



UNITED
KINGDOM



Our theme for April is *circles* – partly inspired by hearing about the fascinating work of Henk Hesselink, at the **Netherlands** Aerospace Centre (developing an idea to build circular runways for efficiency and safety gains) and also by some interesting Venn diagrams spotted in our research this month. A shape with all points the same distance from the centre, a circle delivers many mathematical rules, as well as being old, from before recorded history ... we only have to look to the sky to recognise how long circles have been in our lives. A circle is also the basis for the wheel, probably one of man's greatest inventions.

In investment terms, we are more used to talking about cycles than circles. A cyclical trend refers to a short-term movement or momentum, perhaps between one and three years; a secular cycle can be 20 to 30 years in length, and can have a cyclical element within it. Eventually, they circle back and start again. The fascinating but perhaps less well-named Kondratiev cycle (in fact usually displayed by waves) lasts 40 to 60 years and invariably ends with a major event.

Kondratiev's ideas found a friend in Joseph Schumpeter in the 1930s. Schumpeter (an economist and Harvard professor) saw that the waves seemed to bunch based on innovations which launched revolutions in technology, in particular delivering new industrial and commercial sectors. This has relevance today as we look at a world where the biggest hotel chain owns no property and the biggest taxi firm owns no vehicles, the biggest retailers have no stores and the biggest vendor of cameras calls it a 'phone'. In this environment, 'old' rules tend to get replaced, and this helps lead our perspective on investing in 2017.

Whilst Sir Winston Churchill reminded us that if we do not learn from history we never learn anything, the speed of development of disruptive technologies (and the areas in which they are finding a ready home) is fundamentally changing how many businesses operate and, for an investor, what their prospects are. We must learn more quickly than ever...

One of the biggest questions we have to ask ourselves as investors is the extent to which we see the economic cycle, locally and/or globally, as a driver of returns for our asset(s) of choice. The economic cycle is another circle, moving between growth phases and recessionary periods (or at least contractions), and impacted by interest rates, inflation, employment, consumer spending and other factors. How does all of this affect the local index of equities, for example?



**UNITED
KINGDOM**
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Indices are of course driven by both their constituent parts and by the wholesale buying of the index itself. In the **UK**, we feel more comfortable seeking out assets, managers and sectors, seeking investment opportunities that can deliver in various economic and market conditions. Keep a close eye out, as when the famulus leaves the stage, the magic may be about to be revealed as something rather more prosaic...

We hold lower UK equity holdings than 12 months ago, and they were, in turn, lower than 12 months before. However, despite some short-term caution on many assets, we are pretty fully invested. What we do own in the UK remains skewed towards small cap.



Term or word(s) to watch: *electric* ... having recently seen Tesla overtake Ford (what else would you want a go-ahead car manufacturer to do) in market value, and with increases in power costs in the news, how we produce electricity and what we use it for are likely to remain big news. In the case of Tesla, they produced 76,000 electric cars in 2016, impressive growth, with exciting numbers predicted. For context, Ford sold nearly 6,700,000. Is this the equivalent of President Trump promoting coal when everyone else is working on clean energy?

Tesla is not just building cars, it is also developing the biggest building in the world, in Nevada, to build cheaper, more efficient batteries, which it hopes will not only power cars but homes and businesses too. Here, electricity price rises grabbed the headlines earlier this year and we believe they will again. Rises of up to 15% are pretty eye watering even in a rising inflation environment, and in their own way fuel the rise in the cost of living, a circular action, if you will.

**NORTH
AMERICA**



As confirmed sceptics over the **US** stock market, we have had to continue to swim against the tide in maintaining our relatively low allocations in portfolios. Being contrarian can at times be painful, and although we have not remotely experienced a meaningful correction, the last few weeks have made the bulls pause for thought at least. President Trump's failure to get his healthcare reforms through Congress has served as a sharp reminder that although the Republicans have majorities in both houses of the legislature, this does not mean that Trump will be backed by his party on every decision. Far from it in fact, with the 'Freedom Caucus' group of Republicans now standing in opposition to the President on key issues. Normally this would be an inconvenience for investors, but given that markets are currently defying gravity on the basis of substantial tax reforms being achieved, there are now real question marks over the prevailing stock market narrative.



**NORTH
AMERICA**
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Markets are pricing in reductions in corporation tax of up to 20%, but fiscal conservatives could stand in the way of such plans, especially now the mooted cost savings from Obamacare cannot be fully utilised. Commentators expect that tax reform will be easier to reach agreement on, but the voices of those who believe the US needs to embrace a more conservative fiscal conservatism could continue to be heard. A spending bill has to be approved later this month to prevent another 'government shutdown' and there is opposition to many aspects of what the President is proposing. Markets are going to be skittish around this time, and we are likely to see a vigorous examination of the bull case for US stocks if the flow of negative news accelerates.

