BENTLEY REID

INVESTMENT VIEWS

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EQUITIES	The US pauses as Europe and the emerging markets head higher
BONDS	US Treasuries rally from mid-month lows as Gilts defy gravity
CURRENCIES	The Mexican Peso recovers as the US dollar consolidates
COMMODITIES	Gold recovers from mid-month slump as oil fades
NEWS/VIEWS	New UK probate fees & changes to UK inheritance tax on your home

The reflation trade that lifted stocks, bond yields and the US dollar for the last 6 months has paused for breath. The post-election rise in US Treasury yields and commodity prices has flagged, with the trade weighted dollar 3% off its January peak. President Trump's failure to marshal enough votes to repeal Obamacare, his predecessor's legacy-defining healthcare policy, suggests that the business friendly Trump agenda is far from a fait accompli.

Recent US economic data has also softened. Despite a surge in business and consumer confidence and an equally impressive rebound in the purchasing manager surveys (PMIs), hard economic data has failed to ape these forward looking indicators. Indeed the Atlanta Fed's growth model (the 'Nowcast') is currently projecting just 1% annualised GDP growth in the first quarter. If confirmed, the US growth rate has halved since the last quarter of 2016, posing a threat to over-exuberant equity indices.

Healthcare has long been an emotive issue in Washington. Despite a Republican majority in both chambers of Congress, a handful of the President's party rebelled, claiming the reforms did not go far enough in reducing the government's involvement. Conversely, more moderate GOP members were spooked by a report that the new framework would leave 24 million Americans without healthcare coverage. Trump's blue collar support base would be hardest hit.

Paul Ryan, the Republican House Speaker and Trumpcare advocate, seems set on rescheduling a vote for the coming weeks. However the President, with an approval rating of just 36%, has moved on. Just days after blaming legislators from both parties for the mishap, Trump signed an executive order to unwind Obama's climate change plans. His gaze is now fixed on the thornier, but potentially game-changing, subject of tax reform.

Whilst the specific details remain hazy, the Republican Party is united in wanting to simplify the tax code and address uncompetitive corporate tax rates. The mooted cuts to both personal and corporate taxes could be the catalyst that finally spurs real wage growth and businesses investment; the missing bedrock of faster US growth.

However, according to the Committee for a Responsible Federal Budget, Trump's draft tax plan would add at least U$5trn to the national debt over the next 10 years and herein lies the rub. Obamacare cost savings were meant to finance the reforms. Without them, Trump will struggle to fund his tax promises in a budget neutral way. The Tea Party "small government" advocates, an influential Republican caucus, are likely to vote down any measures that increase the deficit; they remain scarred by a decade of Bush-era policies that added U$1.6trn to the national debt.

With ongoing Congressional gridlock likely and the US Government hitting its debt ceiling during March, it is reasonable to assume that the much tweeted Trump tax cuts and infrastructure spending will be more modest and arrive later than originally advertised. Given subdued private sector activity, we question talk of a US growth lift off.

So with economic drift apparent, where does this leave the inflation/deflation debate? A lot depends on how much of the recent rebound in global manufacturing activity (particularly commodity related) is absorbed by increased end demand and consumption.

The evidence so far suggests that there has been a marked re-stocking cycle, borne of improved sentiment and plentiful cheap credit. After bleeding down inventories in 2016, businesses have raised output to replenish stocks; hence the strong upturn in the PMI surveys. However, final consumption has yet to follow suit. This has created a surge in manufactured goods inventories with firms being forced to reduce prices to market-clearing levels.

This squeeze is most obvious in the US auto industry which has reached saturation point. After several years of debt fuelled new car sales, wholesalers are offering record sales incentives to bleed down excess inventories. New car prices are falling at an 8% annualised rate, whilst used car prices have been on the slide for 8 months. The US oil market faces similar challenges, as resurgent domestic production pushes US crude stocks to a record high of 533 million barrels (source: EIA). This should cap the WTI crude price at around U$50-55/barrel; if so, the inflationary impact of rising oil prices will pass in mid-May.

