ForresterHyde

CHARTERED FINANCIAL PLANNERS

Investment Outlook

Q4 2017

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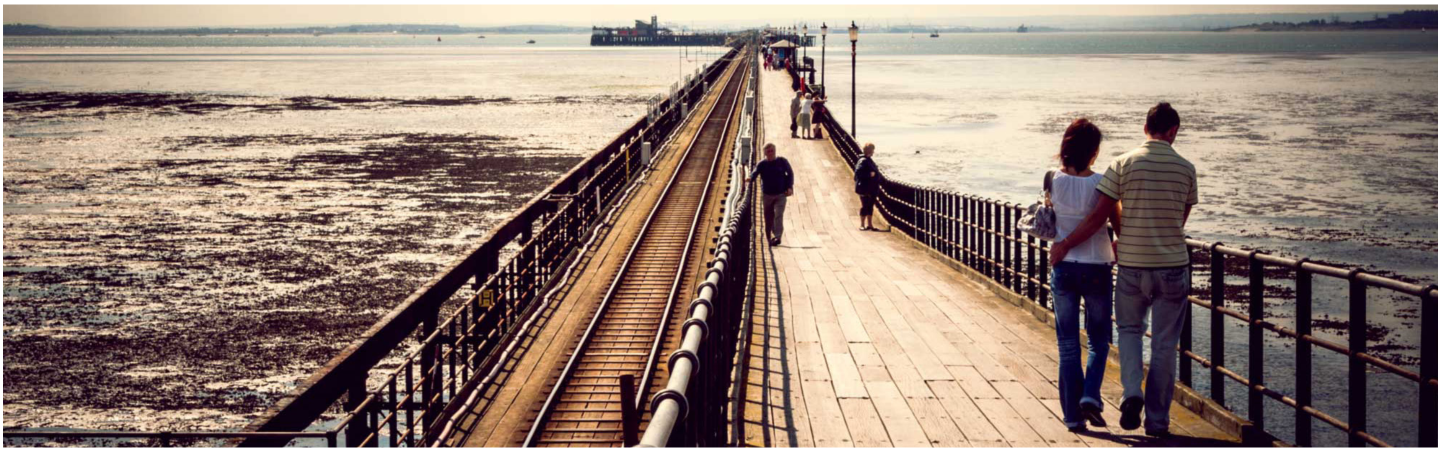


"All markets are born on pessimism, grow on scepticism, mature on optimism and die on europhia"- Sir John Templeton

Introduction

Is the end of the current Bull run nigh? We think not just yet. Corporate earnings are strong, money is cheaply available and interest rates are unlikely to increase significantly in the short term. Excluding the UK, inflation in many developed countries is stubbornly below target and in Emerging Markets it has been falling. Global GDP growth is on the up and Emerging Markets are doing just that – emerging! The IMF forecast global GDP growth will grow by 3.5% this year. Schroder forecast global GDP growth of 3.0%. Nearer to home, the historic forecasts by the Office of Budget Responsibility (OBR) have proved to be too optimistic. Are the OBR now being too pessimistic, slashing productivity growth against a background of sound employment figures with unemployment hovering around 4.3%? According to the Office of National Statistics, UK GDP growth held steady at 0.4% in Q3 2017, whilst at the same time manufacturers reported their highest volume of orders for thirty years; "Lies, damned lies and statistics". – Mark Twain.

Where do the threats come from? Quantitative tightening will slow global credit growth? Demographics, the ratio of workers to consumers has peaked with many labour markets tightening, which ultimately will lead to wage inflation. Corporations are looking to reduce the cost of everything – leading to a structurally deflationary world. Finally, technology to include AI and robotics will ultimately replace a proportion of human workers.

On the other hand, Goldman Sachs forecast the FTSE100 could rise by 7-8% next year. George Soros has been betting on a Stock Market crash since the beginning of this year. So far he has reportedly lost US$1bn.

