australian flagship airline, has stated that the protests will hit their half-year profits by £13m.

Mainland China has virtually no sympathy for the Hong Kong protestors who are seen as unpatriotic and ungrateful. The hope in Beijing seems to be that the average Hong Kong citizens will lose patience and sympathy with the protestors as the economic damage worsens. So far this has not happened at all. The clashes between police and protestors have escalated and become increasingly more violent with police firing live ammunition while protestors retaliating by using petrol bombs.

The Hong Kong protesters were given a major boost by the city's electorate in the November district council elections. This was the first chance that the people of Hong Kong have had to register their feelings about the handling of the crisis. The results saw 17 of the 18 districts now run by pro-democracy councillors due to an unprecedented 71% turning out to vote. This outcome has given Carrie Lam a lot to reflect upon after some high-profile pro-Beijing candidates lost their seats.

The long running unrest will continue to hit business confidence. This may have a longer-term impact on Hong Kong's future as a financial hub. The authorities are all too well aware of the consequences to the island city.

Japan's working population peaked in 1992.

Official GDP data from Japan shows that its economy slowed from 2.2% annual growth in Q1 2019 to 1.3% in Q2. This slowdown however did not deter Prime Minister Shinzo Abe from implementing his twice delayed VAT increases in October. Japanese VAT rates increased from 8% to 10%, which is a modest rate compared to the OECD VAT average of 19.2%, but the last time VAT was raised in 2014 the increase caused a slump in Japanese consumer spending and a recession.

There are two key factors that contribute to Japan's persistent weakness in economic growth. The country's population peaked in 2010 but Japan's working population peaked in 1992. Declines in these key numbers automatically limit GDP growth. Along with the reduction in working-age population, there has also been a fall in labour productivity in recent years. Despite the low level of unemployment, currently at a 26-year low of 2.3%, and the highest job to application ratios for 45 years, wage growth remains slow and there are no signs for a significant expansion in the economy.

Japan is not expected to exceed its inflation target of 2% that the government and the Bank of Japan (BoJ) have worked hard to reach. The BoJ has pursued large scale asset purchases that have resulted in a fourfold increase in the BoJ balance sheet from ¥144tn in March 2012 to ¥572tn in September 2019. Despite this massive investment programme, the latest Japanese CPI annual growth figures are 0.3%. The BoJ has been buying Japanese government bonds from the banking sector, which amounts to a cash for bonds asset swap, rather than buying non-banking sector bonds to provide capital to businesses directly. For this reason, some economists believe that Japan will not hit its inflation targets until its monetary policy changes.

No foreign country has been impacted by the US-China trade dispute more than Japan with exports falling by 8.2% year-on-year to Q3. However, these actual figures were better than had been expected, as the Japanese economy has exceeded expectations.

The reform in corporate governance implemented by Prime Minister Abe has encouraged Japanese corporations to start paying dividends to shareholders boosting shareholder value. Japan's Nikkei 225 index now delivers an average yield of 2.6% which is more than the S&P 500 average and not far behind the Euro Stoxx 600 index average. So far this year the Nikkei 225 index is up 20%.

With P/E ratios of 13.9, Japan's stock market is cheaper than the UK, which is also at historically attractive valuations.

The Eurozone has underperformed amongst the major economies.

The Eurozone has underperformed amongst the major economies. Europe is slowing on the back of weak industrial and trade data. Germany, which is dependent upon trade, is at risk of falling into a technical recession due to its exposure to the auto industry and the global manufacturing cycle. Other European countries have seen growth weaken but have held up better than Germany. Analysts are now looking to France to drive European growth. The French stock market has had an impressive year with the Paris CAC 40 rising 24.8% since January 1st equalling the 25% rise in the DAX Index in Frankfurt. Some overall good news for the Eurozone is that employment figures are steadily improving. Unemployment currently stands at 7.4%, the lowest for 19 years.

Perhaps this year's most important development in the Eurozone was taken by the European Central Bank (ECB) in September. Outgoing President Mario Draghi announced the resumption of its asset purchasing programme. The ECB is now purchasing €20bn per month of Eurozone sovereign bonds. The renewal of its QE policy, that only ended last December, was implemented along with a -0.1% cut in interest rates to -0.5% and the introduction of tiering rates to protect the finances of Eurozone banks. The tiering of deposit rates allows Eurozone banks to avoid the penalty of negative interest rates on their ECB deposits and to encourage lending.

