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update

Knightsbridge Wealth

Dear Friends and Colleagues,

Something quite strange happened on September 30th. The Central Bank in Athens issued a statement to reassure investors that the Greek banking system was safe – from the crisis engulfing Germany's flagship bank.

What a pleasure it must have been for Greece to have a swipe at Germany's lax management of its banking system!

Whatever EU rules say, the German government will surely support Deutche Bank if it needs to, and it is unlikely to go under. But plenty would deny that. Deutche is more leveraged than its peers and it owns an enormous number of derivatives that may turn out to be worthless. Its share price has fallen 42% this year before news broke of a $14bn fine for mortgage related mis-selling in the US.

Germany appears to suggest that the fine is revenge for the recent Europe tax case against Apple. To cap it all, the boss of Credit Suisse recently said that the banking centre is 'not really investible.'

The timing for a banking crisis in Europe is far from ideal, as the continent faces up to Great Britain starting its negotiations to exit the European Union, whilst a number of difficult European elections loom on the horizon.

If you ever needed a reminder that the paths of politics and finance are more inextricably linked than ever before, look no further than the recent Conservative Party conference. The revelation that Article 50 (triggering the two year process to leave the EU) would come before March 2017, and that Brexit is likely to be more of the hard, rather than soft variety, led to a surging stock-market and a continued fall in Sterling, which is now 15% below pre-referendum levels.

Sterling's weakness is not all bad news. It has spurred the UK's manufacturing sector into action, with the Purchasing Manager's Index hitting its highest since June 2014.

Meanwhile, in the US, the Presidential election campaign goes on. At a time when Americans are sick of politicians, Mrs Clinton is the most famous of them. Mr Trump still manages to be thought of as someone who is outside the political class. Perhaps wary of cynicism, many undecided voters look at Trump and Clinton and think there is nothing to choose between them. That is, of course, not the case.

In fact, it is hard to think of two major party candidates who have even been so far apart. For once, it is not an exaggeration to say that this election is not just about who should be President, but want sort of country America should be.

In these challenging times, it has never been more important for international clients to work with a firm that specialises only in meeting their needs. Our strategic partnership with UBS (Union Bank of Switzerland) gives the best of both worlds – personal service and the ability to react in a way that only a small firm can, partnered by one of the world's most prestigious brands.

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Market Report

Equities

Emerging Markets look attractive

Most developed-world stock markets continued to recover from their Brexit induced swoon. Both Britain's FTSE 100 index and America's S&P 500 climbed to record highs. Japan's market trod water, weighed down by concern over the strong yen's impact on heavyweight exporters' earnings.

But despite the market's lacklustre recent performance, it still looks attractive. Abenomics has unleashed a corporate governance revolution, with higher dividends now the standard: earlier this year, the yield on the Topix index eclipsed that on the S&P 500. The prospect of further central-bank action is another reason to like Japan – and continental Europe, where there is also more scope for profits to rise than in the overpriced US market.

The MSCI Emerging Markets index has jumped by almost 30% from its January low, and is at a 13-month high. Emerging markets appear to be over the worst after a torrid few years. Growth is ticking up, helped by a gradual rebound in commodity prices and the Chinese economy. Valuations also look attractive. The most appealing emerging markets are ones with large domestic economies where government policy is moving in a promarket direction, as in India and Vietnam.

Bonds

Prices are sky high

The value of government bonds with a negative yield (ie offering no return) rose above $13trn recently. This universe consists largely of European and Japanese paper: the two economies' quantitative easing (QE) programmes have hoovered up vast amounts of debt and driven prices sky-high (yields move in the opposite direction to prices).

German debt's yield is negative up to a maturity of ten years; in Switzerland's case, the 50-year yield has gone negative. Bonds are hideously overpriced and, thus, acutely vulnerable to a return of inflation. Consider only top-quality, credits with positive yields.

Gold

The ultimate safe haven

The yellow metal dipped in the summer, but remains close to two-year highs. It now looks as though the US Federal Reserve could raise interest rates again sooner than expected, as recent data has been strong. Because gold has no yield, higher rates lessen its relative appeal. However, rates are unlikely to rise anywhere else for sometime. With jitters over Chinese growth, or the Eurozone's viability, prone to flare up again at some stage, the ultimate safe haven and store of value is worth holding, as a form of portfolio insurance.