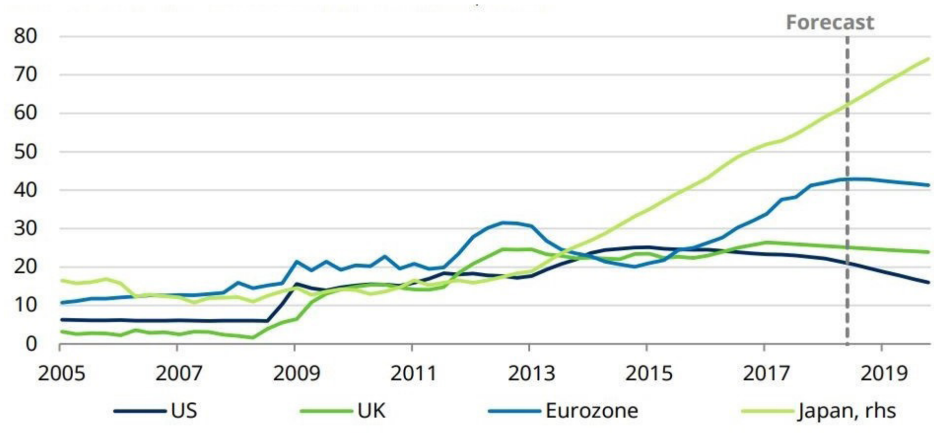
Did you know that as of 7 November 2017 France ran out of money. That is to say, the country had spent all the money raised through taxes and was living on credit. French public spending accounts for 56% of GDP. Spain ran out of money on 11 November, Romania the next day. Week commencing 20 November, Poland was out of Cash and Italy on the 26 November. The UK will be out of money on 6 December, leaving only four EU Countries staying in the black until 31 December. Germany obviously, Cyprus and Malta surprisingly and Sweden. For the EU as a whole the debt to GDP ratio stood at 89%, Italy 137% and Greece 176%. (Source: Institut Molinari.)

To close, the US Federal Reserve announced it would reduce its US$4.5tn Balance Sheet from October, allowing maturing Bonds to run-off rather than continue to roll them over. Initially, US$10bn of Treasuries and Mortgage Backed Securities (MBS), will be allowed to run off each month, rising by an additional US$10bn every three months until ultimately capped at

US$50bn per month. The move to quantitative tightening has begun and although there was some re-pricing at the short end of the curve, US Treasury and MBS yields barely moved in response. Whilst the ECB is on track to taper QE from early 2018, we expect global liquidity will continue to rise, albeit more slowly, over the next twelve to eighteen months largely supported by BofJ.

QE Compared - Value of assets in central banks' balance sheets, % GDP

Thomson Datastream, Schroders Economics Group, 26 September 2017



We now turn to each sector.

Key Points - UK

- The Chancellor announced a raft of measures on 22 November, our Budget report is available on request.
- Consumer confidence is weak on the back of higher consumer price inflation.
- UK dividends grew by 12.7% YoY in Q3 2017.
- We favour corporations with significant overseas earnings.

UK Equity

UK consumer price inflation rose to 2.9% in August and we believe may have peaked at 3% in October, after which it will subside towards the BofE target rate, 2%, as the impact of the pound's fall starts to fade. We were looking for GDP growth this year at or above 2% but the OBR downgraded their forecast to 1.5% 2017, 1.4% 2018, 1.3% 2019-20, rising to 1.5% 2021 and 1.6% 2022. The OBR have adopted a pessimistic stance on the basis of falling productivity whilst at the same time forecasting unemployment will continue to fall. The reduction in unemployment will reduce public borrowing. The official gloom about stalling UK productivity growth is misleading. The method of measurement is subjective, certainly for the productivity of services. According to the OBR, productivity in Education, Healthcare and Social Services has been falling since 1998 at a rate of 4% a year, which we think is an absurdity. The OBR has been wrong over each of the last five years and we do not share their pessimism. However, if the OBR's pessimism proves to be justified the outlook for public finances is far from dreadful. In line with the Chancellor's fiscal rules the structural deficit comes down to below 2% by 2020-21, with some £15bn to spare. If the optimists, including us, prove to be correct, the Chancellor will be in funds ahead of the next election. Paraphrasing Winston Churcill, "Economists have much to be modest about."