With growth stagnating and price pressures abating, there is a slim chance that the 0.25% March US base rate hike could be a case of "one and done". At the very least, 3 or 4 rate rises this year seems doubtful. Even if inflationary pressures prove to be stickier than expected (a real possibility), we suspect the Fed will remain dovish. It will not risk choking off fragile growth, in an attempt to reign in pricing pressures. As such, we expect the Fed to "remain behind the curve" allowing negative real interest rates to persist as it tries to rekindle private sector animal spirits, regardless of what Trump manages to deliver.

IN OTHER NEWS…

Some "bons mots" shared by a friend.

Thatcher wanted a society of people like her father, but produced a society of people like her son. *Eliza Filby*

A book is your greatest friend and will be there through death, divorce and desperation. A book lies on the pillow next to you without snoring. It's something on which I often reflect from spare room. *Gyles Brandreth*

Twin miracles of mascara, her eyes looked like the corpses of two small crows that had crashed into a chalk cliff. *Clive James describing Barbara Cartland*

At my back I always hear, Time's winged chariot hurrying near
which Andrew Marvell translated as
Better get your arse in gear, before you need a Zimmer, dear

EQUITIES

On Wednesday 29th March, British EU envoy Tim Barrow hand delivered a letter to European Council President Donald Tusk, which notified the council (in accordance with Article 50) of the UK's intention to withdraw from the Union. Prime Minister May's letter suggested some broad principles for the negotiations and used a relatively constructive tone.

The UK government will now bring forward legislation to repeal the European Communities Act 1972 which gives effect to EU law in Britain. This legislation will effectively translate the body of European Union law into UK law. Thereafter, it will be in the UK's power to remove law on a piecemeal basis. The government published a white paper to inform the process.

On the domestic front, the Scottish Parliament backed First Minister Nicola Sturgeon's call for a second Scottish referendum. Mrs May was unreceptive, verging on dismissive. Meanwhile, talks in Northern Ireland over re-establishing the power-sharing executive stalled, leaving Stormont in a state of limbo. Despite the political turmoil, the UK market made progress, buoyed by the soft pound and firmer economic news. The FTSE 100 index rose 0.8%, whilst the mid cap index gained 1.1% and the small cap index added 2.7%.

As noted above, Trump failed with his first attempt at US legislation as his bid to repeal the Affordable Care Act failed before it even reached the floor of the House. As a result, US markets quickly started to unwind some of the 'Trumpflation' trades which have favoured financial and infrastructure companies since the November election.

On infrastructure, the need for Trump's proposed $1trn investment was highlighted by a Civil Engineers Report which graded US infrastructure at D+. This means "the infrastructure is in poor to fair condition and mostly below standard, with many elements approaching the end of their service life. A large portion of the system exhibits significant deterioration. Condition and capacity are of serious concern with strong risk of failure".

Although the broad S&P 500 index was flat during the month, technology shares continued to lead the way. Sentiment was boosted by the IPO of Snap Inc. which rallied 59% in its first two trading days, before ending the month up 33%. The company has a market cap of $26bn and is the biggest IPO since Alibaba in 2014. Five of the top seven most valuable companies in the world are now US based tech firms (source: Bloomberg).

In Europe the Dutch election was somewhat of a damp squib with centre-right Prime Minister Mark Rutte scoring a victory over far right leader Geert Wilders. Turnout was exceptionally high at 82%. Although, this election seemed relatively easy to call, the underlying drift of voters from traditional to more populist parties continued. Euroscepticism remains on the rise. The European spotlight now turns to France where Marine Le Pen is running neck and neck with Emmanuel Macron in the polls for the first round of voting on April 23rd. The top two candidates from the first round will then face each other in a second round on May 7th. Macron is widely tipped to win in the second round, but Le Pen's chances cannot be dismissed. The allegations of impropriety surrounding Francois Fillon's finances will have boosted anti-establishment sentiment amongst voters. As in the UK, a generally positive economic timbre encouraged investors to look through the political noise; the MSCI Europe ex UK index gained 4% last month.

