Market Commentary

April 2017

CAPITAL TOWER

The Right Advice At The Right Time

Capital Tower Ltd, 85 Yarmouth Road, Norwich, Norfolk, NR7 0HF

When I was young, it seemed that life was so wonderful
A miracle, oh it was beautiful, magical
And all the birds in the trees, well they'd be singing so happily
Joyfully, playfully watching me
But then they sent me away to teach me how to be sensible
Logical, responsible, practical
And they showed me a world where I could be so dependable
Clinical, intellectual, cynical

There are times when all the world's asleep
The questions run too deep
For such a simple man
Won't you please, please tell me what we've learned
I know it sounds absurd
But please tell me who I am

Now watch what you say or they'll be calling you a radical
Liberal, fanatical, criminal
Won't you sign up your name, we'd like to feel you're
Acceptable, respectable, presentable, a vegetable!

At night, when all the world's asleep
The questions run so deep
For such a simple man
Won't you please, please tell me what we've learned
I know it sounds absurd
But please tell me who I am

Supertramp – 'Logical Song'

"Contrariwise, if it was so, it might be; and if it were so, it would be; but as it isn't, it ain't. That's logic."

Lewis Carroll

March saw the completely illogical Ides of March, which didn't signify anything special in itself – this was just the usual way of saying "15 March". The notion of the Ides being a dangerous date was purely an invention of Shakespeare; each month has an Ides (often the 15th), and this date wasn't significant nor associated with death prior to 1601. However, the preceding day, the 14th, saw the annual Pi Day – an annual celebration of the mathematical constant π (pi). Pi Day is observed on 14 March (3/14 in the US month/day date format) since 3, 1, and 4 are the first three significant digits of π. Pi Approximation Day is observed on 22 July (22/7 in the day/month date format), since the fraction 22⁄7 is a common approximation of π, which is accurate to two decimal places and dates from Archimedes. Just a week before Pi Day, we had already had the first of two budgets this year – but the last of one of them(!).

The details of that budget initially seemed radical, with a proposed increase in National Insurance contributions for the self-employed, and a reduction in the previous budget's tax-free dividend allowance from £5,000 to £2,000. There was also the usual increase in some personal allowances and the confirmed launch of the new Lifetime ISA (LISA). Further a new National Savings product offering 2.2% interest on investments up to £3,000.00.

However, the fall-out from the negative reaction has still to be felt, with a U-turn on the National Insurance increase that will now likely impact on pensions tax relief.

Artemis tell us that thanks to compounding tax changes, the UK tax code at 10 million words and 21,000 pages is the longest in the world. 17 times the length of *War and Peace*. 12 times longer than the complete works of Shakespeare (Alas Poor Taxpayer). 66 times the length of Hong Kong's tax code. All quite logical really…

Summary of key changes

Personal allowance

The tax-free personal allowance is being increased to £11,500 in 2017/18. For higher rate taxpayers, the threshold above which higher earners start paying 40% tax is being increased to £45,000 in 2017/18.

Dividend allowance

From the 2018/19 tax year, the amount of dividend income that is charged at the nil rate will be reduced to £2,000.

Trading and property income allowances

The Government will legislate in the Finance Bill to create two new income tax allowances of £1,000 each for trading and property income. The allowances can be deducted from income instead of actual expenses.

The Money Purchase Annual Allowance (MPAA)

Regulations were introduced from 6 April 2015 to restrict money purchase pension contributions to £10,000 per annum for individuals who have flexibly accessed pension benefits. The Government consulted on reducing the MPAA to £4,000 per annum and has confirmed that this change will be made with effect from 6 April 2017.

QROPS

Transfers to QROPS requested on or after 9 March 2017 will be taxed at a rate of 25% unless at least one of the following applies:

- Both the individual and the QROPS are in the same country after the transfer.
- The QROPS is in one country in the EEA, and the individual is resident in another EEA country after the transfer.
- The QROPS is an occupational pension scheme sponsored by the individual's employer.
- The QROPS is an overseas public service pension

"If Winter comes, can Spring be far behind?"

