ARTORIUS WEALTH

INVESTMENT OUTLOOK

March 2016

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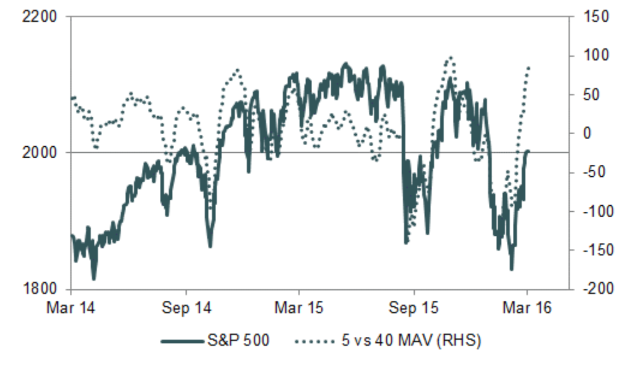
Trump Card?

Like a cat on a hot tin roof, the equity market has jumped in the past few weeks. We doubt that the prospect of Donald Trump becoming President of the USA, or BREXIT are reasons for increased optimisme.

The increases in the equity markets have been sharp and welcomed by most investors; the S&P 500 has climbed from 1829 on the S&P 500 on 11th February to c2000 at the beginning of March. Without a reversal in economic momentum we will look at the opportunity to reduce equity exposure further for clients.

A sharp rally has returned equity markets to the levels seen at the start of 2016, but a rally that appears too much too soon.

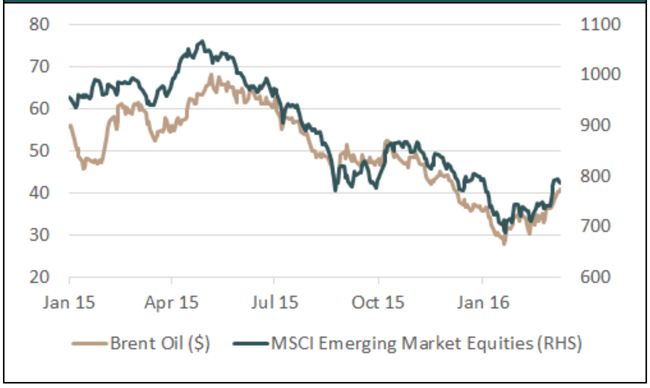


Source: Artorius Wealth, Thomson Reuters

It is important to recognise that the recovery in the oil price has been a significant factor behind the moves in equity markets and there continues to be a very unusual positive correlation between moves in the oil price, moves in the stock market and moves in expectations for interest rates. Similar to periods post the Great Recession in 2009-10 and the Euro Crises in 2011-12, the relationship between oil and equity prices suggest to us that we remain in 'interesting' times.

The rise in the oil price from below $30 to above $40 per barrel in the last six weeks has encouraged a higher level of risk tolerance in other asset classes. The good news of high oil prices is that the immediate risk of prolonged deflation is removed. Deflation, defined as a period of falling prices, is viewed negatively by investors. Companies are challenged to grow revenue when prices are falling.

Oil prices appear to be driving equity markets



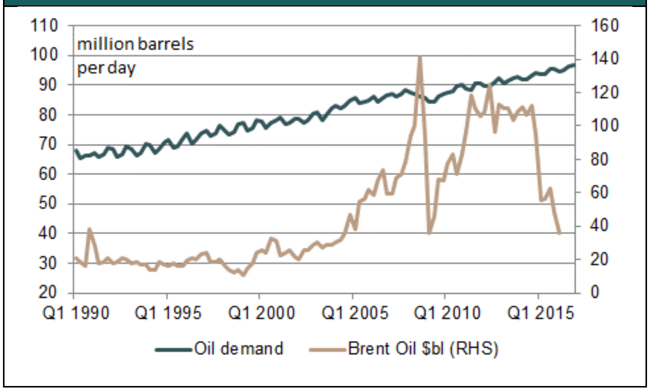
Source: Artorius Wealth, Thomson Reuters

If rising oil prices have removed the risk of deflation, do higher oil prices necessarily spur better economic conditions? We doubt it. We believe that revenue growth remains challenging, as credit conditions tighten in the US with limited appetite for additional debt in other economies.

Oil market imbalance

We note that the recent projections of oil demand remain subdued. A slowing Chinese economy and greater energy efficiency globally has meant that lower oil prices will be corrected by a cut in oil supply.

