ARTORIUS WEALTH

INVESTMENT OUTLOOK

October 2016

MANCHESTER ● LONDON ● ZURICH

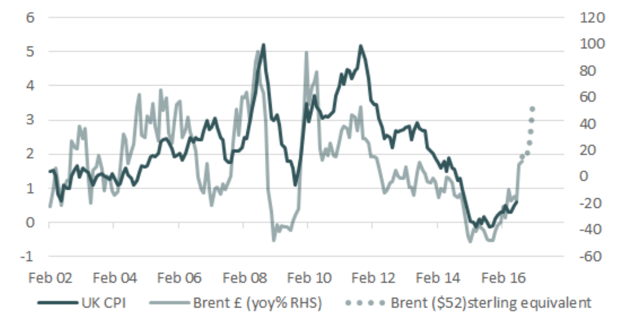
Senior Moments…

Stagflation risk?

Post the referendum, sterling has fallen quicker than its namesake does for Manchester City under an imaginary challenge. Like a striker in the penalty area, seemingly any excuse to take a tumble will do. With recent falls, sterling is close to our long-term fair value, as previously discussed, and the economic impact will shortly be felt via inflation.

In the chart below we have modelled the year on year change of oil prices, in sterling terms, and UK inflation. A key driver of headline inflation over the past 14 years has been the combination of oil prices and the exchange rate of sterling. Our projection for sterling oil prices is based on current levels of both the currency and commodity, and we expect oil inflation to reach c50% in early 2017. The combination of lower sterling and rising oil prices (in US Dollars) means that the benign low inflation backdrop could rapidly change into an environment where headline UK inflation may run close to 3% in 2017.

Lower sterling and higher oil prices are likely to translate into higher inflation

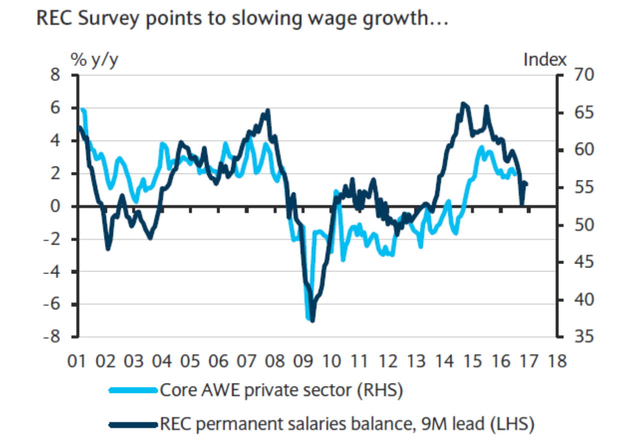


Source: Bloomberg, Artorius Wealth

The resultant inflationary pressure is of the type that UK consumers will find difficult to avoid, as the cost increases are expected to be in imported goods associated with basic living expenses, i.e. food and energy. Recent Bank of England commentary concerning this inflation projection suggest they will look through this inflation blip and not raise interest rates; a stance we support.

The risk for the domestic UK economy comes from the change in inflation on the one hand whilst evidence is emerging that the buoyant wage backdrop of the past few years is also deteriorating. Survey data points to lower wage growth in the UK. If this translates into stagnant wages, as was the case between 2010-14, then the combination of inflation and stagnant wages will mean real wages of UK households falling. Unlike the Bank of England's benign overlooking of inflation, which we agree with, UK households may go back to an environment where every penny counts.

Survey data suggests that the UK wage inflation of the past two years will be replaced by wage stagnation



Source: Barclays, Artorius Wealth

The backdrop enjoyed by the UK consumer facing companies over the past few years is likely to become more challenging if our projections of higher inflation and wage stagnation come to fruition.