Cash

Rates remain at emergency levels

Early this year, savers were looking forward to the Bank of England's first interest-rate rise in almost a decade. Instead, they got Brexit and the first cut in seven years. As a result, savings accounts trimmed their rates too, and the average easy-access account offered just 0.5% last week, compared with 0.66% a year ago.

Commercial property

Deals falling sharply

There were mixed signals in the UK commercial property market in July. The leasing of central London offices was more resilient than expected, up 25% month-on-month, and lending to commercial property companies rose by £123m, according to Capital Economics.

However, the total value of commercial property deals fell, with July's reading down by 42% from its mid-2015 peak.

Currencies

Sterling volatile

The Euro should fall ahead of the expected US rate rise in December. In the second half of next year, the European Central Bank will discuss tapering its current QE easing programme, providing a boost to its currency. Despite severe falls in Sterling, Brexit has not even started and the medium term outlook is volatile.

Feature: Brexit

The new UK Prime Minister, Theresa May, has said that the UK will formally trigger Article 50 by the end of March 2017, implying a formal departure from the EU exactly two years later. To pave the way, parliament is to pass a Great Repeal Act that "marks the first stage in the UK becoming a sovereign... country once again" – it would annul the European Communities Act of 1972, which gave EU law supremacy over ours. What's more, we have an "unequivocal undertaking that any deal with the EU would give us complete control of our borders". In short, "there is no going back now, Britain is going to be an independent country".

While MPs now accept the principle of Brexit, and the government will in any case avoid asking the legislature's permission to trigger Article 50, they might be less inclined to agree to a type of Brexit that looks like a bad deal for Britain.

The Government also focused on sending Brussels a message that it has back-up plans if negotiations break down; a fairly standard negotiating technique used in business and diplomacy.

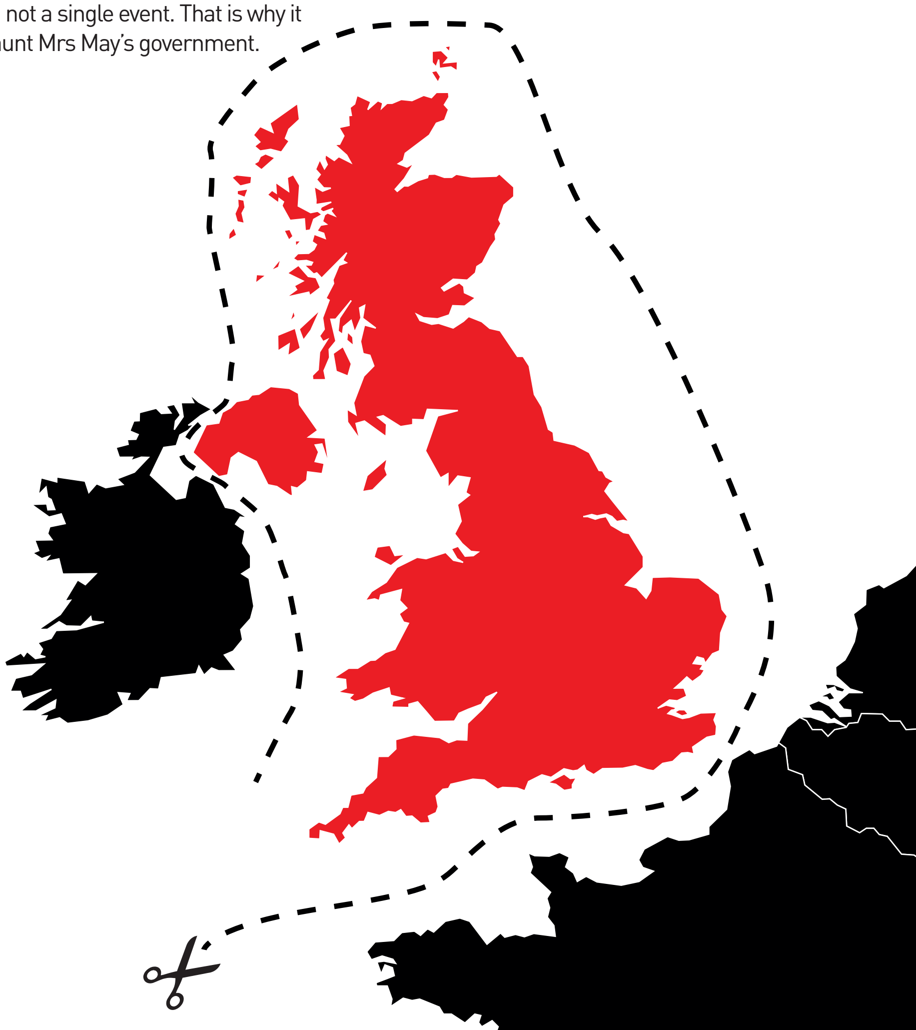
So despite the hint that the UK will leave the single market by taking back control of its borders, behind the scenes, ministers are trying to secure a softish Brexit with control of borders – via work quotas – and a mutually beneficial bespoke agreement on trade and finance. Whether this works or not will depend on events on the continent, but the hope is that an EU showing signs of strain in relation to migration, decides to settle reasonably at the behest of a realistic German government.

