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Global Market Strategy - May 2016

Wealthy perspective

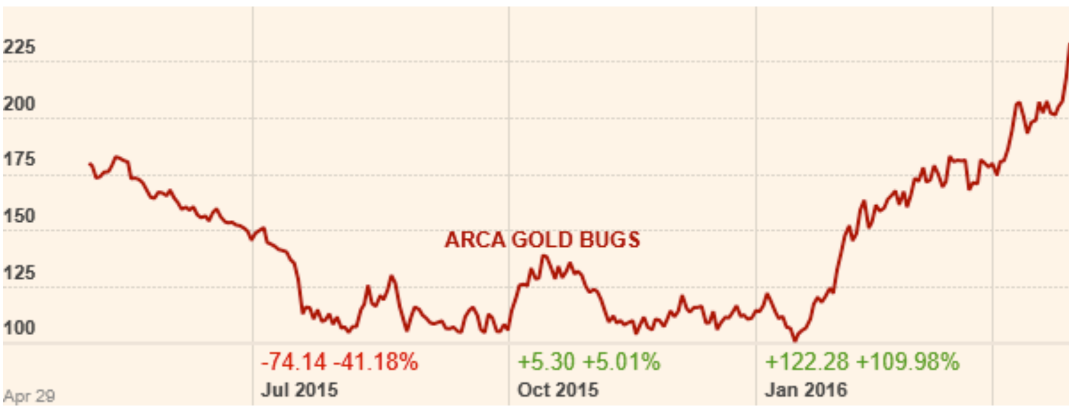
A conference held by a leading fund management company last month, told its audience of independent financial advisors, that it found 50% of those who considered themselves of high net worth were on the verge of depression, and separately, that half those people whom it interviewed earning over £50,000 per annum were prone to stress-related illness.

Depression and stress conditions were being brought about, apparently, either because high-earners were concerned they had taken on a lifestyle they would struggle to sustain, or (and) they felt their financial affairs had run away with them to the extent they were tax-inefficient, had poorly organised and/or outdated structures in place (if they had them at all), and had not enough regular contact from their advisors (if they had them) to give them the confidence they needed to know their affairs were in order.

This was a conference to hammer home to advisors the importance of maintaining contact with clients, at least biannually by means of written communication, and preferably at least once a year in person.

In his recent Blog, fund manager Neil Woodford stressed the importance of engaging a financial advisor when making investment decisions. Not only can financial advisors source good funds but they have more readily available access to the movements of fund managers via specialist trade journals etc. It is also worth considering when investing, whether one would not be better doing so through a trust. After all, for many UK resident high net worth individuals, what is the point of continually growing capital inside one's estate, for it to be taxed at 40% on death? Not only will a financial advisor know about the complex web of the various trusts and their tax consequences on settlor, trustee and beneficiary, he or she can advise on the most relevant structure and holding vehicle for the investment content.

With a quarter of 2016 already behind us, the rally in **gold** prices so far this year has been historic: spot prices are up 23% YTD and the HUI Gold Miners' equity index is up an impressive 79% over the period (up over 100% in January). This price action is coming hot on the heels of a prolonged bear market, which had created a situation where the gold price was heavily oversold. Sellers have been selling for several years, and given expectations of higher US interest rates, why wouldn't they? When the Fed started backtracking, a flurry of buying activity began, and prices moved higher quickly.



Arca Gold Bugs Index (HUI:PSE), last 12 months (Source [ft.com](ft.com))

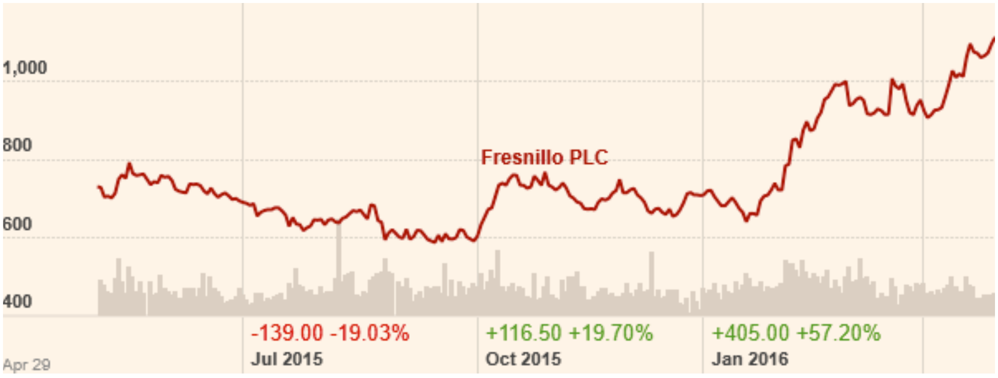
There was however a pause in momentum during April, seen as a healthy sign for what could be another leg higher for gold prices shortly, helped by reports of **China**'s intention to institute a yuan-denominated gold price fix. In the wake of last year's breakup of the London gold price fix, China has become keen to exert a greater influence on the daily pricing of gold. This should come as no surprise, as they've been the world's largest producer and consumer by a fairly wide margin the past few years. Reuters reports that the fix, which could come as early as this month, will be traded on the Shanghai Gold Exchange which although reasonably new, is already the largest physical gold exchange in the world. What this ultimately means for Western bourses, which have historically been the primary drivers of global pricing, is yet unknown.