Very low inflation is a challenge for companies seeking to register sales growth

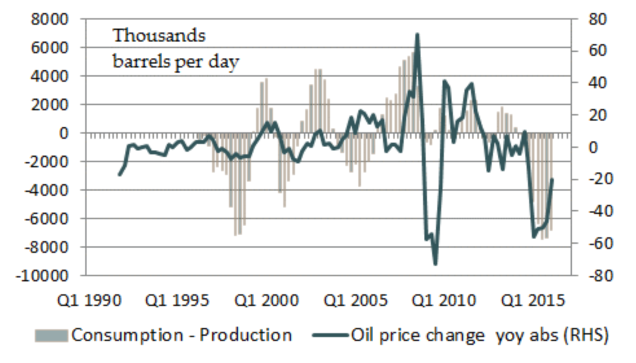


Source: Artorius Wealth, Thomson Reuters

If oil prices were rising due to faster economic growth and higher demand, we would challenge our own assumptions of a subdued outlook. However oil prices have risen over the past few weeks on expectation (or hope) of an agreement between the major oil producing countries to restrict oil supply.

With geopolitical tensions between Saudi Arabia, Russia and Iran likely to prevent a stable outcome in the near term, we expect that the oil prices rally may reverse. Excess supply (or a demand deficit) indicated by multi-year highs of oil stocks will continue to depress oil prices.

Oil production has outstripped oil consumption and resulted in conditions for lower oil prices



Source: Artorius Wealth, Thomson Reuters

Policy dilemma

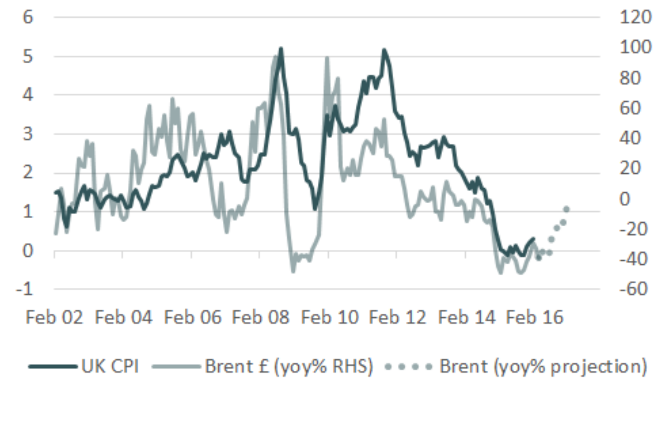
We may be mistaken, of course, about the direction of the oil price. Oil prices may climb higher. We suggest that this would entail different risks for investors, certainly the bond market.

As oil prices have fallen over the past few years, the deflationary environment has supported bond markets, and enticed central banks to either delay interest rate increase, as in the UK, or provide additional monetary stimulus through interest rate cuts or Quantitative Easing (QE).

If the oil price remains at $40, then the deflationary backdrop will change over the course of 2016. In our view, the onset of inflation, even if derived from oil prices, would challenge monetary policy makers to tighten, or at least offer less supportive policy.

If the market is moving from being a deflationary force to one that is inflationary, the revenue support for the likes of the commodity related companies may benefit, but until we see underlying economic growth pickup through wage increases and productivity, then sustainable revenue and profits growth will be a challenge.

UK inflation may rise faster than expected if oil prices remain at $40



Source: Artorius Wealth, Thomson Reuters

If oil prices rise then inflation is a risk, and monetary policy may have to tighten.

If oil prices remain low then the rally enjoyed by equity markets may fade as economic conditions remain poor and equity valuations unappealing.

Fixed income investors are torn between the apparent safe haven status of their asset class and the inflationary risk, with the subsequent change in the policy backdrop.

With the change in asset markets in the past few weeks, there is the temptation to believe that the economic backdrop has improved. With earnings being rapidly downgraded, we suggest that the downside risk has increased in the near term.

As a result we remain underweight equities and will take the opportunity presented by the market rally since mid-February to de-risk the portfolio further.