The Chancellor announced an increase in the living wage by 4.4% and we expect this to filter through into real wage growth next year. Neil Woodford believes the Chancellor delivered a politically shrewd and economically appropriate Budget, with which we concur.

The Markits Economics Manufacturing PMI Index rose to 56.3 and the Services Index to 55.6, suggesting UK Corporate resilience – any reading above 50 is in positive territory. Nearly every region saw growth accelerating, Wales led the way 58.6, the North-West 57.9, East of England 57.3 and Scotland 52.7.

The ONS indicate money coming in from revenues is growing at 4% more than the money going out through spending at 3%, with borrowing this year around 2% of GDP. Revenue growth is forecast to continue to rise so that by 2020 borrowing will approach zero. When borrowing is this low, debt falls as a percentage of growing GDP. By 2021 regardless of Brexit, debt will have fallen to 75% of GDP, en route to a safe target level of 60%.

Janus Henderson's Dividend Tracker confirmed UK Companies paid out £22.4bn in the third quarter of 2017, up 12.7%. Yearly global dividends are forecast to rise by 7.4% this year to US$1.5tn, with Asia Pacific leading the way up 36.2% to US$69.3bn in Q3 2017. North America contributed US$108.6bn in the same period. All seven UK banks passed the BofE stress test to include RBS, with the Governor of the Bank confirming all had sufficient resource to cope with a hard Brexit should this occur.

Consumer confidence is weak on the back of higher consumer price inflation at a rate above wage inflation. We do expect wage inflation to gain traction in 2018.

With political uncertainty and Brexit negotiations lagging we remain neutral.

Key Points - US

- The Fed announced it will reduce its balance sheet from October 2017.
- Further normalisation of monetary policy could put pressure on profit margins.
- Valuations are stretched.

Key Points - Europe

- Eurozone momentum continues.
- Angela Merkel is elected but fails to form a majority coalition goverment.

US Equity

We are almost one year into Trump's tenure in the White House. Americans must now watch Trump's attempts to reform Obamacare and the US tax system and to renegotiate the North American Free Trade (NAFTA) Agreement. Federal Reserve data shows that US industrial output is 152% higher than it was in 1975, but at the same time the number of workers has fallen by 25% - march of the robots. Next year, Trump faces mid-term elections in 36 States and 3 Territories, plus 33 seats in the Senate, of which 23 are currently held by the Democrats. alongside all 435 Delegates for the House of Representatives to form the 116th United States Congress. Republicans currently control both houses, but their lead in the Senate is small 52-46 and only a party with 60 Senators can safely pass legislation. In the lower house the Republicans advantage is 241-194. The President's approval rating is down in the 30s – watch this space.

The Dow Jones Industrial Index was up 14% in his first year in office. The Treasury Secretary, Steven Mnuchin, is targeting annual GDP growth above 3%. US Equities look expensive in absolute terms, but it is the debt statistics which define the outlook for 2018. The personal savings ratio has fallen to just 3.6%. Auto-loans exceeded US$1tn encouraged by a sub-prime lending spree. Amazon's US$136bn of revenues in 2016 represented only 2.7% of the US$4.8tn US retail sales.

Unemployment is not positively impacting wage growth, the U3 headline rate is 4.2%, but the U6 rate which includes discouraged workers who have been out of work for 12 months or more is still 8.3%.

