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Global Market Strategy – December 2017

Yield curve tells a pessimistic story…

Bond aficionados are looked upon as rather geeky!

How exciting can you possibly be if you study the form of US Treasury Notes, UK Gilts or German Bunds? The fact is, the bond market is a predictor of economic growth and it pays to know something about it.

If you borrow money short term, you expect to borrow at a lesser interest rate than for a longer term because the lender faces greater risk and uncertainty the longer the duration of the loan. In a 'normal' market environment **the yield 'curve'** inclines gently. If it ceases to incline, and flattens, the bond market is telling us that interest rates are not expected to be higher further into the future because the economy is not expected to grow (little threat of inflation). This is why the bond market in general and the yield curve in particular is paid so much attention. If the scenario continues, equities will see a sustained sell-off, and if gold is not responding, as one would expect it to under 'normal' circumstances, this could explain why Bitcoin is. Reaching $7,000 for the first time at the end of October, it has soared to $10,000 before the end of November, and 24 hours after passing through $10,000, roared past $11,000. A day later, the price fell 18%.

Neil Woodford, the fund manager of some renown, avoided tech during the dotcom bubble era of the late 90s, and he avoided the banks in the run up to the financial crisis in 2008. He has however come up short since establishing his own brand of business; his Equity Income fund ranks last in its category over one year and is 4th quartile over all reporting periods fund: 3 months, 6 months, 12 months, 3 years. He backed Provident Financial, the sub-prime lender which is verging on the brink of collapse; Oxford Pharmascience which is down 82%, Midatech Pharma which is down 85% and Northwest Biotherapeutics which is down 97%. To borrow from and paraphrase Oscar Wilde, "To back one dud company is unfortunate, to back two is careless…". Neverthesless, Mr Woodfood's views are still widely sought and reported, and he has recently told the FT that there are "too many warning signs flashing red…. a cryptocurrency going through $10,000, European junk bonds yielding less than US Treasuries, historic low levels of volatility".

He has a point, however this week fund managers Quilter Cheviot said they felt world stockmarkets could have further to run. They quoted the rising middle classes in emerging markets, the lack of alternative investment areas, the low inflationary outlook, the increasingly healthy outlook of the PMIs (Purchasing and Manufacturers [Sentiment] Indices) and a decent outlook for corporate earnings, all as reasons why this bull can keep running, although one of the least attractive equity markets in Quilter's view is the UK. While Brexit is unlikely to result in a recession in the UK, the uncertainty which predominates will continue to slow growth in Britain. This contrasts with markets elsewhere which will continue to expand.

A further indicator of a continuing global equity bull market is the **Baltic Dry Index**. It is watched by traders for an indication of the flow of dry commodities around the world, measuring the price of shipping rates across the 23 most used shipping routes. The average price hit rock bottom early last year at around $300, drifting ever lower since 2009 but sustained in part by the demand for precious metals in the wake of the financial crisis. In less than 2 years the BDI is up nearly fivefold, and technical analyst Nicole Elliott sees the price climb continuing. "A rally to the $2,000-$2,300 area is a distinct possibility", she says. For this to happen, from a fundamental perspective freight movement must be increasing.

Dow 25,000 is only 3% away. It is likely we will see it early in the new year, and comfortably so if Donald Trump's US tax reform passes through the Sentate.

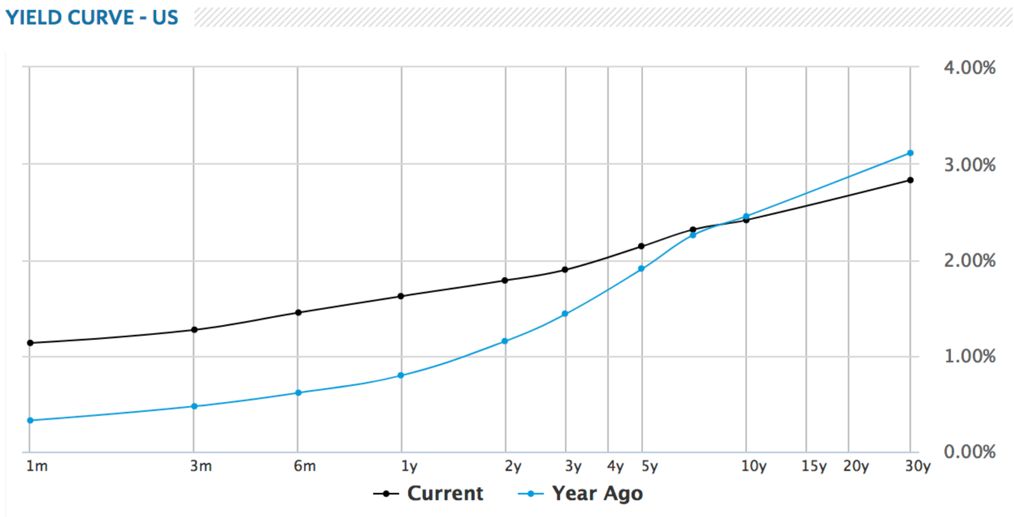
If the bull market continues to 2021 without a 20% correction, it will be the longest in history.