Percy Bysshe Shelley

scheme, and the individual is employed by one of the employers participating in the scheme.

- The QROPS is a pension scheme established by an international organisation to provide benefits in respect of past service, and the individual is employed by that international organisation.

Tax avoidance

The Finance Act 2015 introduced changes to legislation to ensure that promoters of such schemes could not use associated or other new entities to sidestep the intention of the POTAS legislation.

The Government will legislate in the Finance Bill 2017 to strengthen the regime for disclosure of indirect tax avoidance. Scheme promoters will primarily be responsible for disclosing schemes to HMRC in respect of indirect taxes.

The Government will legislate in the Finance Bill 2017 to apply a new 'requirement to correct' for those who have failed to declare UK tax on offshore interests. Tougher sanctions will be applied for those who fail to do this before 1 October 2018.

March also saw the start of spring, and global markets seem to have shrugged off the winter, showing promise of real shoots of recovery. There are still plenty of reasons to fret: China's debt mountain; the flaws in the foundations of the euro; Donald Trump's protectionist tendencies, and so on. But for six months or so there has been growing evidence of increased activity. It has been clearest in the export-oriented economies of Asia. But it is visible in Europe, in America and even, just, in hard-hit emerging markets like Russia and Brazil. The signals are strongest from the more cyclical parts of the global economy, notably manufacturing. Surveys of purchasing managers in America, the eurozone and Asia show factories getting a lot busier (see chart 1). Global trading hubs such as Taiwan and South Korea are bustling. Taiwan's National Development Council publishes a composite indicator that tracks the economy's strength: blue is sluggish, green is stable and red is overheating. The overall economy has been flashing green lights for seven months and is pushing up further.

> "The ladder of success is best climbed by stepping on the rungs of opportunity."
> *Ayn Rand*

This reflects, among other things, demand for semiconductors around the world; this February, exports from Taiwan were up by 28% compared with 2016. Although that is the most striking example, exports are up elsewhere in the region too. South Korea's rose by 20% in February compared with a year earlier. In yuan terms, China's were 11% higher in the first two months of 2017 than in 2016.

This is in part a reflection of how bad things looked 12 months ago; suppliers who overdid the gloom in early 2016 are restocking. Asia's taut supply chains also owe something to the two-to-three-year life-cycle of consumer gadgetry.

But the signs of life run deeper than just those specifics would allow. Business spending on machinery and equipment is picking up. A proxy measure based on shipments of capital goods constructed by economists at JPMorgan Chase (a bank) suggests that worldwide equipment spending grew at an annualised rate of 5.25% in the last quarter of 2016.

The good news goes beyond manufacturing too. American employers, excluding farms, added 235,000 workers to their payroll in February, well above the recent average.

The European Commission's economic-sentiment index, based on surveys of service industries, manufacturers, builders and consumers, is as high as it has been since 2011. After a strong fourth quarter, the Bank of Japan revised up its forecast for growth in the current fiscal year from 1% to 1.4%. UK

"Anyone who is capable of getting themselves made President should on no account be allowed to do the job."
Douglas Adams

unemployment statistics are at 40-year lows.

In America, imports of both consumer goods and capital goods are up. There has been speculation that the "animal spirits" of business folk have been lifted by Mr Trump's election in November, and that cuts in tax and regulations and a subsequent return of the estimated $1trn of untaxed cash held abroad by companies based in America will fuel a big boom in business investment. The initial and most painful stage of economic adjustment in emerging markets is coming to an end. Current-account deficits have narrowed, leaving most countries less reliant on foreign borrowing. Their currencies are a lot more competitive. And interest rates are high, so there is scope to relax monetary policy to boost demand (see chart 4). Business spending is already rising in response.

A chart on Bloomberg provides insight into those economies expected to see the best growth in 2017.

Where's the party?
The current economic expansion began in a dark place. Western economies had been to the brink of financial collapse. Falling house prices, banking failures and an evaporation in faith in the political consensus underpinning democratic capitalism inevitably led to a deep recession. The consequences of the crisis were far reaching and the after-shocks were plentiful – serial crises in Europe, a backlash of financial regulation, and shifts in the political landscape that weakened the centrist consensus and delivered Brexit, Donald Trump and rising populism.