Jerome Powell is on course to succeed Janet Yellen at the FED. The consensus is for a further rate rise this year and two/three more in 2018, moving to a target rate of 2.00/ 2.25%. The FED have started quantitative tightening. The initial withdrawal rate is $10 bn per month, increasing every three months by an additional US$10bn capped at US$50bn. At this rate it will be 2024 before the FED reduces its balance sheet to pre-QE levels.

To conclude, there is little doubt corporate America is mean and lean. Company earnings as a % of GDP stand at a near record high 9.3% compared to a post-1951 average of 6.4%. Standard & Poor's put aggregate EPS earnings per share, for the S&P's 500 Companies at US$145 for 2018, compared to US$40 in 2008; the high and the low. There is the potential for double digit earnings growth in 2018, particularly if modest tax reforms materialise.

We are Positive and modestly overweight to Benchmark.

European Equity

The warm favourite to win the German Election won with a reduced majority, but Angela Merkel has not been able to form a majority coalition. Her authority at home and in Europe is crumbling and, according to Political Analyst Thorsten Benner, "during twelve years in power she has failed to invest booming tax revenues or introduce key reforms in preparation for the digital economy, Germany has the lowest ratio of high-speed broadband in the OECD, while alienating her European partners with her open door refugee policy and hard line fiscal stance". The country faces a constitutional crisis marking the end of Germany's post war order. Notwithstanding, the German economy is booming and exports have pushed the current account surplus to 8.5% of GDP. There is a view that Germany is the real problem for Britain in Brexit talks since the whole structure of the single market, the Euro and the EU Regulatory Regime, has worked to Germany's advantage.

Eurozone unemployment has fallen to 7.7%, its lowest level since 2009. Overall economic growth continued its robust trend. In the three months to September real GDP growth rose by 0.6%, down from 0.7% in the second quarter. Year on year growth reached 2.5%. France's economy grew by 0.5% in the third quarter, whilst Spain's economy grew by 0.8%. Spanish GDP growth is forecast to slow from 3.1% 2017 to 2.8% 2018.

Markit report the Eurozone Composite Purchasing Managers Index hit 57.5, whilst the Services Index rose to 56.2, compared with a score of 60.8 for Manufacturing output, a 87 month high. Ultimately, this will drive up input prices, which will impact selling prices and inflation. For the moment, however, wage growth and core inflation are subdued.

ECB announced monetary tightening from spring 2018, when the Eurozone still has a large output gap and with core inflation at 1.1%. Draghi concedes the ECB will miss its 2% inflation target in 2018 and 2019. Draghi is under pressure from a German led bloc of Northern States to taper QE. The ECB are limited to a 33% cap of each Bond issue. It has publicly stated that a breach of this rule would amount to illegal monetary financing of deficits. The ECB will soon runout of Bunds to buy since Germany is running a large budget surplus and retiring debt. There would be a political and legal storm in Germany if the ECB tried to change the rule. Macron wants closer financial integration, but Germany won't even agree to common deposit insurance, a pre-requisite for any meaningful banking union.

We remain positive.

Key Points - Japan

- The Japanese economy is expected to benefit from continued looser fiscal policy.
- Shinzo Abe re-elected with an increased majority.

Key Points - EM

- Valuations in Emerging Markets look attractive relative to developed markets.

Key Points - Asia

- In november XI Jinping and Donald Trump signed 15 commercial documents worth $235bn cementing Sino - US ties.

Key Points - Commodities

- London remains the heart of the gloal metals trade. Whilst China is the worlds biggest consumer.

Japanese Equity

Shinzo Abe was re-elected with a two thirds majority. Voters had to brave driving rain and strong winds, brought on by Typhoon Lan, to reach ballot boxes. Corporate profits are up with earnings in Q3 expected to rise 14% year on year. Equities trade on an earnings multiple discount to the S&P 500 of about 20%. However, there is a need for improvement in corporate governance and culture. Kobe Steel has admitted faking quality control data, Nissan admitted using unqualified Safety Inspectors and Takata, which produced faulty exploding airbags, was forced to file for bankruptcy protection.