Just as with previous rounds of QE, this asset swap between the ECB and Eurozone banks may not deliver new cash into the hands of businesses and households to spend at the levels desired. Some analysts are suggesting that these measures will not kick start the economy as efficiently as they could and that this is why the ECB has had to re-start QE again because it was not sufficiently successful the first time.

Reducing interest rates to negative levels has not stimulated growth as it does not encourage banks to increase lending levels significantly because there are very small profit margins with ultra-low or negative interest rates. Negative interest rates also have an impact on house prices, savings rates, savings levels and insurance company and pension fund liabilities. Critics of the ECB policy suggest a better way to stimulate growth is to use QE to purchase non-banking sector bonds providing companies with cash directly to spend and invest. The QE programmes in both the US and UK have been more successful at stimulating growth.

The European economy has slowed and the ECB has only limited options to create growth. If there is a recession in Europe or a fresh euro crisis sparked off by sovereign debt levels, then the ECB and Christine Lagarde, the new incoming President, will be challenged.

Mrs Sitharaman has cut corporation taxes to 22%.

India's new Finance Minister, Nirmala Sitharaman, has cut corporation taxes from 30% to 22% and new companies set up since 1st October will have even lower rate of corporation tax at 15%.

India has also merged 10 regional public sector banks into one company and supported a recapitalisation package for other public sector banks.

The Delhi authorities have implemented policies to support mortgage companies, car manufacturers and property developers. The re-elected Modi government is taking a more influential role in India's economy. In order to plug a US$20bn loss in tax revenue, the government has announced the sale of public sector companies and the issue of foreign sovereign bonds.

Without any clear evidence of a boost to global trade and with the Chinese economy not only slowing but also accepting a lower GDP growth target, emerging markets are looking less likely to deliver substantial returns. A weaker US$ will assist growth and those countries that are less exposed to the US-China trade dispute and have strong fundamentals and a reform agenda should still outperform. India is particularly attractive in that regard.

Oil

When Iran attacked oil tankers in the Strait of Hormuz in June the price of oil spiked. Oil prices rose from US$51pb to US$60pb over just a few days. In September, Houthi rebels claimed responsibility for the drone attack on the world's largest oil processing facility at Adqaiq in Saudi Arabia. The attacks on the processor and a major oilfield, operated by Saudi Aramco impacted 5.7 million barrels per day of crude production which is nearly half the kingdom's output and vital to global energy supplies.

The ability of the US to supply more shale oil relatively quickly and the decision by President Trump to make the US strategic petroleum reserves available following the drone attack have kept a lid on further price spikes. By the end of September, prices had fallen back to US$55pb.

The general slowdown in global demand for oil has helped hold down prices. Oil now stands at US$62pb but was expected to average US$65pb in 2019.

Gold

The price of gold has increased from around US$1,300 per ounce at the end of May to peak at US$1,550 in September.

This rise has been driven by central banks steadily buying gold over the past year and in doing so adding an additional 651 metric tonnes to the world's official gold reserves last year. Russia, China and Turkey have led the way in sovereign gold purchases. A further factor driving gold is the very low yields on government bonds and concerns over an economic downturn.

Falling yields has resulted in strong gains in bond markets.

The bull market in bonds has resulted in strong gains for government bond markets with US Treasuries, global bonds and UK gilts up around 10.3% this year. The bond markets have benefited from reduced interest rates, subdued global inflation and a rotation from equity to bonds due to concerns over a possible recession. These factors pushed yields to the point where the US Treasuries yield curve inverted on two occasions this year. The entire German Bund yield curve, with maturities out as far as 25-years, is trading at negative yields.

While sentiment remains bearish, it is possible to see yields fall further rather than rise. The main motivation to invest in long-dated bonds at present is their hedging properties against a recession. The problem is that investors are being asked to pay a high price for this insurance and it may get higher. Duration within the credit market does provide income and diversification from equity. If equity markets do sell off, investors will return to government bonds and investment grade credit. Any rises in yields may only be short lived.

As far as corporate high-yield bonds are concerned, they too have performed well on the back of falling interest rates. Default rates may rise in the coming year but are still likely to remain below historical averages of 4%. Non-investment grade bonds will be more sensitive to the slowing global outlook and to falling profits.