The 'Betsy Ross' flag was an early design for the US flag featuring 13 stars, arranged in a circle (to represent the original 13 colonies), alongside the familiar stripes.

To us, it is not remotely surprising to see other equity markets benefiting from asset allocators beginning to move funds out of the US and this could well gather pace. If investors do get burned by disappointment over the Trump 'growth trade', they will only have themselves to blame – when you buy markets which are 'priced for perfection' you always take on more risk than you should.

EUROPE



Europe's economic data are actually showing signs of improvement. The eurozone's unemployment rate is now close to its eight-year low, with February's Eurostat data showing the rate at 9.5%. At the peak of the financial crisis, the figure had reached 12.1%. Manufacturing data are also suggesting strong growth, with Markits' Purchasing Managers' Index rising to 56.2 in March. The same survey also revealed the highest level of supplier delivery delays for six years, suggesting demand is at a much faster pace than expected.

Whilst economically Europe is (finally) showing signs of recovery, politics still dominate thinking. Prime Minister Mark Rutte's centre-right VVD party won the March general elections in the Netherlands by some margin, although the defeat of the anti-immigration Freedom Party, led by Geert Wilders, was the more prominent focus of headlines and stories. The vote was seen as a gauge of the appetite for populism and the potentially economically damaging isolationist policies associated with this. Rutte's victory represented a win for mainstream politicians, yet the **French** election is the main event.

The first round of the French presidential election takes place on 23 April, with outsider candidate Marine Le Pen and Emmanuel Macron currently both polling around 25%, which would take them through to the second round (7 May).



EUROPE
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Among right-wing views on immigration, Le Pen has suggested withdrawing France from the euro, which would have massive implications for the countries who use the currency.

Polling data currently suggest that Le Pen may well reach the run off stage of the election, although with two-thirds of the French population surveyed wanting to retain the euro, a second round victory looks unlikely. It also must be remembered that whilst foreign policy and defence are in the President's hands, it is not the sole vestige of power. The general election for parliament on 10 and 17 June are also important votes, with the potential for a Prime Minister from an opposition party being appointed who could act to moderate the potential President's actions. This is known as 'cohabitation' and has occurred three times in post-war history, with President Chirac and Prime Minister Jospin between 1997 and 2002 the last such occasion.

We currently have no specific exposure to European equities in portfolios, taking the view that the political risks could harbour large downsides. The Dutch election result indicates these risks may not come to bear, and we constantly review our zero weighting, recognising that Europe has leading companies in many fields and its economy is improving. We are ready to reintroduce European equities, should the risks recede.

JAPAN

The early signs of a loss of faith in the Trump growth story may feel like a vindication of some of our views on areas such as the US and equity market levels in general, but it poses a threat to some of our positions in other areas. One of these is **Japan**, where stock markets have now given up their gains for 2017 as the yen has steadily appreciated, leaving the Nikkei 225 struggling to hold the 19,000 level. Of course, the currency movement is of benefit to sterling investors who are not hedged, and reasonable returns have still been enjoyed, but the fear is that the currency issue could impede further progress. The larger Japanese stock market indices are very heavily skewed to exporters and therefore have benefited from the stronger dollar and weaker yen since November's US election. The Japanese market has always been significantly geared to the global macro picture, and any cracks in that growth story will act as a headwind. The liquidity of the Japanese markets means that it is a natural first stop for overseas investors seeking to take gains at quarter ends, but as domestic equity participation increases, this will hopefully become less of a factor in equity market performance.



Japanese companies were early adopters of the business practice of forming 'quality circles'. These are groups of workers who regularly meet to discuss and solve workplace related problems. They were most popular in the 1980s, but continue to exist in the form of Kaizen groups.