Cyclical upswings in the global economy generally benefit Japanese Equities, particularly during CAPEX booms when Companies are investing in their operations and expanding production. Japan tends to be the economy most exposed to higher CAPEX with a highly specialised Machine Tool sector.

In a reflationary environment with global yields rising, the BofJ's ability to hold down yields through QE will benefit a CAPEX Equity boom. Widening yield differentials could weaken the Japanese Yen, helping exporters, even if there have been signs recently that profits have decoupled from the currency.

Japan's workforce is shrinking, but the country is reluctant to open its doors to immigrants who in any event would have little or no chance of acquiring citizenship. This is the only leading Stock Market where the P/E ratio remains lower than its average for the century so far. The average Tokyo share is currently priced at 14.3 times corporate earnings compared with its long term average of 15.4.

We remain positive.

Emerging Markets

Russia, India and Brazil have experienced a dramatic decline in inflation. In the last three months, all have hit record lows, Russia 3.3% (August), India 1.5% (June) and Brazil 2.5% (August). The overall trend has prompted inflows to EM debt on the expectation of EM Central Banks easing cycles. To a degree, this has been driven by a strengthening of EM currencies and in the case of Brazil and Russia, by recession. Certainly, weaker GDP growth suppressed inflation. The Indian Government announced a huge recapitalisation plan, US$32bn, to strengthen the balance sheets of the State owned banks with a target of ensuring they can meet more than 70% of their capital requirements. The IMF forecast Indian GDP growth of 7.7%, and have upgraded Emerging Economies growth to 4.8% 2017 and 2018 on the back of lower inflation and interest rate cuts. Population growth, strong demographic trends that should drive private consumption and increased urbanisation are all potential drivers for returns from Emerging Markets.

We remain vigilant but overweight.

Asia ex Japan

The Asia Pacific Region continues to lead the global economy with the IMF projecting growth of 5.5% 2017 and 5.4% 2018. Asian countries have accumulated foreign currency reserves. According to Matthew Vaight, Manager of M&G's Asian and Global Emerging Markets Funds, "low debts, lowly valuations and increasing profits is a combination that is hard to find in Western developed markets". M&G see more value in North Asian markets, Korea and Taiwan and in cyclical sectors such as Financials.

China still represents the biggest opportunity and potentially the biggest threat. The Chinese economy has created new markets and supply chains that benefit the whole region boosting trade and reducing reliance on consumption in the West. Fintech is huge in China. Third party payments grew in value to US$11.4tn last year from US$155bn in 2010. The Chinese have embraced financial technology, some 14bn virtual "Red Packets" – traditional Cash filled red envelopes were exchanged at the Chinese New Year.

China led initiatives such as the Asian Infrastructure Investment Bank and the Regional Comprehensive Economic Partnership, a free trade agreement, are intended to ensure the region is fully autonomous. This is where the money is and, in the event of a crisis, China will no longer turn to the IMF or Washington for help.

We remain neutral.

Commodities

Two prominent inflation drivers are Oil and Agricultural Commodity prices which between them impact over half the basket of goods used to calculate inflation in Emerging Markets. The Goldman Sachs Index for Agricultural Commodities fell by 47% between September 2012 and February 2016. Brent Crude prices dropped from US$100pb in August 2014 to US$50pb in January 2015, bottoming at $30pb a year later. Undoubtedly, this contributed to containing domestic price inflation.

Commodities performed well in Q3 2017 supported by a weaker US Dollar. Brent Crude rose 20.1% overall with the IEA increasing expected global demand to 1.7%. Base Metals and Bulks also performed well as Industrial Metals continued to be underpinned by strong Chinese demand. Nickel was among the best performers benefiting from rising Stainless Steel production. Gold rose on the back of political tension, Trump versus Kim Jong-Un. The Agricultural sector performed less impressively, with Protein prices, Lean Hog supply and Salmon all declining following over supply.