For China, gold is a very small part of the currency story. In 2005, China surprised the world with the announcement that they would peg the renminbi to the dollar, but the peg had unintended consequences on the Chinese economy. The strengthening dollar at the time (and by extension, the strong renminbi) eroded China's global share of exports, a short term compromise that the Chinese were willing to make. Now, with their Special Drawing Rights status, the Chinese have unpegged the renminbi from the dollar and the "short-yuan" trade has become one of the most popular trades in global finance. The expectation is that China will deliberately inflate (depreciate) their currency to gain back their share of global exports. Anyone watching the massive levels of capital outflows from mainland China into hard assets around the world, with North American and UK real estate markets being the most popular, will not be surprised. Gold is just one of their targeted assets.

The China story is just one angle of gold's revived prominence. Negative interest rates and banks starting to charge clients for holding deposits is helping to drive investors to alternative 'safe' havens, largely with underestimated but accompanying and very real 'speculation'. As we have seen since mid 2011 when gold reached $1920 per ounce, like any commodity gold can be a volatile and dangerous ride.

With that said, the gold's price action since the beginning of the year gives many reason to believe we have already witnessed the bottom in the gold price.

Silver has underperformed gold until very recently, but silver has now rallied 25% year to date. This suggests one of two things: either silver continues to close its ratio to gold, or it starts to give back some of its gains. The concern is that there is no shortage of supply of silver, therefore reliance on insufficient production as an underpin of price is unfounded, and a weak economy such as exists at present, is not encouraging for industrial demand to prop up the price.



Fresnillo (FRES:LSE), last 12 months (Source: [ft.com](ft.com))

$1400 gold is a real possibility, and, strangely, further gold advances may not be all bad for equities. The US dollar index which has come off markedly over the last two quarters, helped by a seemingly more conscious effort by Janet Yellen and the US Federal Reserve to suppress the dollar's growth in order not to damage chances of growth for emerging markets, China in particular. Such sentiment is in contrast to that felt in 2015 that there would be at least four interest rate rises in the US during 2016.

US dollar index, last 6 months (Source: [ft.com](ft.com))

The Fed has been helped by Japan's central bank decision not to pursue further monetary stimulus, for the time being. The Bank of Japan's decision last week caused the Nikkei to fall quickly, the yen to rise and the dollar to fall. Gold typically moves inversely to the dollar, and in an environment of low growth, prolonged low interest rates, low earnings and a tight labour market, precious metals should advance.

A technical perspective?: Nicole Elliott of [ft.com](ft.com) sounds a note of caution. Her view is that the precious metals' bounce is just that, simply a bounce in a continuing bear market. "A monthly close well above $1400 an ounce [for gold] is needed for a rethink", she says.

Acknowledgements

With due acknowledgement to Eric Angeli of sprottglobal.com for some of the content for the above gold and silver commentary.

Favoured investment plays:

Nil risk:	USD & GBP cash (in preference to Euro cash)
Cautious risk:	AAA Corporate / Government bonds (short duration)
Balanced risk:	Managed / Multi-asset funds / Long-Short Absolute Return funds
Market risk:	UK**, European equity**
Adventurous risk:	**Japan,** Asia**,** US equity
Speculative risk:	Timber, Water, Technology, **China,** India, Other EM, **Gold and gold miners**

Disclosure:

Nicholas Chappell has the following personal investment exposure: Technology (US) 12%, US smaller cos 1%, (Other) US equity 7%, UK smaller cos 7%, (Other) UK equity 12%, Iberia 1%, European Telecoms 1%, (Other) European equity 8%, India 1%, Japan 12%, China 4%, (Other) Asia 12%, Energy 2%, Pharmaceuticals 7%, Long-Short Hedge 2%, Gold miners 11%

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