<p>JAPAN (cont'd)</p>	<p>As we have discussed previously, currency volatility is likely to be a persistent theme in markets, and we have to be cognisant of this when investing, especially in macro sensitive markets like Japan. However, our case here is very much a long-term one and the 'cultural' transformation affecting the Japanese market and society as a whole means that the positive developments should dwarf shorter-term, transitory developments such as yen appreciation.</p>
<p>ASIA</p> 	<p>It has been an eventful month for South Korea, Asia's fourth biggest economy. The missile tests from North Korea grabbed headlines overseas and the agreement to host a powerful US anti-missile system known as Terminal High Altitude Area Device (THAAD) has increased anxiety in the region with China. China views THAAD as a potential threat to its military, especially surrounding the South China Sea, where there are a number of competing claims. Also of concern are its radar capabilities, which would be able to penetrate Chinese territory. This has led to strained economic relations between the two countries, with South Korean retailer Lotte seeing 23 of its stores in mainland China temporarily shut down for 'fire safety reasons'. This came the week after the company had agreed a land swap outside Seoul where THAAD is to be installed. The company was also one of a number of South Korean firms which have faced cyber-attacks from Chinese IP addresses. There has also been a ban on selling travel packages to South Korea in China.</p> <p>Tensions between the two countries will no doubt be an important priority for the next South Korean President, with Moon Jae-in currently the frontrunner for May's election to replace ousted President Park Geun-hye. The economy will also be an important topic. Recent economic data have been improving, most notably in exports, with the Korea Centre for International Finance estimating a 13.7% increase in March. Household debt is now at an all-time high, however, increasing concerns that we may see another credit crisis similar to that of 1997. Rate rises from the US may be a key factor here, increasing debt repayment levels, so the new President may need to tackle this issue.</p> <p>Tensions between the US and China could have negative implications for some Asian countries, as seen by those currently impacting South Korea. We remain broadly positive on Asian equities in view of its economic growth potential.</p>
<p>EMERGING MARKETS</p>	<p>At the beginning of the year, emerging markets seemed to face a daunting array of challenges to their progress. The election of President Trump meant a combination of protectionist rhetoric, a stronger dollar and a potentially more hawkish Federal Reserve led many investors to decide that the tide was definitely against this area of the market.</p>



EMERGING
MARKETS
(cont'd)

Fast forward to the end of March and things look somewhat different. Emerging markets have managed to record their best quarter in five years, catching many off guard. They have performed markedly better than their developed peers and attracted significant inflows in what is a sharp turnaround in sentiment towards the space. Growth in emerging markets is running at a three-year high, and although China faces problems and headwinds to its own growth, other areas such as emerging Europe and Latin America have made meaningful contributions. Expectations of higher interest rates in the US have softened somewhat with the Federal Reserve indicating it would not push ahead with its rate rises too aggressively – adhering to its plan for three rate rises this year. This has reduced the attractiveness of the US as a home for yield-seeking funds, and the recent dollar weakness has alleviated some of the pressures on emerging economies. It isn't just the removal of headwinds which has been of benefit, however. The improvement in growth prospects via tax cuts and infrastructure spending could be a real boost to emerging markets, especially those dependent on the fortunes of the commodity space, and the strong run of emerging markets currencies has also helped. This is to say nothing of valuations.

On most metrics, the emerging market complex can be shown to trade on a significant discount to its developed market peers, and given how expensive the US in particular had become, it is only to be expected that we would have seen some redistribution of investor funds.

We remain cautious, however. Things have certainly improved, but question marks over the reflation and growth story will hamper emerging markets and these have started to surface. The recent news from **South Africa** (yet another finance minister being dismissed by President Zuma – talk about going round in circles!), highlights the country specific risks which lurk in the space, and idiosyncratic developments like these tend to occur at times of general market stress. We are still choosing to see the positives in China, and **India** radiates potential.



ETHICAL



Ethically minded investors have to accept that there will be years such as 2017 when certain sectors of the markets perform exceptionally well and leave their portfolios behind. Mining and energy performed this role last year, and ethical investors were unable to participate in the stellar returns enjoyed by stocks operating in these areas. Exactly what is the 'impact' of applying ethical principles to investment in the long run is somewhat debatable, but **Norway's** sovereign wealth fund has revealed that it has returned around 1.9% less than its benchmark since 2006 due to the exclusion of tobacco and weapons manufacturers.



ETHICAL
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Now these areas of the markets themselves are arguably totally different in their 'non-ethical' nature, but the figure is still interesting. The Norwegian Ministry of Finance has imposed rules on the sovereign wealth fund such that companies like Boeing, Lockheed Martin, General Dynamics, Imperial Tobacco and Philip Morris were all non-eligible for investment. The criteria are not entirely uncontroversial – tobacco being excluded but alcohol not, is one area of contention – and the ethical screening has not been all negative. Some of the other exclusions have been beneficial with the screening on the basis of 'human rights abuse' and 'environmental damage' estimated to have boosted the fund's relative performance by 0.8%.

Of course, those for whom ethical investing is important (and it is a growing number) would argue that a modest underperformance of the benchmark is a small price to pay for 'doing the right thing'.