In their latest Global Financial Stability Report, the IMF raised concerns over the debt levels in emerging markets. Recently this has been driven by falling US treasury yields pushing bond investors to seek higher yields in emerging market credit. This move has challenged creditworthiness. Much of the debt is US$ denominated and there has in the past been vulnerabilities to emerging markets in accessing US$ funding. While there is ample supply today as the Fed has restarted QE, we did see problems in 2008 and with the 2013 taper tantrums when emerging markets were hit by short-term hard currency borrowing restrictions. Since 2013, things have improved as greater numbers of emerging economies are far more resilient.

It is against this backdrop that we are making our investment recommendations

29th November 2019.

PORTFOLIO SELECTIONS

Investment returns have been predominantly very good since the turn of 2019 with significant growth in both equity and bond markets. Despite these returns, it has not felt like a bull market due to so many impending uncertainties. Stock markets around the world have been weighed down by different risks. These uncertainties have come in the form of on-going trade tensions, escalation in tariff rates, fears over a hard Brexit, a global slowdown, a US treasury yield curve inversion, the collapse of Italy's coalition government, riots in Hong Kong, oil price spikes and the threat of the impeachment of Donald Trump. With these distractions and weak economic data, it is no wonder some economists expect a recession in the coming months. Others are far less downbeat. Several of the global headwinds are set to fade in the months ahead. There looks to be growing optimism for an early Phase 1 trade deal between the USA and China. Britain could be leaving the EU with an agreed deal by January 2020. Oil prices are stable and expected to fall back. Bond yields are historically low and are likely to reduce further before they may rise.

The economic outlook remains tricky to navigate. Political outcomes in the UK offer different investment implications. A Brexit deal could see sterling strengthen adding some currency risk to overseas assets, while a delay will offer the reverse.

While the world is captivated over these threats, central bankers have taken direct action to reduce interest rates and supported looser monetary conditions in both the developed and emerging markets. These actions, along with lower bond yields, have given some encouragement that an imminent recession can be averted.

In October, the European Central Bank (ECB) cut interest rates and restarted its €20bn per month bond purchasing QE programme. The Bank of Japan (BoJ) is expected to cut rates in December. The Bank of England (BoE) is also expected to cut rates but not until after the outcome of Brexit is known.

The US Federal Reserve has changed its policy dramatically over the past 12 months, moving from rate rises to rate cuts. We have seen three rate cuts of 0.25% so far in 2019, the same number of rate rises that Jerome Powell previously predicted he would make this year. Markets are now expecting a further two rate cuts in the first half of 2020. This will leave US interest rates at around 1.25% by the time of the US Presidential Elections in November. The Fed now look as if they are happy to see a rise in inflation rather than to try and dampen it as they did this time last year.

Consumer spending, particularly in the USA, is now the only real driver in the world economy. American shoppers are proving to be resilient while their wages improve and employment is at record highs. Despite this consumer boom, some economic data is providing contrasting signals such as manufacturing data which is poor and consumer and labour data which is strong. Production and order books look better than the business surveys. Overall, global growth is weak and investors need to be aware of to this. One clear economic signal to watch throughout 2020 is US consumer spending and new job numbers as they are unlikely to continue at above trend levels.

American companies added 128,000 new jobs in October ahead of the 85,000 expected. This increase came in a month when thousands of General Motors workers were on strike and removed from the official employment numbers as striking workers are treated as unemployed in the USA. The average number of new jobs created per month in Q3 was 143,000 per month. However, forward looking employment surveys do suggest a downward trend in jobs growth with only 50,000 new jobs per month by the end of 2020. These job numbers do support the Federal Reserve's view that the US economy is in good shape. GDP growth recorded a rise of 1.95% year-on-year in Q3 up from the forecasted 1.6%.

Manufacturing survey data remains weak with PMI confidence values below 50 in Q3. We have since seen a significant and widespread easing of monetary policy and the launch of new fiscal stimulus which will take time to have an impact on the real global economy and to counter weaker growth.

