Global Market Strategy – January 2018

- ***2018 should be another good year for stocks***
- ***Continue to look to Asia and Europe***

After a year when global stocks saw their best performance since the financial crisis, we now look to whether they can continue their run.

Low inflation, low bond yields, low wage growth but high corporate earnings prospects and high levels of optimism across the business world, bode well for another good year for stockmarkets globally. Sure, the US is expensive but with a slightly weaker dollar, big export names such as Apple, Boeing, Caterpillar, John Deere etc should continue to prosper, but the real room for growth is in Asia and Europe.

Europe is bedevilled by expansion self-doubt as to whether it really has room for lift-off, following years of indebtedness and swathes of unemployment across the continent. The European Central Bank has slowed dramatically its purchases of corporate bonds, after sweeping up nearly all available government bonds. Central bank buying of bonds generally has helped prop up the bond market at the expense of euphoria entering the stockmarket. When central banks finally relinquish a hold on the bond markets completely - an event most likely still some way off - then that is when the 30 year bull market in bonds will end, and soon after so will the bull in stocks.

The returns to global stockmarkets in 2017 were impressive across many areas: Emerging Markets up 34%, China up 33%, India 33%, Germany 25%, Europe 23%, Japan 22%, Brazil 21%, the US 20%. The FTSE100 was a flatliner until December, when it rose 5%; over the year it rose 7% to finish at a new record of 7688 but at a lofty price earnings of 22. Granted, the S&P500 is at 22.5 times but given the valuation of the FTSE100 and its reliance on two sectors, commodities and financials, 2018 looks like it could be another ho-hum year for the UK's benchmark index.

China by contrast is growing at more than 6% a year, and the Shanghai Composite is valued at 16.6 times forward earnings. Investment there is a leap of faith, and therefore highly speculative, but it could be that in 2018 the acronym STAB (Sina, Tencent, Alibaba, Baidu) becomes as widely known as FANNG (Facebook, Amazon, Netflicks, Nvidia, Google).

Across Asia, Thomson Reuters analysed 1,571 companies, each with a market capitalisation of at least $1 billion, and showed that dividends have grown between 0.5% and 9% from 2012 and 2016. This is a big deal for those seeking income, since dividend pay-outs in Asia are expected to grow by 12 percent year on year 2017-2018. The market in Asia will always have some bumps in the road but earnings and therefore dividend growth are both expected to stay strong. Corporate profits have been climbing, due largely to higher commodity prices, a revival in global demand for consumer products and an improvement in bank profits as loan growth soars.

Taiwan, Hong Kong, Singapore, Malaysia, and Thailand have forward dividend yields in excess of 3 percent, much higher than the US's 1.9 percent. Asia's average yield stands at 2.4 percent. There is therefore a strong argument that investors looking to generate income should shy away from the western world and seek investment into Asian companies that have the ability to provide a far more attractive and sustainable dividend policy. The region is incredibly diverse with both developed and emerging markets and around 5,000 listed companies that have a market capitalisation greater than $500 million.

Asia and EM have been aided by a softened US dollar over the last 12 months, and many are predicting further dollar weakness due to the anticipated slow pace of further US rate rises. Normally, this would presage higher gold prices and even higher commodity prices. Commodity prices may indeed be on the rise in 2018 but Bitcoin may have blunted gold's competitive edge. Bitcoin may have its naysayers but it has forced its way into people's consideration for use as an alternative and legitimate currency.

Last month we looked at the most tax-efficient investment a UK resident individual can make: Pension, up to a maximum value for the 2017/18 tax year of £1,030,000. This month we look at **Venture Capital Trusts, Enterprise Investment Schemes** and **Seed Enterprise Investment Schemes**, all of which are speculative risk as they involve investment in start-up companies, by far the majority of which fail. *For those individuals with the ability to be able to take on high risk investment and tolerate and withstand the possibility of substantial loss*, the tax benefits are considerable:

VCT
- 30% income tax relief on investments up to £200,000 per year
- No claw-back of income tax after five years
- No higher or additional rate tax liability on dividend income
- No capital gains tax (CGT) liability on profits at any time

EIS
- 30% income tax relief on investments up to £1m per year
- No claw-back of income tax after three years
- CGT reinvestment (deferral) relief available without limit
- No capital gains tax (CGT) liability on profits if income tax relief not withdrawn
- 100% inheritance tax relief (IHT) after two years if the underlying investments qualify

SEIS
- 50% income tax relief on investments up to £100,000 per year
- No capital gains tax (CGT) liability on profits
- No claw-back of income tax or CGT relief after three years
- 100% IHT relief after two years if the underlying investments qualify

Once an investor decides they can take on such high risk, then finding the companies worthy of consideration for investment is the really tricky part. The best way to do this is to source those fund management companies with a track record of successful research and outcome, and be willing to accept the associated comparatively high charges for doing so. If you get it right, the profits can be substantial but it has to be borne in mind that of a portfolio of 12-15 companies, typically more than three-quarters will fail. With a fair wind, the remainder might be enough to double your money.

Favoured investment plays for 2018:

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) 32%, Global Equity 17%, US smaller cos 2%, (Other) US equity 7%, Germany 5%, India 4%, (Other) Asia 12%, Pharmaceuticals 15%, Cash 6%

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