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Global Market Strategy – May 2018

Companies with good cashflow to be drivers of equity markets for rest of year

A priority for many parents is to save for their children's future. When considering financial planning options for parents, there is increasing recognition of the value of **offshore single premium investment bonds** in inter-generational financial planning.

The immediate thought for long term child investment in the UK is a Junior Individual Savings Account (JISA). Under JISA rules, when a child reaches age 18, the Junior ISA becomes an adult ISA, and the child gains control over how the money is spent.

It is estimated that parents investing the maximum contribution each year (currently £4,260 but looks set to increase in line with inflation) into a stocks and shares JISA for 18 years could potentially see their child's fund reach over £150,000 (assuming the allowance rises by 2% and investments grow by 4% net), which is a lot of money to give an 18 year old…

Research from one of the major UK life assurance companies shows that just over half of parents (52%) would feel uncomfortable giving their 18 year old child free rein over £150,000, whilst a further 17% would be unsure about doing so. The majority of these parents (58%) would only feel comfortable giving their 18 year old child control over less than £10,000, with 13% of parents saying they wouldn't want their child to have control over any amount.

The research shows just how important control is for parents. 80% of parents said they may want control over how their child spends the money they have saved for them. (An anomaly highlighted by the research showed that although the majority of parents said they would want more control over how their child spends the money, 76% of parents who have invested in either an ISA or a Junior ISA, have invested in a Junior ISA before maximising their own ISA allowance. Of course, a simple step for parents to gain more control could be for them to maximise their own ISA first. Contributions made into an ISA in the parent's name can still be used to fund the child's future but the parent would retain control over when and how the money is spent.) For parents who already maximise their own ISA allowance, offshore bonds can provide them with more control without compromising tax efficiency or simplicity.

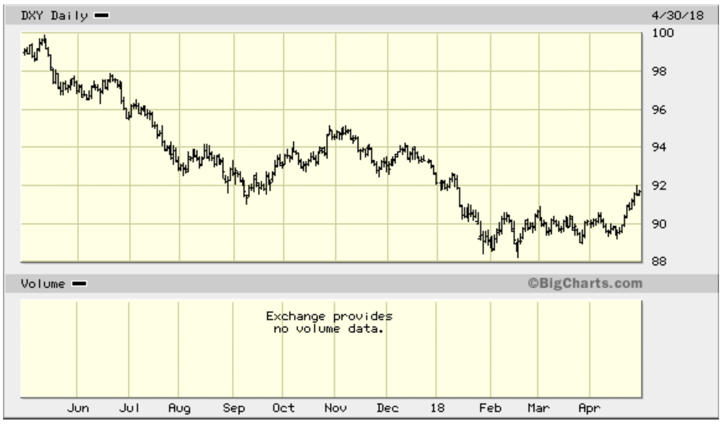
Similar to an ISA, money within an offshore bond will grow virtually tax-free (except for small amounts of withholding tax) and is generally not subject to capital gains tax. Provided the parents don't withdraw more than 5% in a tax year, there is no immediate tax to pay and no need to include it on a tax return, making the offshore bond a simple option for many busy parents (and grandparents). Offshore bonds allow 5% of the initial premium to be withdrawn each year, which is tax deferred so there is no immediate tax to pay. Any unused allowance can be carried forward and used to provide access to future cash lump sums for the child as and when required.

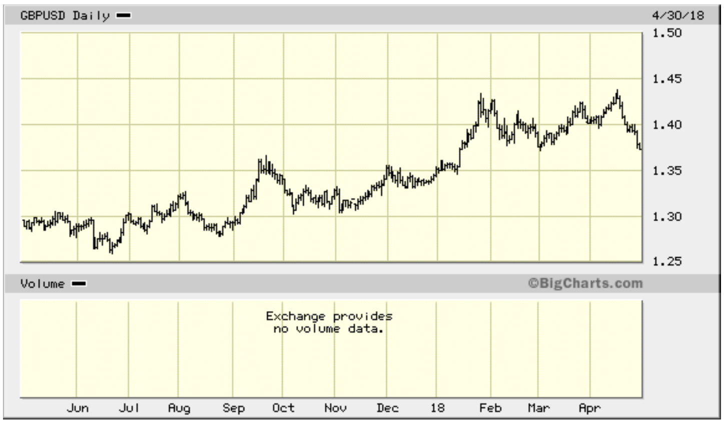
As an offshore bond can be divided into segments, parents will have the added flexibility of being able to assign individual policy segments to their child whenever required (once the child reaches 18). Assigning policy segments means ownership and control can pass to the child with the added advantage of not having to disinvest the money first.

