ARTORIUS WEALTH

INVESTMENT OUTLOOK

Post-Autumn Statement Briefing

November 2016

MANCHESTER LONDON ZURICH

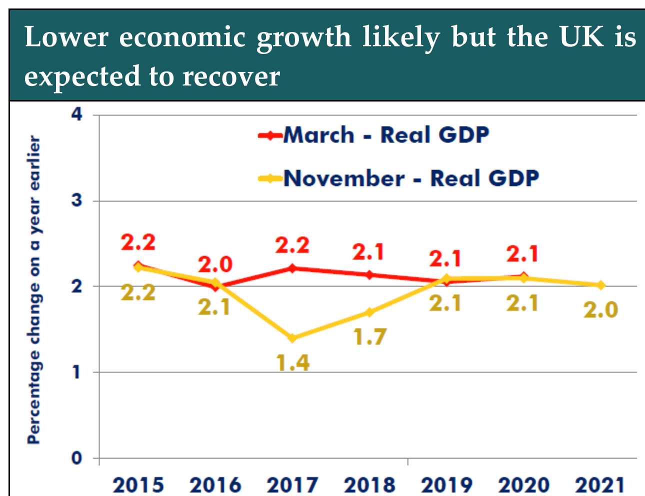
Fiscal ease but a future squeeze?

Looser for longer equal more debt

The UK economy is forecast to be the fastest growing major economy in 2016, but the Office for Budget Responsibility, OBR, has forecast growth to slow and inflation to rise over the next two years.

According to the OBR the economy will grow more slowly than we expected in March, with GDP growth in 2017 revised down from 2.2 to 1.4 % and cumulative growth over the whole forecast revised down by 1.4 percentage points. Inflation is forecast to peak at 2.6% and unemployment to rise modestly to 5.5% during 2018. Subdued earnings growth and higher inflation mean that real income growth stalls in 2017.

Lower economic growth likely but the UK is expected to recover



Source: OBR, Artorius Wealth

According to the International Monetary Fund (IMF), between 2007 and 2010 the UK experienced the largest increase in public debt in the G7 and in 2009-10 it faced a post-war peak deficit of 10.1% of GDP. However, over the last six years the deficit has been cut by almost two-thirds from its 2009-10 level to 4% of GDP last year. This has been critical in slowing the rise in public debt as a share of GDP. Despite significant progress, the UK still had one of the highest deficits among advanced economies in 2015, and further work remains to be done to bring the public finances under control.

After the failure of meeting any of its previous fiscal targets, and increased uncertainty over the future the Government has set itself new targets. New fiscal targets are needed to provide the flexibility to support the economy and create space for more investment in roads, rail, research, and housing. The new fiscal mandate requires a structural deficit – i.e. borrowing unrelated to temporary weakness in the economy – below 2% of GDP in 2020-21, which would mean halving it in this Parliament. Separately, net debt must fall relative to GDP in 2020-21. The new welfare cap only applies in 2021-22 and is only to be assessed at the start of the next Parliament.

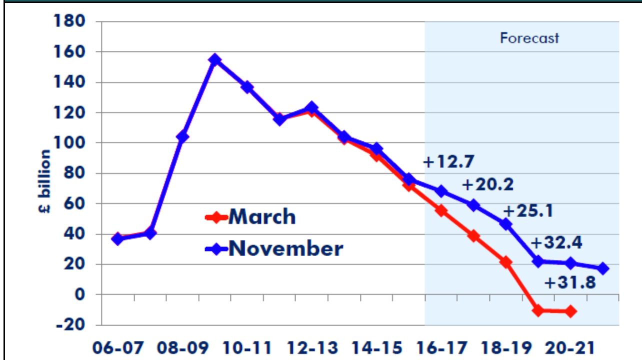
Government finances forecast to be £122bn worse off in the period until 2021 than forecast in March's Budget. Debt will rise from 84.2% of GDP last year to 87.3% this year, peaking at 90.2% in 2017-18.