FIXED
INCOME



We commented here last month that **UK** bond yields fell markedly in February with the 10-year coming in from 1.45% to 1.17%, as dovish comments from the Bank of England increased the attractiveness of the asset class. These moves do look overdone to us – despite seeing yields almost back to where they were in early November, UK inflation and rate rises (even those led by the Fed) do not look gilt-friendly. Last month we saw the February inflation figure come in at 2.3%, and can only believe this will go through 3% pretty soon. In this environment, bank bonds have been doing well and may continue to do so, as higher rates (even anticipated ones) may allow more margin back in.

We prefer high yield, though of course this is no zero sum game. In Europe, for example, the issuance of new debt is pretty low, and in a period where the hunt for income is pretty much it, this might be surprising. However, yields have come in, so there are questions to be asked.

In the US high yield market, there are predictions of the opposite, a wall (not **Mexican** in nature) of money, as around \$1 trillion of debt matures between now and 2021. That seems a way off, and much of it is nearer 2021 than today. However, events may suggest that early refinancing makes a lot of sense, as rates are rising, and with President Trump looking to review the banking regulation which hit harder after 2008/9, timing could be good now, much tougher later. Yields are better in the US than in Europe, and if the economic news continues to at least be fair, defaults should not be an issue.

This asset class remains very susceptible to changes in sentiment and more so to changes in interest rates. High yield still seems attractive, and we are looking to increase holdings here in lower risk portfolios.



COMMODITIES
& SPECIALIST

It appears that US energy policy may be going *full circle*. In yet another controversial executive order, President Trump outlined his plans to repeal the climate change policies introduced by the Obama administration. The Clean Power Plan aimed to reduce CO₂ pollution from the energy sector to 32% below 2005 levels by 2030. Part of this plan was to reduce the greenhouse gas emissions from **coal**-fired power plants, which critics described as a 'war on coal'. According to figures from the US Energy Information Administration, CO₂ emissions were already 20% lower than 2005 levels at the end of 2015 and the US looked set to meet its targets. This latest move could have stark implications for the climate change movement as a whole and undermine the progress made in the 2015 Paris Accord as President Trump seeks to 'protect US jobs'.

The news is certainly popular with US coal miners, many of whom have filed for bankruptcy in recent years. Although, even with President Trump's backing, stimulating coal consumption could prove difficult. Indeed, research by Reuters states that out of the 32 US utilities firms contacted, 20 said that they would not change their investment plans following the order. This is fundamentally due to costs. Given the fall in the price of oil, natural gas and renewable energy production, there would appear to be very little incentive for US utilities to use coal-fired plants. On the production side, many mining firms have long since diversified away from coal mines, and the process of re-opening those that have been mothballed will take time.



With this in mind, surely President Trump has some reasons for attempting to reignite the industry? One reason is job creation. Employment in the US coal industry has fallen by over 65% since 1980, resulting in the loss of around 150,000 jobs and blighting communities, so any attempt to boost employment will be well received in these regions. Others have cited the export opportunities that coal production presents, with its use still prevalent in emerging economies. Whatever his reasons, President Trump's latest executive order highlights his commitment to natural resource production and a clear divergence away from the global trend towards renewable energy.

We continue to hold exposure to gold across all portfolios and to the broader mining sector in higher risk portfolios.

PROPERTY

Figures from the Nationwide Building Society revealed that the average UK house price fell to £207,308 in March, 0.3% lower than the month before. The annual rate still saw a 3.5% rise in the average price, which is still positive, and is the lowest 12-month growth figure since August 2015.

**PROPERTY**
(cont'd)



It is logical that stories on house prices are often in the news, with the purchase of a main residence often the biggest single purchase and most expensive asset people own. Changes in value therefore can have a psychological impact. If house prices are going up, people feel wealthier, so can afford to spend more, which in turn creates more jobs and so the economy should do better. Evidence from a recent report from Lloyds Bank also supports this, with the 20 areas in the UK which have seen unemployment fall the furthest over the last 10 years having seen house prices increasing at almost double the national average (48% against 25%), with the London Borough of Waltham Forest seeing an increase of 96% in prices since 2007.

It is important, however, not to associate the performance of residential property with that of commercial property. These can, and do, behave very differently. Indeed, looking back to performance from March 1997 to the end of February, the price return of the Halifax Property index (seasonally adjusted) has increased 226.8%, with the IPD UK All Property (commercial) increasing by 46.4%. Arguably a shortage of new housing stock has been a factor in this large price difference, and valuation dynamics also play a part. For residential, there are generally more transactions, which means there are more reference prices. If a house on a street comes up for sale, the price of another house down the road will give a good guide to the value. For commercial premises, this is more difficult to gauge. For example, there may only be a handful of office buildings in a town, and if none of them has changed hands recently, the valuation is harder to estimate.