Elsewhere, emerging markets gained 1.8% led by Asia ex Japan which gained 2.4%. The Asia index is now up 10% in the first three months of the year. In India, Prime Minister Narendra Modi gained a ringing endorsement for his recent reform agenda, despite the upheaval of his de-monetisation scheme. His BJP party won 434 of 690 seats in five state elections, including 80% of the 403 seats in populous Uttar Pradesh. This reaffirmed mandate may well encourage Modi to enact further key reforms.

In South Korea, president Park Geun-Hye became their first leader to be impeached after the court removed her immunity from prosecution. The country is also facing escalating tension with China about the arrival of the US-built THAAD defence system. It is designed to shoot down incoming missiles, in the face of increased rocket tests by its northern neighbour. China is concerned that the powerful radar system could be used to spy on its activities. Given the cast of players and the unpredictability of the North Korean premier, tensions on the Korean peninsula bear close attention.

BONDS

The US Federal Reserve raised rates by 0.25% in March, taking the base rate from 0.75% to 1%. The move was widely expected and the Fed stuck to its guidance of two further rate rises this year. The bond market had begun to price in a slightly more aggressive rate path, so yields on 10 year Treasuries retreated to 2.4% from an intra month high of 2.6%. The Fed's forecast for economic growth is 2.1% this year and next, before slowing to 1.9% in 2019. The Fed's preferred measure of inflation, the personal consumer expenditures (PCE) index, rose to 2.1% in February which is marginally ahead of the 2% neutral rate. With inflation base effects from lower oil prices one year ago set to abate in the near future, the Fed seems in no rush to aggressively tighten policy. Indeed, core PCE inflation (which strips out food and energy costs) is running at 1.8%.

UK Gilts continued to defy our bearish views, with the benchmark yield unchanged at 1.1%. This is despite a tick up in UK inflation to 2.3%. Rising fuel prices at the pump were the main cause, while food prices also increased for the first time in 31 months. Core inflation rose 2% and was again surprisingly strong. In a sign that price rises could be stickier than expected the ONS reported factory gate inflation of 3.7%, the largest increase in more than five years. Index linked gilts, our only sterling bond exposure, gained 0.7% last month.

Meanwhile, the ratings agency Moody's warned that Scotland could see its credit status downgraded to junk if it leaves the UK, as falling oil prices pressure public finances. Scotland runs a near 10% annual budget deficit.

The Eurozone continued to see a pick-up in economic lead indicators. The Markit Eurozone manufacturing PMI rose to 56.2 from 55.4 in February, whilst Eurozone unemployment fell to 9.5%, the lowest level since May 2009. The headline number disguises the divergence between member states with low unemployment, like Germany (3.9%), and those with high unemployment like Spain (18.0%) or Greece (23.1%). Inflation, as measured by HICP, was 1.5% in March compared to 2.0% in February. The fall was due, in part, to lower oil prices. The yield on a ten year German Bund rose from 0.2% to 0.3% over the month.

The Reserve Bank of Australia said that "recent data continued to suggest that there had been a build-up of risks associated with the housing market" in the minutes of its March meeting. Further macro prudential measures could be required, after previous measures introduced in 2015 proved less effective than first thought. The May budget could see new affordability measures to help less wealthy home buyers in the hotter markets of Sydney and Melbourne. The central bank rate remained unchanged at 1.5%, with the benchmark 10 year bond yield little changed at 2.7%.

Elsewhere, Fitch downgraded Saudi Arabia from AA- to A+ due to its rising budget deficit, falling oil prices and increased debt. It will be interesting to see how this reality impacts OPEC's production cut strategy.

CURRENCIES

The trade weighted US dollar (DXY) fell by 0.8% this month and is now 1.8% weaker for the year to date. A combination of Trump's failure to enact healthcare reform and a pick-up in Eurozone growth indicators saw the Euro rally against the dollar. The Euro represents over 57% of the DXY basket of currencies. The forthcoming election in France is thus crucial for the near term dollar outlook; any sign of Le Pen momentum will create a safety bid for the greenback.