Whilst Brent prices peaked in September, we believe prices will trade in a narrow band. BP's free cash flow driven by production growth, cost cutting and refining exposure will lead to outperformance at current prices.

Our Portfolio exposure to this sector is via the Investec Enhanced Natural Resources Fund, which holds both BP and Rio Tinto, with the latter again generating a strong free cash flow.

We remain positive to benchmark by default.

Property

Key Points - Property

- We are looking to re-enter this sector in Q1 2018.

Builders remain cautious on the Brexit outcome with the amount of new build London office development falling to a three year low. 1.8m sq.ft. of offices across 25 buildings, 21% below average started this year according to Deloitte's latest Crane Survey. However, the intrepid Investment Committee have been interviewing Property Fund Managers with a view to re-entering this sector in Q1 2018. The consensus has been positive nationally, driven by online distribution and warehousing by industrial and, to a lesser extent, by retail. Previously, our Portfolios accessed this sector through the L&G UK Property Feeder Fund. This fund continues to attract money and is now close to being a £3bn behemoth. Property is an illiquid asset and post Brexit Managers are overweight Cash. The L&G Fund retains a 5% bid offer spread, with an ongoing charge of 0.75%.

Whilst this fund remains on our Panel, we are looking for an alternative. Property tends to be weakly correlated to other asset classes. We are seeking a non-London Office Central Fund with sustained high occupancy, a proven Manager and yielding circa 4.5% with potential capital upside. We have a short list which we are reviewing.

We remain neutral to benchmark.

Fixed Interest

In practice while we allocate in this sector over four separate asset classes we group these classes either as Government or Corporate debt – see below:

Category	Asset Class	Fund
Government	UK Gillts	Threadneedle Sterling Bond
	Global Gilts	L&G Global Inflation Linked Bond
Corporate	UK Corporate	BlackRock Corporate Bond
		Kames High Yield Bond
		Rathbone Strategic Bond
	Global Corporate	JPM Global Ex UK Bond
		Newton Global Dynamic Bond

Key Points - Gov Bonds

- Global liquidity will continue to rise but the pace of increase will slow.

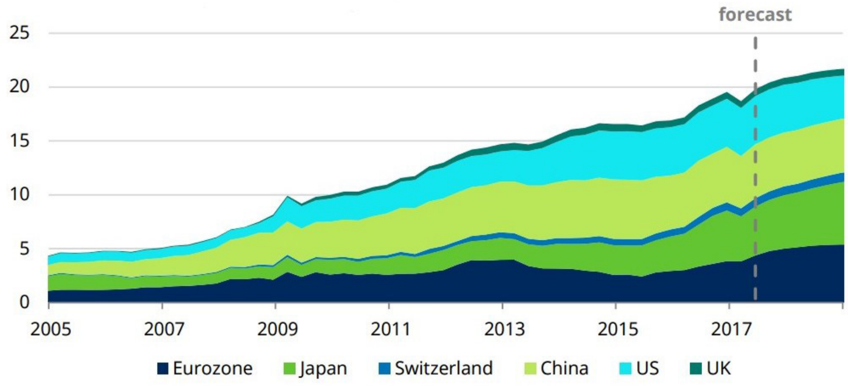
Government Bonds

The Federal Reserve and ECB are moving from Quantitative Easing to Quantitative Tightening. In a world of efficient markets, this will have been anticipated and priced in. The Federal Open Market Committee (FOMC) are forecasting a terminal rate of 2.75%, in 2012 their forecast was for a rate of 4.25%. It is estimated central banks have injected US$1.5tn of liquidity through asset purchases over the past year led by the BofJ and ECB.

The chart below shows the projections for Central Bank balance sheets going forward and indicates global liquidity will continue to rise. The pace of liquidity growth will decelerate, and by the end of 2018 will be half its current rate and will almost grind to a halt in 2019. The ECB's programme has been larger as a share of GDP and Eurozone markets than the FED's. As a result, we have seen a squeeze on Eurozone Sovereign Bonds driving down German Bund yields to near zero, whilst France, Italy and Spain have seen record lows.