Asset Allocation Views

Equities	⊖
US	⊖
UK	⊜
Europe ex UK	⊜
Japan	⊜
Pacific ex Japan	⊜
Emerging Markets	⊜

Fixed Income	⊜
Government	⊜
Investment Grade	⊜
High Yield	⊜
Emerging Market	⊜
Cash	⊕

Alternatives	⊜
UK Real Estate	⊜
Infrastructure	⊜
Private Equity	⊜

⊕ = Positive view
⊖ = Negative view
⊜ = Neutral

Source: Artorius Wealth

Our Tactical Asset Allocation (TAA) tilts to the SAA to reflect our shorter-term cyclical views. Actual client portfolios will vary according to mandate, benchmark, risk profile and the availability of individual asset classes in different regions.

ASSET CLASS OVERVIEW

Equity	SAA	Commentary	TAA
US -3 **-2** -1 0 1 2 3	22%	We increased our negative stance on US equities from 'slight' to 'moderate' in early December. From a valuation perspective the US equity market appears fully valued and earnings revisions are weak. The risk of higher interest rates and tighter credit conditions, as seen in surveys, threaten the subdued economy.	-7%
UK -3 -2 -1 **0** 1 2 3	7%	We prefer mid-caps, implemented through exposure to the FTSE 250 Index, as they avoid the dominance of the commodity related companies found in the FTSE 100 index.	-
Europe ex UK -3 -2 -1 **0** 1 2 3	7%	We are of the opinion that the ECB's commitment to its asset-purchase programme will remain intact and continue to support the region's recovery.	-
Japan -3 -2 -1 **0** 1 2 3	0%	Following the Yen's depreciation, the earnings growth of Japan has been robust but challenges remain longer term such as demographics.	-
Pacific ex Japan -3 -2 -1 **0** 1 2 3	5%	With economic challenges emerging in developed economies Asian and emerging market economies and their equity markets have already slowed and fallen respectively.	-
Emerging Markets -3 -2 -1 **0** 1 2 3	5%	The outlook is mixed as valuations are lower than in developed markets but the weakening momentum is a risk that we will look to manage in coming months	-
Global -3 -2 -1 **0** 1 2 3	3%	In contrast to our regional asset allocation we have a global equity theme of water. As the global population grows, water resources are stretched and companies in water industry should benefit from increased expenditure.	-

Fixed Income	SAA	Commentary	TAA
Cash -3 -2 -1 0 1 **2** 3	0%	We opt for cash in the face of unattractive opportunities, in other asset classes. Long term we look to deploy cash holdings in higher return generating assets, but in times of turbulence cash offers a safe haven.	+7%
Government -3 -2 -1 **0** 1 2 3	14%	We remain neutral on government bonds overall, as the inflation outlook appears subdued in the near-term. The prospect of further bond buying from the ECB is likely to keep bund yields low, which in turn should prevent yields in other markets rising too far too soon.	-
Investment Grade -3 -2 -1 **0** 1 2 3	9%	In the UK and Europe there has been a modest increase in credit spreads in 2016, but returns remain attractive in most scenarios relative to government bond markets.	-
High Yield -3 -2 -1 **0** 1 2 3	4%	High yield markets in the UK and Euro area are shielded to date from the US high yield bond market.	-
Emerging Market -3 -2 -1 **0** 1 2 3	3%	We believe that valuations are attractive and sufficient to outweigh the potential volatility caused by the Fed's rate rises.	-

Alternatives	SAA	Commentary	TAA
UK Real Estate -3 -2 -1 **0** 1 2 3	10%	Yields and rental growth of 3% should also make a useful contribution to robust total return in 2016. Valuations appear stretched in absolute terms limiting long-term returns.	-
Infrastructure -3 -2 -1 **0** 1 2 3	5%	Valuations remain full, with limited scope for disappointment, but cash flow generation is drawing fund flows.	-
Private Equity -3 -2 -1 **0** 1 2 3	6%	The asset class most correlated to the economy, in terms of risk. PE houses are expected to deliver positive returns until the economy slows markedly or credit costs rise to curtail private market activity.	-

Source: Artorius Wealth

Key: The numbers reflect a quantitative description of our tactical positions relative to the strategic benchmarks. Our Strategic Asset Allocation (SAA) solutions offer a blend of assets that over a medium terms (5-7 years) will, in our view, provided the optimal mix of returns and risk at a given level of risk tolerance. Our Tactical Asset Allocation (TAA) tilts to the SAA reflect our shorter-term cyclical views. The SAA and TAA positions reflect a medium risk sterling on-shore based client portfolio. Views are subject to change and implementation in portfolios will reflect specific client requirements.

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