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Global Market Strategy – February 2017

UK budget looms March 8th - Use pension allowances while they last!
Be patient! Opportunity to buy the market looms…

The cost of tax relief and National Insurance relief to the UK government as a consequence of **pension planning** contributions during the last tax year was £48 billion.

Two-thirds of the relief goes to the benefit of higher rate and additional rate taxpayers, and with the introduction on April 6th 2016 of the 'tapered annual allowance', reducing the capacity of higher earners to reduce their tax bill via pension contributions, it is as important as ever to try to 'carry forward' unused allowances from prior tax years.

Pensions are considered the most tax-efficient investment one can make now in the UK, for the following reasons:

- tax free growth and no tax on arising dividends
- tax relief on, currently, all categories of taxpayer contributions via an increase in the basic rate tax band
- there is a Lifetime Allowance (LTA) of £1 million which can be accumulated and sheltered from inheritance tax, thus the fund can potentially be passed down the generations; there is no compulsion to purchase an annuity
- up to 25% of the fund can be drawn tax-free after age 55; the balance of the fund can be drawn subject to an individual's marginal rate of income tax at the time
- Self-Invested Personal Pensions (SIPPs) and Small Self-Administered Schemes (SSASs) can be used as a tax-efficient means of business property purchase (although lack of pension investment diversification and liquidity are cited as potential disadvantages of this strategy)

In certain circumstances it makes sense to move tax-advantaged Individual Savings Account money into pension, indeed the basic rate tax uplift as a minimum is a big incentive to do so. However, the implication of being potentially subject to tax on withdrawals in excess of the 25% tax free lump sum allowance has to be weighed carefully.

Much has been written about plunging bond yields over the last few months, and the fact that we are at the end of the 35 year bull market in bonds. The depth of the UK bond market was reached in December, and those UK workers lucky enough to be part of a **final salary** pension scheme were able to secure the very best transfer values for their gold plated pensions because pension trustees would rather be rid of the responsibility of having to pay someone a guaranteed pension for years into the future based on lower and lower bond yields. Such is the reliance on bonds to be able to guarantee future pension payments, that pension trustees have been caught out by the double whammy of decreasing yields over 30 years, and increasing equity values since 2009 when trustees were encouraged to reduce future risk by shunning equities and increasing bond exposure. As a consequence, 85% of Defined Benefit ('DB') schemes in the UK are now in deficit, meaning they don't have the assets to meet their obligations to pensioners in the future.

In 1993 average asset ownership of a UK DB scheme was 57% UK equities, 3% index-linked gilts and 2% alternatives, with property and cash making up the balance. Now however, the average content is 15% equities, 9% gilts and 9% alternatives - in other words a complete de-risking and consequently a lack of growth potential.

Over the next 30 years, of those DB schemes in a relatively strong financial position, 6% are estimated to suffer default, with an estimated 11% loss to members' benefits. Of those DB schemes classified as 'weak', 19% will likely suffer default, with an estimated 19% loss to members' benefits.

Not surprisingly, given such a backdrop, many many workers in DB schemes are now asking for transfer values from scheme administrators to take advantage of generous sums being offered, and have capital under their own control within a Defined Contribution (DC) scheme. If inflation is about to gather pace (food and petrol prices are those most notably affected at present), the purple patch for transfer values which we are in now, will be gone. That said, every case has to be examined carefully, and the Financial Conduct Authority's starting point is that DB members should remain where they are unless a compelling case is made to the contrary.

Donald Trump's determination to keep the world on its toes during his first two weeks in the White House has caused the Volatility Index (VIX) to rise gently from lethargy around 10, to currently just below 13. He has also succeeded in talking the dollar off its highs, most notably through his ban on nationals from certain Middle East countries from entering the US for the foreseeable future.

Nevertheless, Michael Farr of US investment advisors Farr, Miller & Washington, and technical specialist Ed Yardini both see markets moving higher, particularly in the US, following Trump's determination to have US cash and manufacturing brought back to the US, with plans to cut corporation tax from 35% to 15%. This could result in up to $2 trillion being repatriated, the inevitable consequence of which would be share buy-backs and hence, higher stock prices. Yardini sees the S&P500 moving up from current levels of 2270, through 2300, 2400 and indeed through 2500, arguing indeed for increased allocation to US equities in spite of 'fully valued' observations by most commentators.

Kate Moore, BlackRock's Chief Equity Strategist, sees gradual dollar appreciation during 2017, and feels equities are undoubtedly the place to be for investors. BlackRock are consequently overweight EM and Japan and 'Neutral' on Europe and the US. Overweighting Japan appears a consensus trade, since Japanese equities are unquestionably undervalued, and they stand to benefit if Ms Moore is correct in her belief that the dollar will strengthen this year.

So should we chase this market? Thomas Lee of Fundstrat Global Advisors cautions this tactic. He has found that 27 of the last 29 occasions, during the six months following the Presidential election the market has fallen an average of 7%. The two exceptions over that time period: 1929 and 2013. Corporates, steady buyers of stocks until now, will pause, says Lee, and the S&P500 will fall to 2150 during the first quarter, presenting investors with a chance to buy in. "Buy CRAP", he says, computers (ie tech - Bernstein analyst Toni Sacconaghi sees Apple to $140 this year), resources (infrastructure), American banks (as prospects for higher rates increase, though slower than one thinks), and phone carriers (telecoms).

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:	Water, Technology, **China, India, Other EM, Natural Resources**

Disclosure:

Nicholas Chappell has the following personal investment exposure: Technology (US) 21%, Global Equity 16%, US smaller cos 2%, (Other) US equity 9%, UK equity 4%, Germany 4%, (Other) European equity 9%, Japan 6%, India 4%, (Other) Asia 16%, Pharmaceuticals 7%, Natural Resources 2%,