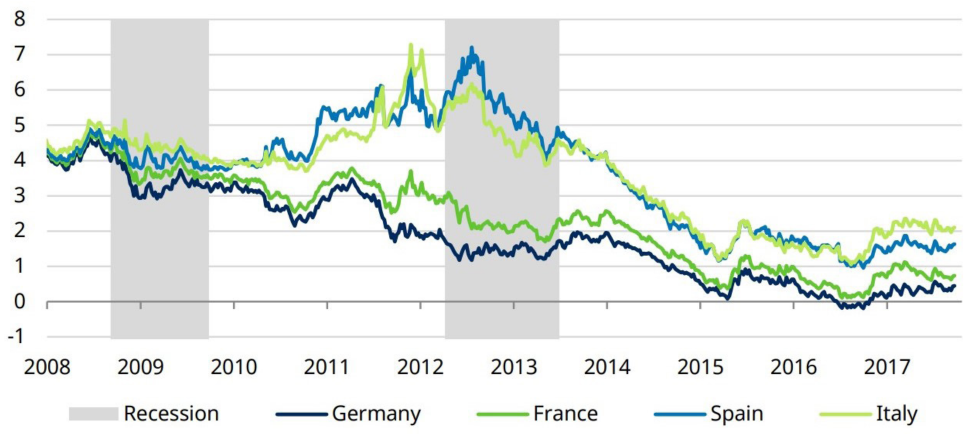
Central Bank Liquidity - Value of assets in central banks' balance sheets. USD tn

Thomson Datastream, Schroders Economics Group,



Eurozone Yields at Lows During ECB QE- 10y sovereign yields, %

Thomson Datastream, Schroders Economics Group, 25 September 2017



The ECB's action has had a significant impact, with private investors switching from Sovereign Bonds. One of the main beneficiaries has been UK Gilts which received £35.2bn of funding in the year to July 2017 through Eurozone Gilt purchase.

Ten year UK Gilt yield started and ended in October at 1.33% peaking at 1.40%. A boost from the Services Sector trigger a quarter percent rate increase and we do not anticipate a further rate increase until late next year. Mark Carney said in his November press conference that he anticipated only two rate rises in the next two years. Research suggests inflation has peaked and will fall back to the 2% target.

We remain negative.

Key Points - Corporate Bond

- Credit spreads remain tight.
- We continue to favour unconstrained funds.

Corporate Bonds

We continue to favour unconstrained and shorter duration Fixed Interest Funds. In Q3 2017 we reduced exposure to Kames High Yield Bond Fund. Credit spreads remained tight through October. Whilst political uncertainty is high and economic growth appears to be slowing (we remain to be convinced) we do not think a recession is round the corner.

We remain neutral.

Key Points - Cash

- The return from cash on deposit will remain below the rate of inflation.

Cash

We said it all at 1 September and refer you back to Q3 Outlook. In summary, we remain negative and underweight benchmark. We do not hold Cash on term deposit, but gain exposure by splitting exposure between the Royal London Cash Plus Fund and the AXA Sterling Credit Short Duration Bond Fund.

We remain negative and underweight benchmark.

Key Points - Conclusion

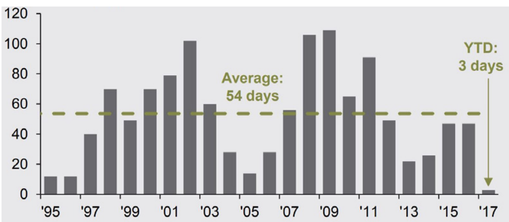
- Going into 2018 we continue to favour Equities over Cash and Fixed Interest securities.