There is also more diversity in the types of commercial property, with the major IPD sectors being Office, Industrial, Residential and Other (leisure). These each have their own underlying drivers. For example, within retail, we have frequently written about the change in shopping patterns with high streets becoming shorter, the first out of town shopping centres and now the rise of e-commerce changing traditional business models. Distribution assets, on the other hand, has been one of the hottest sectors across commercial property, as supply chains are built out.

Finally, and most importantly, investing in UK commercial property should be seen as a long-term income play, rather than seeking a rise in capital growth. Going back to the 20-year performance figures, when the total return figures are considered, the IPD UK All Property index is up 434.9% – the income adding over eight times the return. So when you next see headlines on house prices, do not assume that the same trend is being seen in commercial property.



<p>PROPERTY (cont'd)</p>	<p>Whilst the UK economy affects both, residential and commercial property prices are not highly correlated to each other. Commercial property remains attractive as a long-term income generating investment, with the occupational market remaining resilient, particularly in smaller lot sizes and in the regions. We continue to hold property for this income and as a diversifier in portfolios.</p>
<p>CURRENCY</p> 	<p>Italy is ‘drowning in debt’, with the Government owing 133% of GDP (in the UK it is around 89%). This is an economy around eight times bigger than Greece, about which we all (still) seem to get so vexed. Unless growth can come through, pretty strong, pretty soon, when rates rise in Europe (as they seemingly must), Italy will be in real trouble. When one then takes into account the political changes possible (though by no means certain), the currency we may yet again all be focusing on could be the euro. From a high of over €1.30 to £1 before the EU referendum, and off a low of €1.10 to £1 in October 2016, the euro has been relatively strong against the pound, now at c. €1.16. If Italy doesn’t ‘play her cards right’, expect ‘higher, higher’ rather than ‘lower’ ... and of course French voters could still have a say...</p>
<p>UK INTEREST RATES</p> 	<p>The last time the UK was at war with Spain (we know, we’re not, but it makes for a more interesting paragraph than saying rates here haven’t risen, again), was during the Second Egyptian-Ottoman war of 1839–1841. The Ottoman Empire and the British Empire fought Egypt Eyalet, France and Spain. At that time, UK interest rates were between 4% and 6% (briefly) and inflation rocked between 0.7% and 7.3% before a harsh period of deflation, which in 1843 saw –11.3%.</p> <p>Assuming peace continues to reign with Spain (and others), we might expect higher inflation here in 2017 and possibly into 2018, though we have to hope nothing brings about another dose of deflation at 1843 levels within a few years ... and perhaps we can expect a modest rise in the Bank of England rate this calendar year?</p>



NUMBERS OF THE MONTH

Our monthly look at numbers which may or may not have grabbed the headlines.

50

**The Article of the Lisbon Treaty
activated by Theresa May to
withdraw the UK from the EU**

2.3%

**UK CPI in February, the
highest since September
2013**

£5.05bn

**The write down Toshiba took for
its US nuclear business**

MARKET DATA

Index	31.03.17	1 month	1 Year	3 Years
Bovespa (Brazil)	64,984.07	-2.52%	29.82%	30.57%
RTS (Russia)	1,113.76	1.30%	27.11%	-9.16%
MSCI United Kingdom	2,132.80	0.88%	18.61%	9.72%
Numis UK Smaller Companies	5,378.68	2.15%	18.21%	10.41%
MSCI United Kingdom All Cap	1,365.94	0.87%	17.65%	10.65%
M-DAX (Germany)	23,904.08	2.30%	17.19%	45.21%
BSE (India)	29,620.50	3.05%	16.88%	32.32%
Dow Jones Industrials	20,663.22	-0.72%	16.84%	26.59%
CAC 40 (France)	5,122.51	5.43%	16.82%	16.65%
Hang Seng	24,111.59	1.56%	16.11%	8.85%
S&P 500	2,362.72	-0.04%	14.71%	27.19%
Nikkei 225	18,909.26	-1.10%	12.83%	27.53%
MSCI United Kingdom Small Cap	388.21	0.80%	11.37%	15.53%
Shanghai A (China)	3,374.66	-0.58%	7.35%	58.52%
IBOXX UK Sterling Gilts All Mat.	126.87	-0.31%	3.17%	14.68%
IPD UK All Property*		0.70%	2.80%	35.33%

*Figures delayed by one month

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