Inevitably, analysts have been downgrading their forecasts for global growth in 2019 and 2020 due to the soft economic data and on-going trade tensions. There has been some improvement in the outlook over trade, global GDP growth is now expected to hit 2.6% in 2019 and forecast to be 2.4% in 2020. Analysts are saying that the business cycle hit a low in Q2 2019 and has been improving since. In November, sensing a turning point in global activity, equity markets moved to new highs after rate cuts, easing trade tensions and improved growth expectations.

In general, the global economy looks to be withstanding the uncertainties it faces. The fears of an imminent recession look a little overblown for now and into 2020. Overall our portfolios are tilting towards caution but are exposed to risk assets in order to tap into late-cycle growth. We see equity as fair value but bonds as expensive and while a recession may not materialise, we think it makes sense to maintain our conservative positioning.

We have maintained our overall asset allocations but have moved some money into the UK assets in order to take advantage of a post Brexit Britain and reduce our exposure to international currency in case sterling were to strengthen further. We will retain our holdings in the US as their stock market remains the most dynamic. We will also maintain our emerging market holdings which will be impacted by a slowing world but aided by any US-China trade resolution. We remain underweight in European equity markets even though they have performed well in 2019. While we missed out on this growth, we did capture better returns elsewhere. We are not attracted to the outlook for Europe or the ability of the ECB to prevent a slowdown.

We are neutral on Japan, even after a fantastic world cup and entertaining running rugby. We have maintained our modest positions. Japanese equity valuations are attractive, but export weakness and a strong ¥ remain a headwind on growth. The recent increase to the consumption tax or VAT may present a problem with reduced consumer demand.

With global growth slowing, one theme that seems to have been developing since early 2019, is the

convergence of sovereign bond yields as interest rates have been cut and inflation remained subdued. As yields fall, capital values should rise and purchasers will now get very poor value for money due to such low yields. The most attractive sovereign bonds are US treasuries. As far as corporate credit is concerned, we have moved up the quality ratings in our credit holdings with more UK investment grade corporate bonds. Although we do not see global interest rates rising, we have reduced some exposure to long dated credit and the associated duration risk. New levels of quantitative easing from the Fed and the ECB will keep high yield credit default rates stable and therefore both US and UK short-dated high-yield look favourable. Emerging market bonds will maintain a modest position in the portfolios due to their higher yields.

A low interest rate future gives a boost to equity and high-yield credit. However, with a slowdown anticipated, we will move in part to larger dividend paying stocks ahead of smaller companies. As the yield curve has flattened, investors who are concerned about duration risk can get about as much yield on short-term liquidity as on 10-year treasuries. We are aware of the impact of currency risk so have sought more credit and gilt exposure from the UK. We retain our UK conventional long-dated gilts as an insurance on recession.

While monetary policy will act to cushion the downside, it is debatable whether monetary easing will avert any recession on its own. This late into the expansion cycle, central banks need governments to step in and start some fiscal stimulus as well. In the UK, irrespective of the outcome of the general election, we are likely to see increased government spending as well as the Bank of England cut interest rates. However, elsewhere in the world the likelihood of similar government actions is limited. With a Democrat dominated US Congress, President Trump is powerless to get government spending increases through. Japan is facing a new VAT increase that may impact consumption and most European governments other than Germany have very high debt-to-GDP ratios.

With little scope for new government spending, the Fed may have to cut rates even further and grow its balance sheet by more than the current US$ 720bn per year that it is currently acquiring and the ECB may have to do likewise.

Heightened trade tensions and expensive import tariffs were the biggest threat to the global economy in 2019. If these are reduced then this concern can be resolved and central banks can engineer a soft landing. As we move into 2020 investors will need to ride out some elements of volatility. Our expectations are for subdued but positive growth, low inflationary pressure and lower interest rates.

As of 1st November 2019, the best performing funds held in our portfolios over the past 6 months have been;

Black Rock Gold and General	28.39%
Vanguard Long Duration Gilt Index	12.75%
Janus Henderson Long Dated Credit	10.06%
I Shares Global Property Securities	9.76%
Polar Capital Global Insurance	8.01%
First State Global Listed Infrastructure	7.99%
Schroder Global Healthcare	6.38%

Gold has done well on the back of recessionary fears but has fallen back recently due to an improved outlook. Likewise, long dated gilts and bonds have benefited from both lower interest rates and QE pushing down yields and so raising prices. These funds have also seen negative returns over the past month. All of the other funds have benefited from the growth of the US economy.

