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Global Market Strategy – December 2016

"Gold has entered a new bull market" - JPMorgan

JPMorgan's prediction in May that **gold** had entered a new bull market was 5 months after it actually started but it has come to an apparent sudden end, falling 8% in a hurry following Trump's election victory, resultant heightened expectation of US inflation and a consequent higher dollar.

Donald Trump's election has turned the markets on their head. Coming into November, the MSCI emerging markets index was up 17% for the year and there was measured expectation of a further 0.25% interest rate increase for the US in December. There were even those who believed it unlikely there would not be another rate rise until the end of 2017. However, now 85% of fund managers (up from 70% in October) feel inflation will rise, and rate rises to quell it will strengthen the dollar and make EM debt harder to repay. Yields on EM debt, which is volatile at the best of times but had become sought after in the wake of ever dwindling yields in hard currencies, rose suddenly following Trumps's victory. Bonds were sold, and shares in fund managers specialising in EM securities fell between 6 and 10%.

For those investors insistent on investing in **high yield debt**, Morgan Stanley recommend Brazil, Argentina, Russia and Korea, and are heavily bearish on Mexico, South Africa and Malaysia.

The next US President has brought to an end a 30 year bull market in **bonds**. The enhanced feeling of higher inflation, prompted by greater borrowing by the US in order to fund planned infrastructure investment, has taken money out of bonds and precious metals, and fuelled a renewed rally in stocks, specifically financial, commodity and biotechnology, in preference to the technology sector.

Fundstrat's Tom Lee believes the **US equity market** is right in the middle of a long term bull run similar to those of the administrations of Dwight Eisenhower and Ronald Reagan. "The two longest bull markets in history 1953-1974 and 1982-1999 were preceded by a Republican 'revolution,' " he wrote last month. Lee likened Trump to the Republican presidents in this way: Eisenhower in the early 1950s invested in infrastructure, and Reagan pursued tax cuts and deregulation, much like that which Trump has promised to carry out in his presidency. Since Election Day, the S&P500 has gained 3% and the Nasdaq and Dow Jones industrial average have both climbed 4%, with the Dow breaking through 19,000 for the first time. Lee advocated focusing on groups that have lagged in the last seven years, that means concentrating on energy, basic materials, mining, steels, [communication] equipment, industrials, technology, financials; and avoid healthcare.

Sprott Asset Management, which has its own **precious metals** fund and is normally one of the most bullish advocates of the sector, circulated a bulletin eight days after the US election when gold was at $1222, saying they were looking to "use the rallies to reposition the fund to more liquid positions and lower volatility holdings." They continued, "The surprising Trump election victory appears to be a game changer and the market moves have the look and feel of a massive squeeze. In the short term, the sharp moves in yields (nominal and real) and the overwhelming USD strength is very negative for gold. Right now we are oversold enough to wait for a rally to reposition the funds. Medium term there will be a lot of volatility and repositioning across most asset classes. We still do not know what the actual polices will be going forward nor how it will ultimately impact growth. Longer term the amount of debt that needs to be funded will be staggering. So far the market is running on the optimism of tax cuts and stimulus spending. But at some point the market will need to factor in the realities of how this debt will be financed, higher yields slowing growth, the stronger USD pressuring vulnerable emerging markets and US exports, and rising trade protectionism pushing inflation higher and growth lower…. We do not believe that Trump's plan can be self-financed through tax credits to businesses and the debt levels that will accompany the plan cannot be ignored for long." In summary. momentum is not with gold, and under such circumstances investors are better out of its way.

Those who have felt left behind by 'globalisation', and who have seen the rich get richer through QE-inflated asset markets, have voted against status quo, first through Brexit, and second through electing a businessman to the White House. Now they have the chance to deal further blows to the establishment during the constitutional referendum in Italy in December, the General Election in the Netherlands next March, and during the Presidential Election in France in April. If there are more 'upsets', equity markets could easily tumble 10-20%, under which circumstance the Federal Reserve in the US will doubtless launch QE5. The combination of this and the cost of financing increasing US debt could then provide the next launch pad for a resumption of the gold rally which then would almost certainly take the price to well above its record height of £1930 in 2011.

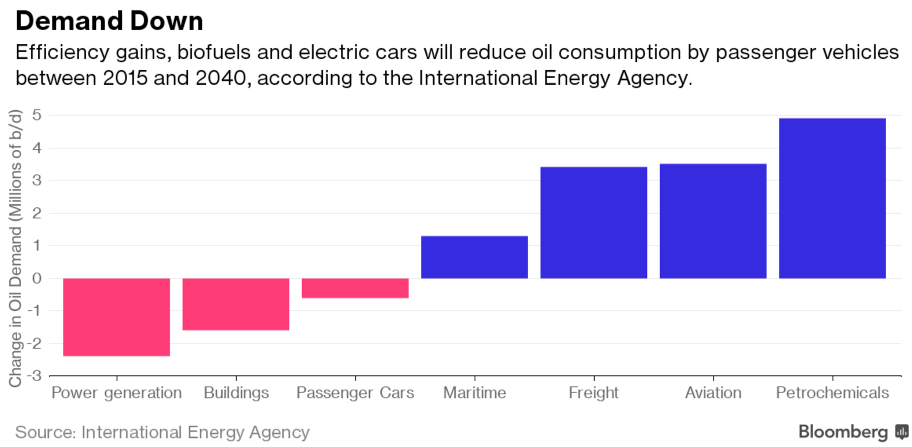
At this moment however, downside risk is too great. Gold currently trades at $1169, having fallen more than 8% in November. If it closes at this level, its next support is $1050.