The crisis and subsequent recession were so severe and existentialist that they have continued to be the major influence on investor, consumer and political sentiment, even today. This is why the current expansion has never delivered any kind of feel-good factor, why downside risks have continued to be emphasised over potential returns, and why central banks have felt it necessary to

continue to provide extraordinary levels of monetary accommodation. Ten years ago, at the end of Q1 2007, the US Fed's key policy interest rate – the Fed Funds Rate – stood at 5.25%. We are now around 7.5 years into an economic expansion, and that rate is just 1.0% – even after three increases. The shock of 2008 was so huge that it continues to affect us today. No one wants to ever experience that again, so everything is pretty risk averse – and we share nightmares about that dark place triggered by "risks" like a Chinese hard landing, a collapse of the euro, a trade war, or worse.

It has been difficult to enjoy the economic expansion. It might well have been a relatively long one by historical standards, but it's been no party because anything worth worrying about always has that warning attached to it which says "what if?" Despite solid growth, an improved policy safety net and solid employment gains, many voters appear to express their desire for a different world and have little faith in the approach of "fixing" the system that delivered the crisis in the first place. Thus globalisation is rejected in favour of nativism. The decisions taken by corporations about where to locate new investment are being driven as much by politics as by profit maximisation. Central banks are criticised for printing money and keeping interest rates too low at the same time as governments are being urged to spend, spend, spend. Orthodoxy, preached by "experts", falls on deaf ears.

Yet, the expansion continues. Growth is now strong, and for once there seems to be more synchronisation in growth between the leading economic nations. Millions of jobs have been created in recent years. Even in the euro area, the unemployment rate has come down steadily since it peaked at 12.1% in 2013. Wealth has been created. The S&P500 equity index is up more than 250% in price terms since the satanically low level of 666 reached in March 2009. Bond markets have delivered very strong wealth growth and housing has recovered. Even the Fed is confident enough about the economy to be able to discuss the prospect of two more increases in the Fed Funds Rate this year and three to four hikes next year.

So even though it hasn't felt like it, this expansion has been long and strong. Investment strategies that have tilted towards owning risky assets have paid off, especially over the last year. Not for everyone, of course. So far this year, the more equity-like parts of the fixed income market have delivered the strongest returns. High yield total returns are in the 1.5%–2.0% range, and emerging market sovereign debt returns are close to 3.0%. US equity indices have delivered 6% price returns, while European bourses have also seen index levels rise by over 4% in aggregate. It would appear that it is only relatively recently that more and more investors have become participants in the rally.

Does the Stock Market Care Who the President Is?
One of our most favoured American commentators, Ben Carlson, tries to answer this.

"Plenty has been said by pundits, economists, portfolio managers, strategists and the financial media about what President Donald Trump's economic plans, cabinet selections, trade talk, fiscal policy and other ideas will mean for the markets. Some see the Trump rally since early November as a sign that investors believe his policies will be market-friendly for the next four years. Others see the surge — part of the eight-year long bull market — as little more than a sugar high and predict Trump is likely to crash the markets through policy mistakes or a poorly worded tweet.

"Yet it would be pure speculation at this point to forecast whether Trump will cause a boom or a bust in the stock market. Either is always a possibility, but in the stock market, risk is typically much easier to predict than returns. Returns are promised to no one, but risk is ever-present.