The forecast implies that Government will impose fiscal tightening in 2019-20, just ahead of an election around the same time that BREXIT occurs. This seems unlikely and will mean that, even if the UK doesn't have a recession by 2020, i.e. 12 years after the 2008 recession, the UK's fiscal position remains fragile.

Government spending projections imply a fall in real spending per person over the next five years. The last three years of the Spending Review period up to 2019-20 will see real spending per person fall by around 2% a year, with a particularly sharp cut planned for 2019-20. The forecast from the OBR implies further spending cuts, and a small increase in taxation revenues.

Public sector net borrowing has been revised higher; i.e. the government will be borrowing more than previously been expected. Confronted by a near-term economic slowdown and a structural deterioration in the public finances, the Government has opted neither for a large near-term fiscal stimulus nor for more austerity over the medium term. Instead the Chancellor has proposed a much looser 'fiscal mandate' that gives him scope for almost 2½% of GDP (£56 billion) more structural borrowing in 2020-21 than his predecessor was aiming for in March.

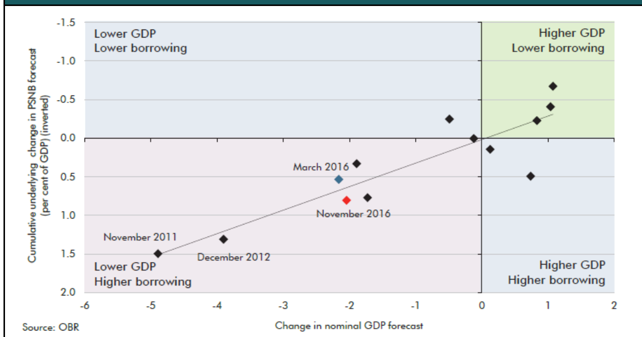
Public sector net borrowing projected to be higher than previously believed.



Source: OBR, Artorius Wealth

The cumulative increase in borrowing over the five years from 2016-17 to 2020-21 is 0.8% of GDP, the third largest revision the OBR have made (after November 2011 and December 2012). As with past revisions, the size of the hit to borrowing is closely correlated with the extent to which they have revised down nominal GDP growth. So if growth is weaker than expected then deficits will be higher.

Underlying fiscal forecast and overall nominal GDP revisions since 2010



Source: OBR, Artorius Wealth

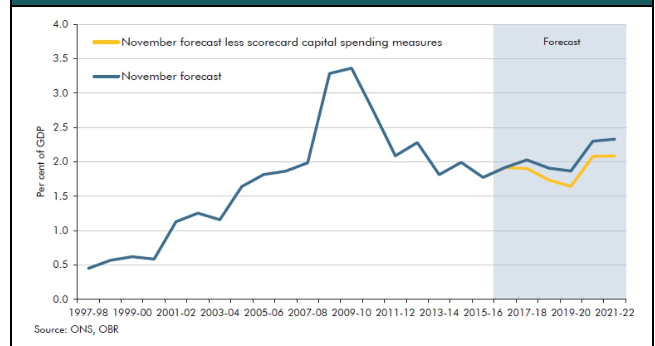
A move in the right direction

A new National Productivity Investment Fund to provide £23 billion of additional spending over five years, ensuring the UK's economy is fit for the future. The fund will be used for projects such as roads and water connections that will support the construction of up to 100,000 new homes in the areas where they are needed most, with over £2.5 billion invested in housing in 2019-20 or £8.1 billion over 4 years. Although even the OBR suggest that the support given will be dampened by measures effecting the Housing Associations.

In addition, there is an extra £2 billion to be spent for Research and Development (R&D) by 2020-21, or cumulatively £4.7 billion over four years.

The reversal of cuts in public investment is to be welcomed, and is likely to be more effective in driving economic growth and improving productivity in the medium term. But the increase is relatively modest but is a step in the right direction economically.