The US dollar's weakness was broad based last month. Sterling gained 1.4% whilst the euro and yen added 0.7% and 1.2% respectively. The Australian dollar was one of the few major currencies to weaken. In addition to the RBA's comments on the housing market (see above) retail sales were notably weak. They fell 0.1% on the previous month as clothing sales dropped 2.9%; hot weather delayed consumers refreshing their autumn wardrobes.

Emerging market currencies also benefited from US dollar weakness with the Mexican Peso rebounding 7%. Having borne the brunt of the Trump twitter trade tirade, Mexico would be a key beneficiary if the administration waters down its threatened changes to the NAFTA trade agreement. The Indian Rupee was also strong, bolstered by the political success of Modi (as above).

The one emerging market currency slowpoke was the South African Rand, as President Zuma sacked his widely respected finance minister, Pravin Gordhan. The currency dropped over 2%. Mr Zuma and Mr Gordhan have been at logger-heads about fiscal policy, cronyism and the influence of the Guptas, a prominent business family connected to Mr Zuma. Ratings agency S&P was quick to downgrade the country's debt to junk status.

GOLD/COMMODITIES

US WTI oil fell through $50 per barrel for the first time this year before recovering by month end. Although reports suggest that OPEC members are 90% compliant with the agreed output cuts, question marks remain about how long they can maintain this discipline in the face of increased American production. The Baker Hughes US rig count has doubled since its low in May 2016, with US inventories continuing to build. The OPEC cartel's current agreement runs until May. In other oil news, the IPO of a small part of Saudi state owned oil leviathan, Aramco, is moving forward. The company is rumoured to be valued at about $2.5trn. To set that in context, Apple, the world largest quoted company, is worth $760bn and accounts for 3.7% of the S&P500.

In metal markets gold, having fallen by 4% during the first half of the month, recovered its shine after the publication of the relatively dovish Fed minutes. It closed unchanged at $1,249/oz. We continue to believe that bullion offers excellent protection from geopolitical risk and further monetary debasement. It is also pleasing to note that much of last year's speculative long interest in the gold futures market has been washed out, setting the metal on a firmer footing to head higher from here.

In the coal markets, President Trump signed an executive order on March 28th to roll back Obama's climate change regulations, notably the Clean Power Plan. The move will delay some coal plant closures in the short term, but it is unlikely to precipitate a coal employment renaissance. The industry is facing increased competitive pressure from lower natural gas prices and renewable energy sources. Furthermore, although coal output may rise, automation will limit new jobs. Since 1980 coal employment has shrunk 60% despite an 8% production increase (source: NY Times). Companies like Caterpillar are already selling self-driving trucks to Australian mines.

Agricultural commodity prices remained weak, as per the trend of the past four years. The latest planting report suggests US farmers plan to sow soybeans across an area the size of Germany this year. This follows a harvest in Brazil that is set to exceed 100m tonnes for the first time. Even as farmers add acreage, inventories remain well stocked following several bumper years. Soybeans prices fell 9% in March.

NEWS & VIEWS

New UK probate fees

From May 2017 new probate fees will apply in relation to UK estates. The existing flat rate administration fees of £215 will disappear to be replaced by a tiered system based on the value of the estate.

Value of estate	Proposed fee
Up to £50,000	£0
>£50,000 to £300,000	£300
>£300,000 to £500,000	£1,000
>£500,000 to £1M	£4,000
>£1M to £1.6M	£8,000
>£1.6M to £2M	£12,000
>£2M	£20,000

This is quite a significant change from the current arrangement. Essentially higher value estates will subsidise lower value estates. The higher tiered rates are akin to additional Inheritance Tax, reflecting the ongoing battle to balance the Nation's books.