"One of the funny things about the stock market is that every time one person buys, another sells, and both think they are astute."
William Feather

> "We cannot solve our problems with the same thinking we used when we created them."
> *Albert Einstein*

"And risk does not discriminate based on who the president happens to be. I took a look back at every president since Herbert Hoover to see how bad stock market losses have been for each four-year term in office. The following table shows the worst drawdown on the S&P 500 for each term going back to the late 1920s:

President	Inaguration Date	End of Term	Worst Stock Market Drawdown
Herbert Hoover	Mar. 4, 1929	Mar. 3, 1933	-86.19%
Franklin Roosevelt*	Mar. 4, 1933	Jan. 19, 1937	-33.93%
	Jan. 20, 1937	Jan. 19, 1941	-54.47%
	Jan. 20, 1941	Apr. 11, 1945	-28.79%
Harry Truman	Apr. 12, 1945	Jan. 19, 1949	-28.47%
	Jan. 20, 1949	Jan. 19, 1953	-14.02%
Dwight Eisenhower	Jan. 20, 1953	Jan. 20, 1957	-14.43%
	Jan. 21, 1957	Jan. 19, 1961	-20.66%
John F. Kennedy	Jan. 20, 1961	Jan. 19, 1965	-27.97%
Lyndon Johnson	Jan. 20, 1965	Jan. 19, 1969	-22.18%
Richard Nixon	Jan. 20, 1969	Jan. 19, 1973	-34.73%
	Jan. 20, 1973	Jan. 19, 1977	-47.32%
Jimmy Carter	Jan. 20, 1977	Jan. 19, 1981	-17.07%
Ronald Reagan	Jan. 20, 1981	Jan. 20, 1985	-25.30%
	Jan. 21, 1985	Jan. 19, 1989	-33.51%
George Bush	Jan. 20, 1989	Jan. 19, 1993	-19.92%
Bill Clinton	Jan. 20, 1993	Jan. 19, 1997	-8.94%
	Jan. 20, 1997	Jan. 19, 2001	-19.34%
George W. Bush	Jan. 20, 2001	Jan. 19, 2005	-43.46%
	Jan. 20, 2005	Jan. 19, 2009	-51.93%
Barack Obama	Jan. 20, 2009	Jan. 19, 2013	-22.60%
	Jan. 21, 2013	Jan. 19, 2017	-14.16%
Donald Trump	Jan. 20, 2017	???	???

*Lyndon Johnson sworn in Nov. 22, 1963
**Gerald Ford sworn in Aug. 9, 1974

"Every president saw severe corrections or bear markets on their watch. The average loss over all four-year terms was 30 percent. The average loss under a Republican administration was 37 percent, while the average loss under the Democrats was 24 percent. But these differences don't really tell you much about the two parties. The stock market does not care about Republicans or Democrats. Presidents have far less control over the markets than most people would have you believe. There are no magical levers they can pull to force stocks to rise or fall. Policy decisions often affect the economy with a lag. And the economy and stock market are rarely operating in sync.

"In addition, it really depends on where we are in the cycle when presidents come into office. The metrics are almost always different, depending on the starting date in office, for interest rates, market valuations, inflation, unemployment, demographics, economic growth and the length of the current expansion or contraction in the economy. Also, the president has no control over monetary policy. The Federal Reserve likely has more to do with economic success or failure than the president."

SUMMARY

So it was Brangelina in 2016. This year's biggest divorce story is of course…Brexit. UK Prime Minister Theresa May has formally triggered legal proceedings to cut ties with the European Union, which sets off two years of contentious talks as negotiators sort out the nitty-gritty details of a break-up that will impact the lives of half a billion people.

While markets have had a little wobble towards the end of March, it would be surprising if this turned into a significant correction.

There are plenty of things that could change that, of course. The problem is that they are 'known unknowns'. The French election, the timing and implementation of the Trump legislative agenda (any 'actions' instigated by the FBI may also need to be monitored), and how China deals with the consequences of a slower medium-term growth path all generate a degree of uncertainty. But they have for a while, and, unless the uncertainties crystalise into "known" outcomes, their impact on market sentiment is rather diminished.

As such, it is likely that volatility will remain relatively low going into the Easter break and until the serious run-in to the first round of the French Presidential Election.

You can track the impact on the UK with Bloomberg's very useful Brexit barometer and daily Brexit Bulletin newsletter.

Meanwhile…
We remain…cautiously optimistic.

Capital Tower Ltd, 85 Yarmouth Road, Norwich, Norfolk, NR7 0HF
Capital Tower Ltd Registered in England and Wales No. 03411161
Authorised and regulated by the Financial Conduct Authority