Provided the child is a non-taxpayer, there could be no tax to pay when money is withdrawn (provided any growth on the assigned segments is below the child's personal allowances). The child could also benefit from any unused 5% withdrawals carried forward on the assigned assigned. This provides parents with flexibility and control over intergenerational planning; money can be drip fed to children as and when the parents want it to be, but provides parents with the flexibility to leave the money invested for the longer term, or use the money for something else altogether.

Offshore bonds are lump sum investments (minimum £20,000) and because of their tax treatment and ease of administration are widely used for trust and alternative [offshore] pension investment.

The **dollar's t**rajectory changed course (momentarily?) during the second half of April. Bank of England governor Mark Carney put the kibosh on sterling's momentum by confirming what many already believe, namely that although interest rates are bound to rise because they cannot go much lower, their appreciation will be slow. Similarly, Mario Draghi of the European Central Bank, gave no hint during his end April statement of an end date to asset purchases in order to underpin the fragile growth of European economies. There was no data from the US which suggested rises in US interest rates would be faster than currently expected (two or three rate rises of 0.25% each) for the rest of the year, and the dollar's rise by default has weakened gold and returns from emerging markets. Peace in the Koreas will do nothing for gold, so the only hope for gold bugs now is an escalation of geopolitical events in the Middle East, which sadly is a real possibility.



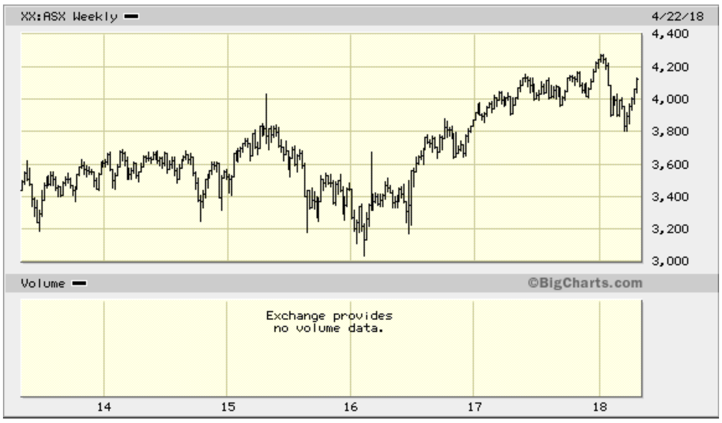


Dollar index, 1 year (Source: BigCharts.com)

Pound/Dollar rate, 1 year

Despite what would normally be seen as euphoric **US earnings** numbers (year on year average increase in earnings of 24.6% for S&P500 companies, according to Thomson Reuters) for the first quarter of 2018, markets reaction has been noticeably underwhelming. Those who have beaten analyst estimates have seen very small increases in their share prices, while those in line have seen declines and those missing have been hammered, viz Caterpillar, seen as a barometer for the economy, which fell 6.2% on April 24th when its CFO declared its then current share price would be the "high water mark" for the year. An amazing 79% of companies beat estimates but Caterpillar's statement awoke market makers to the fact that earnings are a backward-looking indicator. If Cat's earnings are as good as it gets, perhaps all other earnings' announcements will trace a similar outlook, and a move of the 10 year Treasury through 3% has also made investors question the worth of remaining in equities. The flip side of the unenthusiastic welcome to US earnings is that the S&P500 now trades on just 15.5 times price earnings, so the US is bizarrely inexpensive. Investors will be rewarded if they concentrate on companies with good cashflow (ie the likes of FAANG, Microsoft etc). Companies such as Tesla, with no cashflow and highly indebted, are likely to struggle - and a word of warning from technical analyst, Nicole Elliott: if the Nasdaq suffers a fall of 10% from its current level of 7066 through its 200 day moving average of 6320, then expect it to fall further to 5500, which would be a fall of 22%.

