ARTORIUS WEALTH

INVESTMENT OUTLOOK

February 2017

MANCHESTER LONDON ZURICH

Heart strings

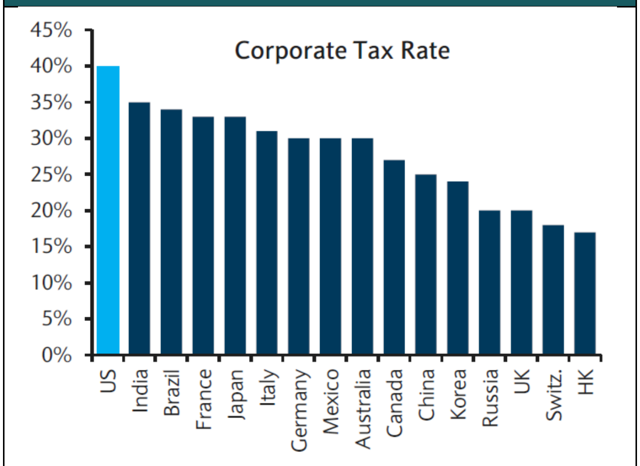
As St Valentine Day approaches, with love and sonnets in the air (for some), investors appear to be having their heart strings pulled by the tweets of the US President and his entourage. Having swapped the rhetorical grace of Obama with the directness of Trump, we wake each day wondering whom or what has been the target of President's ire. The importance of political economic analysis that has risen markedly since the Financial Crises appears to be at a crescendo.

Post the immediate reaction to the US election when risk assets rallied in unison, there appears to be greater discrimination by investors. Whilst the perceived 'safe-haven' assets such as gold has rallied $100 from December lows, the higher risk Emerging Market equities have led the global equity market higher over the past month. The rally in both may reflect the anti-US dollar sentiment creeping into mind-set as potential protectionism and the new US Government's own statements on the desire for a lower dollar.

Hope and Reason

The initial hope for a Trump led administration was a tax cut in 2017. This was initially estimated to have the potential to deliver a potential 12% increase in reported profits supporting the surge in US equities post the election. This would be partly offset by the proposed Border Adjustment Tax (BAT) which is estimated to reduce profitability by 6%.

Headline Corporate Tax Rates: Elevated in the US



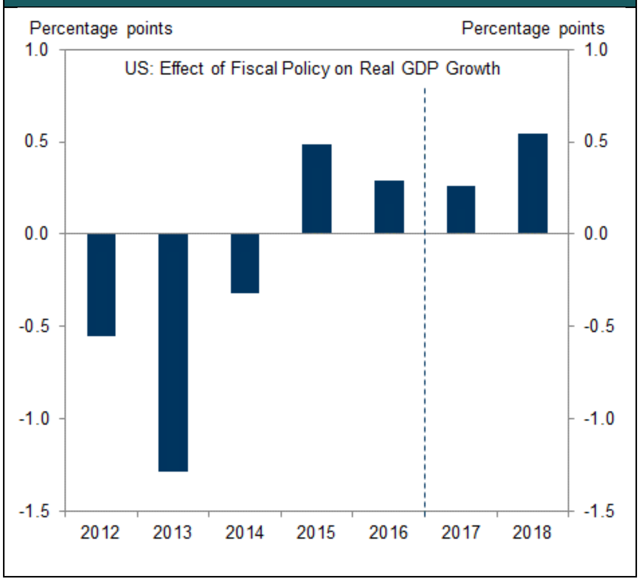
Source: Artorius Wealth, Barclays Wealth

Assessing the impact of tax reform and borrowing costs is complicated by other potential modifications to the tax code. The House Republican plan would eliminate the deductibility of net interest expense. Although interest on current debt would likely be grandfathered, if interest had not been deductible profits would be reduced by some 6% according to analysts.

The potential tax reform legislation under the Trump administration will also encourage firms to repatriate $200 billion of overseas cash next year. A significant portion of returning funds will be directed to buybacks based on the pattern of the 2004 tax holiday.

The probability of significant legislative activity has increased as the Republicans have single-party control of the Executive and both Senate and Congress. Tax reform appears to be prominent on the policy agenda in 2017. The potential tax cuts may capture headlines but the fiscal feast is likely to be bedevilled with details, but the overall economic impact is expected to be positive.

US fiscal policy is expected to be a positive effect on the US economy



Source: Artorius Wealth, Goldman Sachs

Poll dancing

Given the shock and awe of BREXIT and Trump, investors are understandably and increasingly wary of the elections Europe in 2017. Dutch elections in March 2017 followed quickly by French Presidential elections through April and May. Whilst it is a low probability event risk, in our view, the German elections hold a small prospect of the AdF upsetting the political applecart. In each of the countries, the very open case for further challenge to the European Union is a real presence at the ballot box.