It won't be easy. EU members do not have an obvious incentive to cut a deal as they export about 3% of their GDP to Britain, while UK exports to them amount to 12.5% of British GDP.

Mrs May put forward her agenda to open the UK beyond the EU. She called this 'Global Britain.' This should entail a willingness to welcome international capital and labour, which would benefit the country regardless of its relations with the EU.

There will also be differences in Brussels. The European Commission has picked a former French foreign minister and commissioner, Michel Barnier, to take charge of the negotiations. The European Council has a former Belgian diplomat, Didier Seeuws. The European Parliament has chosen a former Belgian prime minister and keen EU federalist, Guy Verhofstadt. These three can be expected to have disagreements over the best way to handle Brexit.

It is evident from this that Brexit will be a process, not a single event. That is why it could haunt Mrs May's government.



Greek crisis has gone quiet. For how long?

It's a year since the Greek crisis was declared to be over. But rather than returning to health, the Greek economy has continued its downward spiral. It is burdened with a monumental Đ320bn of debt – some 180% of GDP. Helena Smith in the Observer said recently that fatalism is fast replacing pessimism on the streets.

Greece's economic output was 1.4% lower in the first three months of 2016 than it was a year earlier. Consumer spending was down by 1.3%. And the country is now struggling with the highest unemployment rate in Europe – 24%. Without debt relief, the International Monetary Fund believes that interest payments on the country's burgeoning debt pile will account for 60% of its budget by 2060.

This shouldn't be a huge surprise. There were obvious problems with the 2015 deal that secured Greece its third bailout in five years. It was always bound to make it more difficult for the country's economy to recover. Creditors had unrealistic growth expectations. The crisis was bound to flare up again – it was a case of when, not if.

The government has stoked these flames. By refusing to cut spending and, instead, increasing tax and insurance contribution rates, it has deepened the problem. In June, it raised tax rates on hotels, fuel, cigarettes, alcohol, coffee, and even increased a property tax it had vowed to scrap.

The 2015 bailout package assumes that Greece will run a budget surplus, once debt interest payments are excluded, of 3.5% of GDP each year. The IMF, which has now slightly softened its stance towards Greece, has noted that the only way that the country could sustain such a budget surplus would be to cut wages and pensions even further – once again forcing Greeks to foot the bill.

It also accepts that it is "no longer tenable" to imagine that Greece can shift from having one of the Eurozone's weakest productivity growth rates to the highest. Almost all agree that last summer's bailout simply kicks the can down the road. It's becoming increasingly clear that more discussions on debt relief will be needed. Germany would prefer these to be pushed back until after its own election next autumn, but the chances are that Greece will be back in the headlines before then.