As of 1st November 2019, the poorest performing funds held within our portfolios over the past 6 months have been;

Baillie Gifford American	-2.42%
Liontrust Special Situations	-0.36%
Fidelity Emerging Asia	0.83%
Stewart Indian Subcontinent	0.94%

Both the Baillie Gifford and Liontrust funds were hit by significant portfolio volatility over the past 3 months but have more recently picked up. The other funds have performed disappointedly due to the strength of sterling and slowing economic activity.

As far as the 32nd Edition of our portfolios are concerned, across all seven portfolios, sixteen new funds have entered our selections while twenty five funds have either been dropped or substituted. We have done this for a number of reasons. These being, to reduce the number of funds in the portfolios, reduce overall costs by replacing some more expensive funds with index trackers and as a result of several funds recently falling out of our fund ratings analysis. Some of the deductions have also come about due to us closing two portfolios. The Defensive Portfolio and Balanced Income Portfolio have been virtually unused for three years so we have decided to discontinue them. We do not expect future portfolios to have anywhere near such movement.

The funds removed are: -	TER
ASI Global Index Linked Bond	0.82%
Artemis US Smaller Companies	1.97%
Baillie Gifford American	0.64%
Baillie Gifford Emerging Markets Growth	0.89%
Baillie Gifford Japanese Smaller Companies	0.91%
Blackrock Cash	0.34%
BNY Mellon Global Income	0.88%
Fidelity Asian Dividend	1.04%
Fidelity Emerging Asia	1.18%
Fidelity Index Emerging Markets	0.20%
HSBC FTSE 250 Index	0.35%
HSBC FTSE All Share	0.09%
I Shares Index linked Gilt Tracker	0.22%
Janus Henderson Long Dated Credit	0.62%
Jupiter Financial Opportunities	1.99%
Jupiter Japan income	1.34%
L&G Global Inflation Linked Bond Index	0.78%
L&G Pacific Index	0.19%
L&G US Index	0.11%
MI Twenty Four Dynamic Bond	1.09%
M&G Emerging Market Bond	0.99%
Neptune Income	1.11%
Royal London Sterling Extra Yield Bond	0.83%
Schroder Global Healthcare	1.12%
Vanguard UK Long Duration Gilt Index	0.16%

The funds added are: -	TER
ASI Global Smaller Companies	1.10%
Artemis Strategic Bond	0.72%
Baillie Gifford Japan Income Growth	0.64%
Fidelity Global Dividend	1.08%
iShares North American Equity Index	0.13%
I Shares UK Equity Index	0.64%
Loomis Sayles US Equity Leaders	1.09%
Muzinich Global Tactical Credit	1.01%
Royal London Short Term Money Markets	0.10%
Schroder Asian Income	0.95%
Schroder US Smaller Companies	0.98%
Vanguard Global Bond Index	0.29%
Vanguard UK Government Bond Index	0.16%
Vanguard UK Investment Grade Bond Index	0.12%
Vanguard Pacific ex Japan Index	0.19%
Vanguard US Government Bond Index	0.16%

We are pleased to report that at the time of writing, even with the rise in sterling in October, our seven portfolios have performed well as compared against the relevant national Investment Association (IA) benchmarks. The relative performance is measured over six time periods, 6 months, 1 year, 2 years, 3 years, 4 years and % years. Collectively our portfolios outperformed their respective benchmarks on 36 out of 42 occasions which is an 86% competency.

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

Collectively our eight portfolios outperformed their respective national benchmarks on 36 out of 42 occasions.

PORTFOLIO PERFORMANCE

The Estate Capital Investment Portfolios

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

There is a wide range of asset classes across global markets available to investors. Our portfolios bring together a diversity of global equities, fixed interest securities, cash deposits, commodities, precious metals, infrastructure and property. The global balance of investments across differing asset classes is the primary driver of portfolio returns.

Our asset allocation is built using a fully modelled asset allocation tool. This system is powered by research from actuaries Willis Towers Watson and investment data from Financial Express.

This modelling system offers us great accuracy to build and test the most efficient blend of assets for our nine model portfolios. Each new edition of our portfolios is published on our website with fact sheets, performance figures, risk ratings and range of returns.

We benchmark and publish our portfolio performance against the most relevant national averages and are happy to say that our selections have enjoyed an enviable track record.