The **UK stockmarket** has been a dull performer for 18 years. Investors have got tired of following the so-called gurus of the UK market like Neil Woodford and Mark Barnett, and they've rightly looked elsewhere to global equity-focused managers such as Terry Smith and Nick Train. Now, however, could be the time to refocus on the UK, especially the mid-caps with low interest rates, low inflation (expected to fall from the current 3%) and weaker pound. Mark Slater is the one to follow in this space.



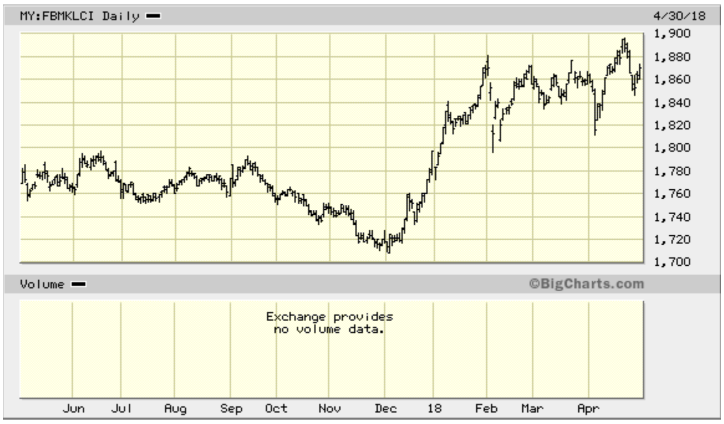
FTSE All Share, 5 years (Source: BigCharts.com)

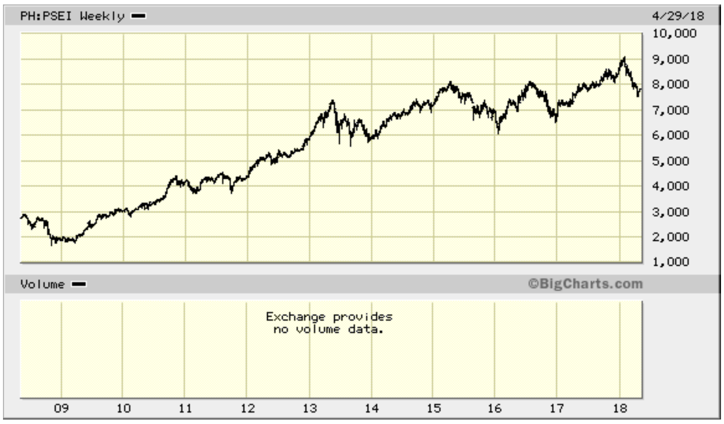
Dollar/Yen, 6 months

Japan looks more attractive with a stronger dollar (weaker yen). The Nikkei has reversed for the last 6 weeks, and looking at the dollar/yen chart, above, it's easy to see why.

China too has greater appeal. Its central bank has gently eased monetary policy of late. Their ten year bond briefly dipped to 3.5% in April when the People's Bank of China cut the required reserve ratio ("RRR" - the amount of cash bank must hold in reserve to cover loan defaults), suggesting already loose liquidity would extend for the medium to long term, thus encouraging corporate investment and expansion in the face of a slightly stronger dollar/yuan relationship.

Speaking of Nicole Elliott, she has been seeking out bullish trend charts across world indices of late, and two left-field ones are Kuala Lumpur and the Philippines. Ms Elliott sees a 20% rise coming for the KL index and she describes the chart for the Philippines as "very positive over the medium and long term". Make of that what you will…





Kuala Lumpur stockmarket, 1 year (Source: BIgCharts.com)

Philippines stockmarket, 10 years

Favoured investment plays:

Nil risk:	Cash
Cautious risk:	AAA Corporate bonds
Balanced risk:	Managed / Multi-asset funds / Long-Short Absolute Return funds
Market risk:	**UK, European equity**
Adventurous risk:	**Japan, Asia,** 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) 31%, Global Equity 19%, US smaller cos 2%, (Other) US equity 6%, Germany 5%, India 4%, (Other) Asia 13%, Pharmaceuticals 14%, China 4%, Cash 2%

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May 1st 2018