Public sector net investment on the up



Source: OBR, Artorius Wealth

Delaying the day of destiny

The UK is a long way from achieving fiscal balance. The Chancellor has used his new office to dampen the targeting on unrealistic and economically damaging goals, and resetting the focus and near term investment into the UK economy. Increasing public investment in housing, infrastructure and R&D should aid greater levels of productivity across the UK economy.

The 2016 Autumn Statement may well prove to be a first supportive step that the fiscal policy makers have delivered since the financial crises. The extent to which the fiscal deficit still needs to be reduced poses a medium term issue for the Chancellor and looks like it has been delayed until post the next election.

For investors, we suggest that the measures make the UK government bond market less appealing, and we recommend a preference for shorter dated corporate bond exposure where appropriate and are thus positioned in discretionary portfolios.

ASSET ALLOCATION VIEWS

Equities	Negative
US	Negative
UK	Neutral
Europe ex UK	Neutral
Japan	Neutral
Pacific ex Japan	Negative
Emerging Markets	Neutral

Fixed Income	Neutral
Government	Negative
Investment Grade	Positive
High Yield	Neutral
Emerging Market	Neutral
Cash	Positive

Alternatives	Neutral
UK Real Estate	Neutral
Infrastructure	Neutral
Private Equity	Neutral

(+) = 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 per 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%	We remain concerned over the Asian equity universe. An economic slowdown in China and collapse in commodity prices weighs heavily. Growth risks and monetary conditions in the US cause us to reduce exposure in clients' portfolios.	-2.5%
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.	-
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.	+9.5%
Government -3 **-2** -1 0 1 2 3	14%	The fall in bond yields in 2016 has benefitted portfolios. with a change in dynamic as the Bank of Japan look to support the economy via Helicopter Money and a concentration of risk in the financial markets we have de-risked the bond exposure by moving to a shorter duration fund	-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.

Important information

Artorius Wealth provides this document in good faith and for information purposes only. All expressions of opinion reflect the judgment of Artorius Wealth at this date and are subject to change. Information has been obtained from sources considered reliable, but we do not guarantee that the foregoing report is accurate or complete and do not accept any liability for any errors or omissions, nor for any actions taken based on its content. Nothing in this document is intended to be, or should be construed as, regulated advice. Reliance should not be placed on the information contained within this document when taking individual investment or strategic decisions.

Any advisory services we provide will be subject to a formal Engagement Letter signed by both parties. Any Investment Management services we provide will be subject to a formal Investment Management Agreement, which will include an agreed mandate.

Past performance is not a guarantee of future performance and investors may not get back the amount originally invested. Investing involves risk, including possible loss of principal.

Artorius Wealth is a trading name of Alfred Simmons Investment Management Ltd. Artorius Wealth London and Artorius Wealth Manchester are appointed representatives of Alfred Simmons Investment Management Ltd which is authorised and regulated by the Financial Conduct Authority.

Artorius Wealth Switzerland AG is a provider of wealth management services to the benefit of private individuals. We are an active member of the Swiss Association of Asset Managers ("SAAM") – a Swiss self-regulating organization in matters of anti-money laundering and asset management recognized by the Swiss Financial Market Supervisory Authority ("FINMA"). For clients of Artorius Wealth Switzerland this document is intended for 'Qualified Investors' only and is not intended as an offer or solicitation for the purchase or sale of any financial instrument.

Our Contact Details

ARTORIUS WEALTH LONDON

Gridiron, 6th Floor

One Pancras Square

London, N1C 4AG

+44 (0)20 3039 3040

ARTORIUS WEALTH MANCHESTER

2nd Floor, The Boardwalk,

21 Little Peter Street

Manchester M15 4PS

+44 (0)161 711 0730

ARTORIUS WEALTH ZURICH

Schlüsselgasse 3,

8001 Zurich,

Switzerland

+41 (0) 44 542 8338

FP20161123777 Enddate22112017