Investors rediscover Africa

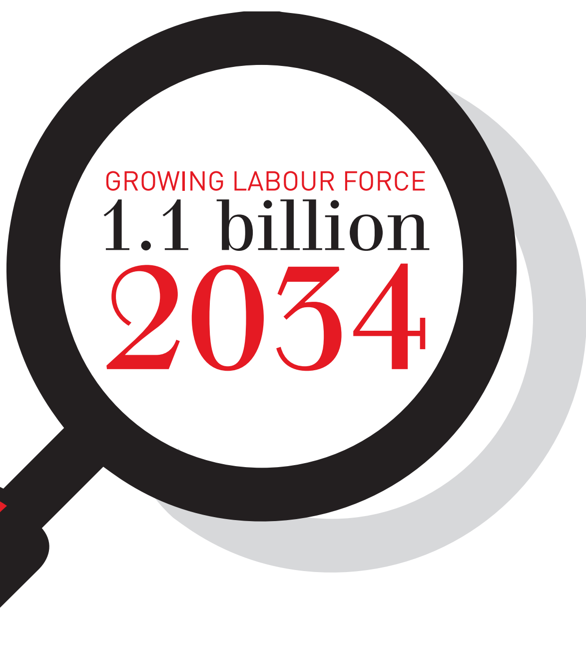
A few years ago, the financial press was full of talk about Africa's investment potential. But the story has gone off the boil amid the downturn in commodity prices and an especially disappointing performance by continental heavyweight South Africa in the past few years. Between 2010 and 2015, Africa's GDP expanded by an annual average of 3.3%, compared with 5.4% for the previous five years.

However, the GDP statistics tell a "misleadingly negative story", says a new report by the McKinsey Global Institute. The slowdown stemmed largely from the northern African states, whose performance was dented by the Arab Spring and the slide in the oil exporters' economies. In the rest of the continent, average GDP growth accelerated slightly in 2010-2015. It concluded that the "overall outlook remains promising".

Africa is the region with the fastest rate of urbanisation in the world. Over the next ten years, another 187 million Africans will live in cities – equivalent to ten more Cairo's. Productivity in cities is always higher than in the countryside, which bodes well for income growth and consumption. Another factor in Africa's favour is its young population and growing labour force. The latter is expected to number 1.1 billion by 2034. The spread of the Internet and smartphones should galvanise growth; electronic payments are sweeping cross the region and changing the business landscape.

Still, as David Pilling points out in the Financial Times, there are no guarantees. He says that the "sweet spot" that saw Asia take off consisted of an expanding workforce and fewer children; stubbornly high fertility may prevent Africa making this demographic transition. Meanwhile, if basic infrastructure isn't provided, technology may prove more of "a scrappy fix than a productivity-enhancing miracle".

Yet you get the feeling that something is 'going on'. It may be time for global investors to rediscover the Africa story and the discretionary fund managers that we work with are exploring the best ways of achieving exposure to this incredible continent, without the risk of direct investment.



US heading for a slump?

Two key drivers of US stock-market gains are under threat: historically high profit margins and share buybacks. The former have kept profits elevated in recent years despite lacklustre sales growth; as for the latter, "companies (as opposed to individuals and institutions) have been the only consistent net buyer of shares for years", reported the Lex column in the Financial Times.

The operating profit margin of America's non-financial companies has slid from 25% to almost 22% in the past two years. And the tailwind from buybacks is easing. They were down by a fifth year-on-year in the first seven months of 2016. Earnings have declined over the past five quarters, so there is less cash around to scoop up shares. Many companies have borrowed money to buy their own shares, but corporate debt is at record levels, so there seems limited scope for this to continue.

This doesn't mean overpriced stocks will suddenly collapse.

With interest rates at near-record lows, the most important tailwind of all in recent years is still blowing strongly, providing ample liquidity.

Indeed, a pick-up in growth is more likely than a recession this year. GDP should increase by 2.2% in 2017, compared with 1.5% this year. Business investment growth should rebound from 0.7% to 2.8% in 2017, and exports tick up to 1.7%.

So it's no wonder that investors expect corporate earnings to bounce back. Earnings have declined for five consecutive quarters, but may have reached an inflection point. Notably, once you exclude energy companies, both sales and earnings figures for the S&P were actually positive during the second quarter of the year.

Expect the US to keep pumping out growth for a while yet.