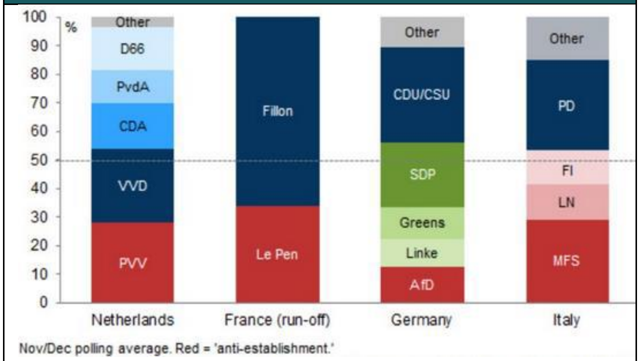
European elections pose political and investment risk through 2017

Country	Event	Data	Probability/ impact
Netherlands	Party for Freedom victory leading to an EU referendum	March 2017	Medium / High
France	President Le Pen leading to EU event risk	May 2017	Low / Very high
Germany	Far-right Alternative for Deutschland (AdF)	Oct 2017	Very low / Very high

Source: Artorius Wealth

Given the shocks from 2016, investors are pricing in some degree of event risk, as shown by the widening in the yields between the debt from the respective economies. Of some comfort for those believing that the status quo will prevail is the lack of breakthrough in the 'protest' vote registered in opinion polls for the relevant 'popular' or anti-mainstream political parties.

Popular parties lack majority support but coalition calculus make governing a balancing act



Source: Artorius Wealth, Goldman Sachs

In many of the countries the election will result in a coalition government, so the eventual outcome may rely on smoke-filled rooms and agreements by political parties post-election, rather than a clear reflection of electorate intentions. One wily parliamentarian spoke of BREXIT being a lesson in the dangers of democracy.

In coming months, we think that political factors may be as important in driving markets as the economic backdrop.

Given the upbeat readings from the Euro area economy, the European Central Bank (ECB) may step further away from Quantitative Easing and follow the US Federal Reserve in tightening monetary policy. With inflation rising in the Euro area, German monetary policymakers may become more vocal in the need to shift monetary policy. Any change in policy may prompt a rethink in the relative merits of the Euro, and lead the Euro to rise against a US Dollar that also appears to be willed lower by the US Government.

Market musings

Shifting political sands, fiscal feasts and potential reversals in currency fortunes make for interesting times for investors. Despite unattractive valuations in US equities, the uptick in US profitability and improving global economy means that we remain underweight US equities, but overweight Emerging Market equities in clients' discretionary portfolios.

Within fixed income, we have reduced interest rate risk and added more exposure to corporate debt, and retain a full weighting to Emerging Market bonds.

In direct UK and European equity holdings we continue to deploy the systematic approach of owning those companies that are returning shareholder capital without the use of leverage. We can illustrate this approach has worked over the long-run as well believing intuitively that any company management team that has an instinct to return capital to its ultimate owners, the shareholder, without the use of financial engineering, debt, is worthy of support.

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)** tilt verses the **Strategic Asset Allocation (SAA)** reflect our shorter-term 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 2015. The risk of tighter credit conditions, threaten the subdued economy, especially the Small Cap sector which accounts for most of the underweight view.	-7%
UK -3 -2 -1 **0** 1 2 3	7%	Post the BREXIT referendum we have switched from our long standing exposure to domestic FTSE 250 to FTSE 100 which is likely to benefit from the fall in sterling, as the larger companies have most of their profits derived from overseas.	-
Europe ex UK -3 -2 -1 **0** 1 2 3	7%	We believe that the ECB's commitment to its asset-purchase programme will remain supportive of 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 (i.e. demographics).	-
Pacific ex Japan -3 -2 -1 **0** 1 2 3	5%	Global economic growth prospects have brightened which should benefit the region, so we have moved back to a Neutral stance as of December 2016	-
Emerging Markets -3 -2 -1 **0** 1 **2** 3	5%	Whilst China weighs on the universe the use of an active fund manager gives clients' portfolios access to relatively undervalued asset class. Similar to Asian equities the brighter global economic prospects should favour the region so we have moved overweight the region.	+2.5%
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.	+4.5%
Government -3 **-2** -1 0 1 2 3	14%	We have turned negative on government bonds post the recent BREXIT inspired rally. Rising interest rates in the US is likely to push yields higher and bond prices lower.	-7%
Investment Grade -3 -2 -1 0 1 **2** 3	9%	In the UK and Euro bond markets a new buyer of last resort (the respective Central Banks) will keep yields lower for longer. The yield pick-up and slight reduction in volatility makes it a compelling place to invest proceeds in comparison with the underlying government bond market.	+7%
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%	UK real estate may struggle in the face of BREXIT. It is a sector that offers both long-term opportunities, but near term risk depending on policy and investor response. However, for longer term investors, the income generation should prove resilient.	-
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 term (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) tilt verses the Strategic Asset Allocation (SAA) reflect our shorter-term views. Actual client portfolios will vary according to mandate, benchmark, risk profile and the availability of individual asset classes in different regions. 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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