Old Mutual International's David Denton spoke at an international client seminar in Marbella last month, imploring attendees to understand **the importance of pension investment**. Government uplift via tax relief; ability to 'carry forward' unused annual allowance for up to 3 years; 'gross roll-up' permitting faster growth as income and gains grow without tax deduction; 25% allowable tax exempt lump sum (now called the 'pension commencement lump sum'); ability to phase 'income' from the lump sum; ability to pass the fund tax free to 'nominated' beneficiaries if you die before age 75 - (taxable at marginal rate of the nominated beneficiary if you die post 75). Granted, there is a cap to the 'Lifetime [Pension] Allowance' - of £1,030,000 from 2018/19 - and although the figure has been cut back over the years, nevertheless it is a decent amount of money to be given such generous tax terms, and yet for those who don't fully understand the benefits, personal pensions are still viewed with much scepticism.

Until April 6th 2015 when chancellor George Osborne brought in Flexible Pensions or Pension Freedoms, those with 'Final Salary' pension schemes were seen to have 'gold-plated' good fortune. Since the financial crisis, however, many final salary employees have been tempted by the prospect of controlling the destiny of their pension pot, especially since only 49% of corporate final salary pension schemes are 'in surplus', ie they have sufficient assets to enable them to meet their obligations to both 'members in payment' and those yet to retire. If a pension fund goes into administration when a member has commenced receiving his pension, he should continue to receive the same pension, index-linked, although the index is likely to change from RPI to the less generous CPI measure of inflation. If a member has yet to commence receiving his pension however, and his employer's scheme goes into administration and becomes the property of the Pension Protection Fund, the member will receive only 90% of his expected pension up to a maximum of £38,000 per annum. So while on the face of it final salary pensions should be copper-bottomed, fewer are, and many members of final salary schemes are preferring to take advantage of historically low bond yields which are determining highly 'generous' transfer values by actuaries effectively helping pension scheme administrators discharge some of the weight of their future obligations to members, and transferring to Defined Contribution Personal Pensions, where the member takes on the risk of managing their fund themself. It's not for everyone of course, but ironically, because of 'risk' now attaching to belonging to the majority of final salary schemes, the Financial Conduct Authority is going to remove the stipulation to financial advisors that they start counselling a client on a possible transfer out of a final salary scheme from the premise that it is not the right course of action for a member to take.

In short, if you are UK resident and have capacity to contribute to a personal pension, get to it, up to the maximum permitted limit of the greater of £3,600 gross or your net relevant UK earnings for the tax year up to a maximum annual allowance of £40,000 (plus the ability to 'carry forward' unused relief for a maximum of 3 years if you already had a personal pension of some description in place during the year from which you are carrying forward some or all of the allowance, even if you haven't contributed to that pension for years and years). If you are an overseas tax resident, you can help your UK based children or grandchildren make pension contributions; after all, they cannot access them under normal circumstances until they are 55. Most importantly, if you have a UK pension and your circumstances have materially changed since you established it (divorce etc), ensure your Nomination Form is up to date - or ensure you have one in the first place.

Next month, we'll look at another generous UK savings scheme. The UK is full of them.



The flattening US yield curve to December 1st 2017

Baltic Dry Index to December 1st 2017

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**

Disclosure:

Nicholas Chappell has the following personal investment exposure: Technology (including new energy, all US) 30%, Global Equity 17%, US smaller cos 2%, (Other) US equity 8%, Germany 5%, India 4%, (Other) Asia 20%, Pharmaceuticals 14%