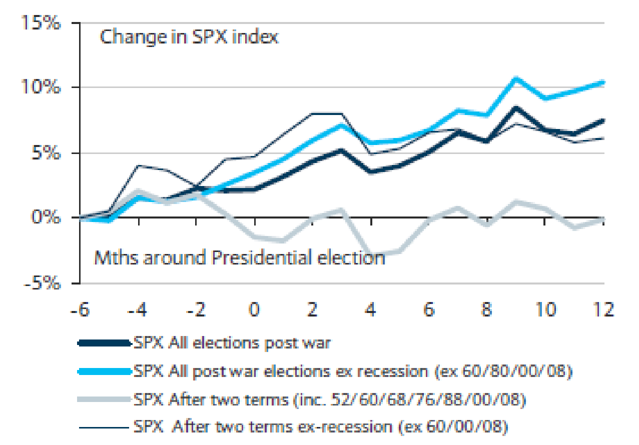
From an investment perspective, this inflationary backdrop is likely to be most keenly felt in the UK equity market by those companies facing the UK consumer. Clients' portfolios have typically less than 10% of their exposure to UK equities as we run a global equity strategy, and we strategically avoid the bias of having too much exposure to our own equity market. In this way we have shielded clients from much of the effect of BREXIT in the equity market.

Post the BREXIT vote in June, we switched our UK equity positions in clients' portfolios to favour the internationally focussed companies having been fans of the domestic orientated companies to that point.

US elections…lots of chatter but does it matter?

It is worth bearing in mind the US equity market typically is impacted more by a change of president if there is a recession, otherwise the historic upward trend is maintained.

If the US economy avoids a recession, then a change in President doesn't appear to impact the equity market



Source: Barclays, Artorius Wealth

Whilst politicians are known for their ability to change their minds, once in office the need for agreement with a Senate and Congress means that policy promises on the stump are possibly less 'durable' than most politicians utterances. The policy outlines have been compared to a 'CEOs' plan vs a 'wonks' view. A CEO often has a simple vision enabling a company to move forward, as opposed to a 'wonks' nerdy appreciation of the complexities of reality and the bringing a variety of solutions to bear.

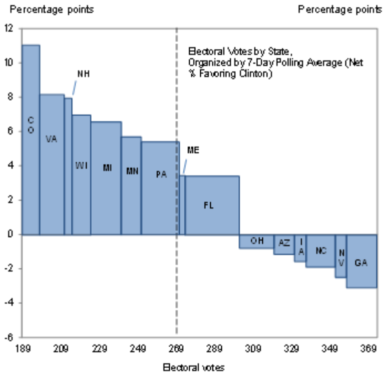
Trump's economic plans include reforming and simplifying individual income tax law by reducing the number of tax brackets from seven to three. According to his proposal, "tax rates will be 12%, 25% or 33%…" while low-income households would pay no income tax at all. To incentivize investment in the United States, Trump recommends renegotiating international trade agreements, such as the North American Free Trade Agreement. Trump's proposals also include regulatory reform.

Clinton's proposed tax code reforms include closing loopholes – such as the carried interest loophole – that allow corporations and very wealthy individuals to pay lower tax rates, and imposing a risk fee on major Wall Street institutions. Clinton further proposes infrastructure spending as a means of growing the economy and reforming college financing.

According to the independent Tax Policy Center, Trump's latest plan would reduce federal revenues by $6.2 trillion over the next decade, with nearly half of the tax cuts going to the highest-income one percent of households. Clinton, by contrast, would boost federal revenue by $1.4 trillion over the next decade, with the bottom 80 percent of households receiving tax cuts and the top one percent paying over 90 percent of the net tax increase. Trump's tax cuts would increase incentives to save, invest, and work, while Clinton's proposals would discourage those activities at the margin. The resultant increase in national debt due to policy is significantly larger under the Trump plans.

The nature of the election is that the outcome is dependent on the make-up of the electoral college. Clinton holds a significant lead when the opinion polls are analysed via the prism of the electoral college. Such a leadership was enjoyed by President Obama in the last election. Whilst the opinion polls detailed a close race, the result ended up as an electoral college landslide. A Trump Presidency isn't one which most commentators have given much credence. Given the nature of the voting public to do the unexpected, as reflected in the BREXIT outcome, dismissing the improbable can be unwise.

Clinton lead in the electoral college appears dominant



Source: Goldman Sachs, Artorius Wealth

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%	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

FP20161017334 Enddate16112016