Conclusion

Clearly Brexit negotiations are negatively impacting sentiment. The tone of the forecasting by the OBR and by the OECD has become steadily more doom laden. This must impact the public mood and the concessions that the Politicians negotiating Britain's exit will be prepared to make. It is a matter of historical fact that markets are overdue a correction. It is almost always the case that wage growth correlates with productivity growth and currently wage growth lags inflation. Poor productivity growth is not unique to the UK, it afflicts all advanced economies. Bizarrely Equity volatility in the US and Europe has collapsed to the lowest levels on record. Stock Markets are in the midst of an eerie calm. US Stocks have gone more than 325 trading days – well over a year without a correction of more than 5% - unusual but not unprecedented. See 1960's and in the mid-1990's.

Number of Days when the MSCI World has moved +/- 1%, USD

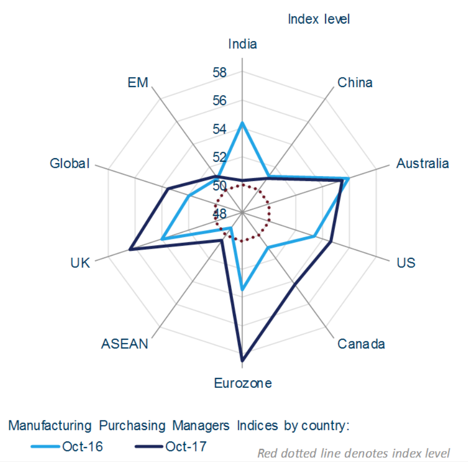
MSCI, Thomson Reuters Datastream, JPM, 30 September 2017



Business surveys show the economic upturn is gaining traction, see below.

Global Growth Improvements

Source: Markit, Haver, October 2017



The spider web shows that year on year to October 2017 purchasing managers gained confidence, with the exception of India. Emerging Markets and China remain in positive territory, above 50, but here confidence is unchanged from October 2016. Analyst consensus forecasts UK and Global Dividend payments will be higher in 2018 than 2017. Royal Dutch Shell signalled the end of the three year Oil downturn by restarting its all cash Shareholder payments and will begin the US$25bn process of buying back the Shares that have been paid in lieu of Cash Dividends to be concluded by 2020.

FTSE-100 Companies generate an average annual dividend yield of 4.4%. Half of the Index's forecast profits come from Banks, Insurers, Miners and Oils, all sectors which will benefit from a more buoyant global economy.

We are not complacent, we have managed risk and volatility in our lower risk Portfolios, whilst striving to attain positive returns across risk spectrums. Credit markets have sensitive antennae, signalling warning alerts. Credit tightening, excess public and private debt, Brexit, Trump and North Korea are all potential threats. Will there be a correction next year? Probably. Will markets make a recovery? History says probably yes and relatively quickly. For Q4 2017 we continue to favour Equities over Cash and Fixed Interest securities.

Performance

Portfolio	3 Month %	12 Month %
Forrester-Hyde Aggressive Model Portfolio	2.91	18.46
Forrester-Hyde Assertive Model Portfolio	2.56	14.77
Forrester-Hyde Balanced Model Portfolio	1.80	10.61
Forrester-Hyde Cautious Model Portfolio	1.02	6.97
Forrester-Hyde Conservative Model Portfolio	0.45	5.11

Portfolio	3 Month %	12 Month %
Forrester-Hyde Passive Plus Assertive Model Portfolio	2.46	14.28
Forrester-Hyde Passive Plus Balanced Model Portfolio	1.79	11.25
Forrester-Hyde Passive Plus Cautious Model Portfolio	1.10	9.04

Asset Class	3 Month %	12 Month %
Euro STOXX 50	0.40	24.37
FTSE 100	0.22	12.32
FTSE Actuaries UK Conventional Gilts All Stocks	-2.18	1.99
IBOXX UK Sterling Corporate All Maturities	-1.45	5.61
MSCI Emerging Markets	-1.35	22.59
MSCI World	2.24	14.13
S&P 500	3.20	12.72

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