Against this backdrop, markets are extravagantly confident. The S&P 500 is currently trading at 18 times next year's projected earnings – its highest level since 2002. This hasn't stopped investors piling into riskier and more cyclically geared sectors of the economy. Technology stocks have rallied strongly over the past month. Both Apple and Alphabet have gained some 10%.

Yet the reality is that earnings results have set a somewhat lacklustre tone for the remainder of the year. Estimates for the current third quarter are still falling. And uncertainty about the US election, and the fallout from Brexit, continue. Moreover, earnings declines this protracted have historically always been accompanied by equity bear markets, which have yet to be seen in the US.

It's also worth bearing in mind that US retail sales data is relatively sluggish. Real personal income growth has slowed significantly. The pace of employment growth has dropped. And there's a risk that the Fed will raise interest rates faster than markets expect.

Put all these together, and the highest prospective earnings multiples since the dotcom boom look like irrational exuberance.

Oil's bounce unlikely to continue

For some time, many have said that OPEC, the oil producers' cartel, had less influence and can no longer move markets the way it used to. They would have had a recent suprise when prices bounced by 5% on the news that OPEC had agreed to cut output for the first time since 2008.

It has been pumping at full throttle in a bid to increase supply, drive down prices and put US shale producers out of business. But this has proved expensive, especially for Saudi Arabia, which racked up a budget deficit of 15% of GDP last year and has had to borrow money for the first time in years. It has even had to reduce civil servants' privileges and trim ministerial pay. So OPEC is now willing to contemplate taking its foot off the accelerator. The idea is to limit production, with the details are to be hammered out in November.

According to Goldman Sachs, if the cut is fully implemented, oil prices would jump by $7-$10 a barrel. A key issue, though, is the on-going tension and mistrust between Saudi Arabia and Iran.

Iran is determined to regain market share after being frozen out by years of sanctions, and may not be adequately placated by Saudi's offer of a cut in return for Iran freezing output at current levels. OPEC is also notoriously ineffective when it comes to policing production quotas. What's more, non-OPEC producers are ramping up production.

Russia, for instance, is desperate for cash, and is likely to hit record production this month. US shale producers have become far more cost-effective in recent years, allowing more to operate at lower prices. This ultimately puts a ceiling on the oil price and only foolhardy optimists will bet on a durable oil-price upswing.

Asia's economies are shining again

Across the developed world, investors are holding their breath, wondering which extreme monetary-policy tool central bankers will wield next to try to generate sustainable growth. But if it's growth you're after, forget the major Western economies. The four fastest-growing economies in the world are all in developing Asia. Each is run by pro-business leaders, and should see accelerating growth over the next two years. They are achieving this without monetary gimmicks, and with relatively normal interest rates.

Indonesia, Vietnam, India and the Philippines. Their success increasingly matters for the rest of us. The US will need to grow by more than 1.7% this year, just to match the contribution of these four to overall global GDP growth.

Bond investors are taking note. Government bonds offering positive yields are increasingly rare today. As a result, emerging-market bond-fund inflows have been strong all year, driving yields lower as prices rise. Stock markets have been firm too. Indonesia's is up 14.6% year to date, Vietnam's 14.0%, India's 9.3% and even the Philippines' – despite growing political concerns – gained 8.6%. The currencies of all four have been stable, so returns for overseas investors have been impressive.