Uplift of the Nil Rate Band (NRB) on death

Readers will probably be aware from recent press reports that the individual nil rate band of £325,000 (the amount of a deceased persons estate that is exempt from inheritance tax) is going to be increased in circumstances where the deceased person's main residence is passed down to direct descendants.

The key issue to take away is that Wills may well need revision to take advantage of the additional inheritance tax exemption if the main home (or proceeds from the sale of the main home) is not currently left to children or grandchildren. If Wills do not reflect passing down of the main home (or sale proceeds thereof) then the uplift may be lost.

The additional relief on death is £100,000 per person from 6 April 2017, rising to £175,000 from 6 April 2020. In effect this will raise the exemption from inheritance tax for married couples to £1m from April 2020. In other words, two £325,000 original nil bands plus two £175,000 new residence nil bands. The bands can be passed on and transferred between spouses and civil partners on death to the extent they were unused on first death.

One downside to the new rules is that, for estates worth more than £2m, there will be little or no benefit. The new residence band is reduced by £1 for every £2 that the deceased's net estate exceeds £2m. So for an individual the extra benefit is lost when his/her net estate exceeds £2.35 million (or £2.7 million for a surviving spouse).

If you have any questions relating to these new rules or would like to review related matters, please contact your usual Executive at Bentley Reid or Stuart Hambling, in the London office, on 0207 227 8436.

POLICY SUMMARY MATRIX

The matrix set out below is a summary of our current policy stance on the various equity and bond markets which we monitor. It is not intended as anything other than a guide on where we stand and we will change the content as our views alter. Cash exposure is a residual and will tend to be high when negatives outweigh positives and vice versa.

6-12 MONTH VIEW	OVERALL	EQUITIES	BONDS	ALTERNATIVES
+	ALTERNATIVES	Asia Latin America	Inflation Linked	Uncorrelated Strategies, Gold
○		UK, European Australian High Yield Technology Healthcare Resources	Australian	
−	EQUITIES BONDS	US, Japanese	US, UK European Japanese Corporate High Yield	

MARKET PERFORMANCE

All performance numbers show % changes except for bond yields which show yield changes.

	31-MAR-17	1 MTH	3 MTH	12 MTH
CURRENCIES (VS USD)				
GBP	1.2550	+1.4%	+1.7%	-12.6%
CHF	0.9971	+0.3%	+1.6%	-4.1%
AUD	0.7629	-0.4%	+5.8%	-0.4%
JPY	111.39	+1.2%	+5.0%	+1.1%
EUR	1.0652	+0.7%	+1.3%	-6.4%
BOND YIELDS (10 yr)				
UK	1.14	-0.01	-0.10	-0.28
US	2.39	+0.00	-0.06	+0.62
Germany	0.33	+0.12	+0.12	+0.17
Australia	2.70	-0.02	-0.06	+0.21
Japan	0.07	+0.02	+0.02	+0.10
EQUITIES				
US. S&P 500 (USD)	2,362.72	+0.0%	+5.5%	+14.7%
UK. FTSE 100 (GBP)	7,322.92	+0.8%	+2.5%	+18.6%
MSCI Europe ex UK (EUR)	1,287.80	+4.0%	+6.4%	+14.6%
Japan. Topix (JPY)	1,512.60	-1.5%	-0.4%	+12.3%
China. Shanghai Comp (RMB)	3,222.51	-0.6%	+3.8%	+7.3%
HK. Hang Seng (HKD)	24,111.59	+1.6%	+9.6%	+16.1%
Australia. All Ords (AUD)	5,903.84	+2.5%	+3.2%	+14.6%
MSCI Pacific ex Japan (USD)	1,298.44	+2.1%	+10.7%	+13.8%
MSCI World (USD)	1,853.69	+0.8%	+5.9%	+12.5%
MSCI World (GBP)	1,477.99	-0.2%	+4.2%	+29.1%
COMMODITIES				
Oil (WTI)	50.60	-7.0%	-9.7%	+14.1%
Gold	1,249.35	+0.1%	+8.4%	+1.3%

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