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

Cumulative Portfolio Performance from 25th November 2019

Below are the past five year's gross investment returns for each of our portfolios from 25th November 2019

Portfolio	*6 months*	*1 year*	*2 years*	*3 years*	*4 years*	*5 years*
Cautious	2.87%	7.52%	7.34%	17.71%	25.66%	30.92%
Conservative Income	3.10%	6.59%	5.51%	15.29%	21.60%	25.79%
Conservative Alpha	3.18%	8.79%	9.00%	22.76%	31.95%	39.06%
Balanced Beta	3.82%	8.84%	7.00%	20.53%	34.25%	36.52%
Balanced Alpha	3.57%	9.70%	8.45%	25.14%	42.01%	47.93%
Speculative Beta	4.58%	10.19%	8.45%	23.07%	42.94%	43.07%
Speculative Alpha	3.76%	10.75%	9.68%	28.76%	48.16%	54.75%

Discrete Portfolio Performance from 25th November 2019

Below are the gross investment returns for each of our portfolios for each 12 month period over the last five years from 25th November 2019

Portfolio	*2019*	*2018*	*2017*	*2016*	*2015*
Cautious	6.65%	0.95%	8.06%	8.07%	5.18%
Conservative Income	5.54%	-0.49%	8.32%	7.03%	4.36%
Conservative Alpha	7.80%	1.24%	10.96%	9.05%	6.02%
Balanced Beta	7.52%	-0.45%	10.21%	13.51%	3.06%
Balanced Alpha	8.48%	0.59%	12.25%	15.65%	5.92%
Speculative Beta	8.47%	-0.20%	10.89%	18.61%	2.23%
Speculative Alpha	8.91%	0.93%	14.54%	16.85%	7.10%

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 25th November 2014 to 25th November 2019 calculated using bid prices with income reinvested into the fund net of tax.

Asset Allocation June 2020 - Edition 32

Portfolio	*Risk*	*Money Markets*	*Fixed Interest*	*Property*	*UK Equity*	*US Equity*	*Europe Equity*	*Asian Equity*	*Japan Equity*	*Global Equity*	*Other Assets*
Cautious	3	22%	45%	5%	10%	9%	1%	5%	1%	2%	0%
Conservative Income	4	15%	40%	7%	22%	5%	2%	6%	2%	1%	0%
Conservative Alpha	4	15%	42%	5%	11%	13%	2%	7%	2%	3%	0%
Balanced Beta	5	8%	38%	5%	13%	19%	2%	11%	2%	2%	0%
Balanced Alpha	6	8%	31%	5%	15%	17%	2%	13%	2%	5%	2%
Speculative Beta	7	6%	26%	8%	14%	25%	2%	14%	2%	1%	2%
Speculative Alpha	8	7%	22%	8%	15%	19%	2%	15%	3%	7%	2%

Perspective Range of Return & Volatility

Portfolio	*Risk*	*Return*	*High*	*Low*
Cautious	3	3.37%	17.37%	-10.63%
Conservative Income	4	3.94%	21.36%	-13.47%
Conservative Alpha	4	3.94%	21.36%	-13.47%
Balanced Beta	5	4.64%	25.47%	-16.19%
Balanced Alpha	6	5.15%	29.39%	-19.10%
Speculative Beta	7	5.76%	33.42%	-21.90%
Speculative Alpha	7	5.76%	33.42%	-21.90%

Investment Ratios

Portfolio	*Risk*	*Beta*	*Alpha*	*Sharpe Ratio*	*Info Ratio*
Cautious	3	1.05	1.99	0.44	1.32
Conservative Income	4	0.91	0.92	0.20	0.62
Conservative Alpha	4	0.85	3.30	0.67	1.22
Balanced Beta	5	1.02	1.78	0.42	1.17
Balanced Alpha	6	0.78	2.71	0.58	0.54
Speculative Beta	7	0.85	1.65	0.45	0.42
Speculative Alpha	8	0.91	2.99	0.65	0.92

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

Financial Advice & Wealth Management

7 Uplands Crescent
Swansea
SA2 0PA

Phone: 01792 477763
Email: mail@estatecapital.co.uk
www.estatecapital.co.uk

Authorised and regulated by the Financial Conduct Authority.