One other area Trump's election victory has helped is **Japanese stocks.** The stronger dollar has led to a weaker yen, and Japan's predominantly export driven economy has seen large and small cap stocks respond well. Legg Mason's successful Japan Equity fund is up 39% over the last year, and 97% up over the last 3 years, but it began to slide before the US election in anticipation of a slightly weaker dollar. Now, though, fund managers are back in favour of Japanese equities as a result of the prospect of a stronger dollar. BNP Paribas are forecasting Y128 to the US dollar over the next 12 months, from a current level of 114 (already weaker by 9% since the US election).

Similarly in **Europe**. Britain has the task of negotiating 27 different trade agreements across Europe, but the uncertainty of this compared to questions over the outcome of referenda and elections in France, Italy and Holland is minimal, and could spell substantial weakness for the euro, consequently greater competitiveness for European exports and fuel for European equities.

Regrettably, from a consumer's point of view, we shouldn't be surprised to see **oil** up to $60 during 2017. According to the lead energy analyst at BCA Research, over the last couple of years the level of demand has had nothing to do with supply. There was a surge in supply in 2014/15 which has been and will be worked off in 2016/17. In 2018, in the wake of relatively low production and continuing demand expansion, the supply/demand equation will not be in balance, and the oil price is expected to rise during 2017 in anticipation of this. BCA's analysis does not include the deal struck by OPEC to cut back production by 1.2m B/D which caused an immediate 8.2% spike in oil to $50. The OPEC agreement could even take oil to $70 in 2017, if it holds. The deal is only for six months. Will Russia and Iran stick to it?

Paradoxically, oil consumption for the fuelling of automobiles has all but peaked, according to the International Energy Agency (IEA), and will gradually decline in the wake of more efficient **electric vehicles.** That shift will have profound consequences for the oil-refining industry because gasoline accounts for one in four barrels consumed worldwide. "Electric cars are happening", according to IEA Executive Director Fatih Birol, adding that their number will rise from little more than 1 million last year to more than 150 million by 2040.



However, the IEA still forecasts overall oil demand growing for several decades because of higher consumption of diesel, fuel oil and jet fuel by the shipping, trucking, aviation and petrochemical industries.

UK technical comment - A UK domiciled individual with children remarries and dies intestate

When a UK resident, UK domiciled man or woman marries a 'non-dom', and as an example has children from a previous marriage, on his or her remarriage his/her prior Will is revoked. (Indeed the Will would be revoked if he/she remarried a UK dom). Unless a new Will was validly executed, then on death the he/she would be deemed to have died intestate.

The rules determining how an intestate's estate in England and Wales is distributed were changed in 2014:

- Where the deceased is survived by his spouse or civil partner and children (which includes adopted and illegitimate children but not stepchildren), the estate is distributed as follows:

i) the spouse or civil partner receives all personal possessions
ii) the spouse or civil partner receives £250,000 (or the whole estate if less)
iii) the rest of the estate is split equally into two halves: the spouse or civil partner takes one half and the children the other half (held on trust where the child in under 18)

- Where the deceased is survived by his spouse or civil partner but no children, the spouse or civil partner receives everything
- Where the deceased has neither spouse, civil partner nor children, his surviving relatives inherit in the following order: parents, siblings, grandparents, uncles/aunts
- Where the deceased has no surviving relatives, everything passes to the Crown

Note also that if someone dies intestate having remarried, then their new spouse is entitled to be appointed their personal representative with sole authority to administer their deceased's partner's estate. This could enable the survivor to vary, at their discretion, the distribution of the estate by means of a Deed of Variation, executed within two years of death, which would be recognised for tax purposes as if it had been made by the deceased themselves.

Favoured investment plays:

Nil risk:	USD cash (in preference to Euro cash)
Cautious risk:	AAA Corporate
Balanced risk:	Managed / Multi-asset funds / Long-Short Absolute Return funds
Market risk:	UK**,** European equity
Adventurous risk:	**Japan, Asia, Germany,** US equity, UK/European/US smaller company sector
Speculative risk:	Timber, Water, Technology, **China, India,** Other EM, **Natural Resources**

Disclosure:

Nicholas Chappell has the following personal investment exposure: Technology (US) 20%, Global Equity 9%, US smaller cos 2%, (Other) US equity 10%, UK smaller cos 11%, Germany 4%, (Other) European equity 8%, Japan 13%, (Other) Asia 15%, Pharmaceuticals 7%, Natural Resources 1%