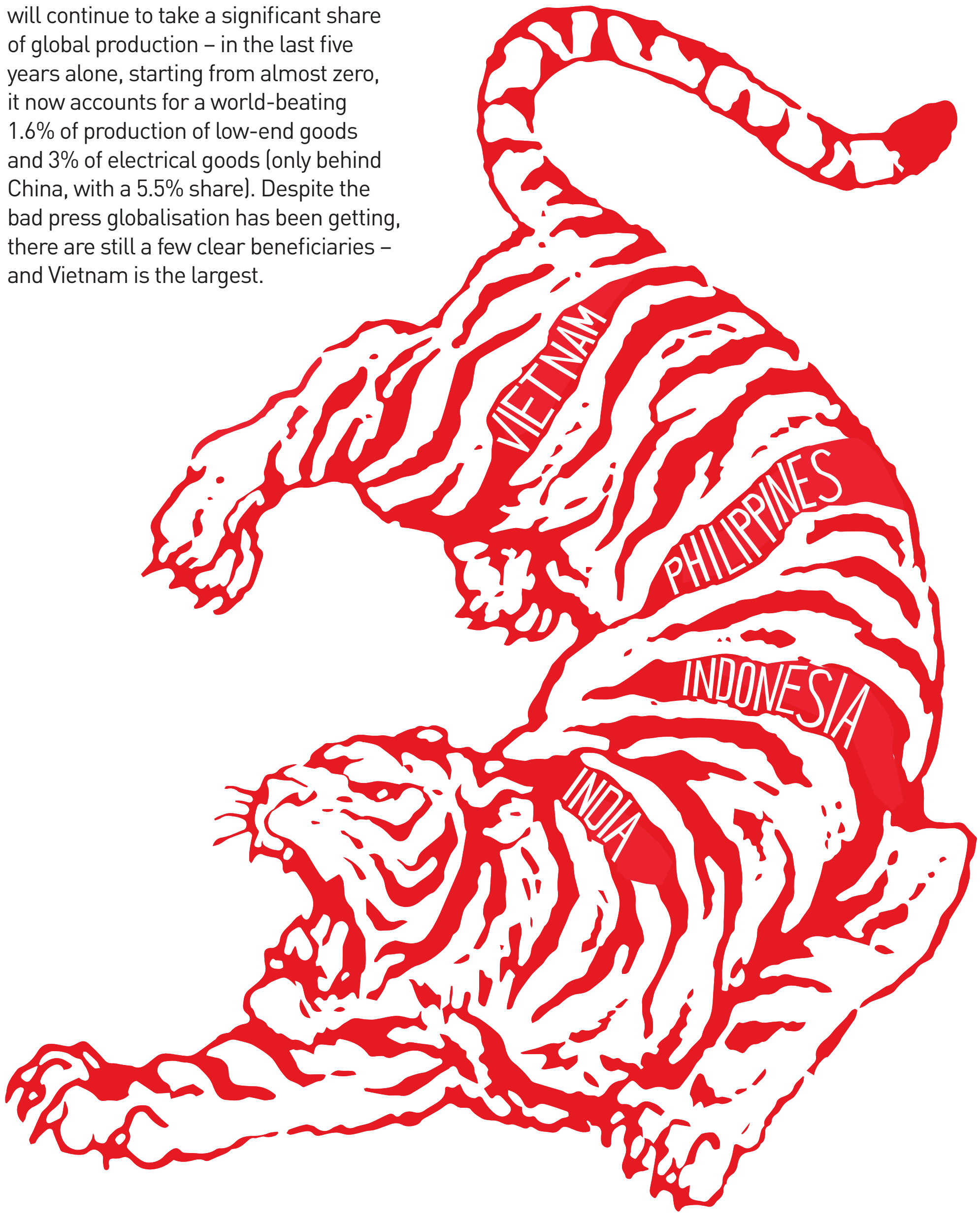
So what are the risks of investing in these high-growth marvels? Generally speaking, emerging markets are more volatile than developed markets (the ups and downs are greater and more frequent).

All emerging Asian countries have large, young, well-educated populations, which helps the investment case. But they need to tick three of the four following boxes to become a great medium-term investment story: low wage levels, both relative to the Western world and now, more importantly, to Asian rivals, particularly China; pro-business leaders who encourage high levels of foreign investment; controlled levels of corruption – corruption is only tolerated if it's pro-growth; and a solvent banking sector, supported by the government, that can allow for strong infrastructure investment.

Of the four, Vietnam is the most obvious classic development story. Vietnam is following a carbon copy of the North Asian command- economy development model, and is right now at the stage of easiest gains. Vietnamese wages are a quarter of East Coast Chinese wages, despite its large, very well educated workforce. The country is still run by the Communist Party and so can follow a command-economy model.

The last two prime ministers have worked hard to encourage foreign investment, with South Korea and the Samsung group doing a lot of the heavy lifting. This has allowed electronics industry to emerge in Vietnam. Until wages get near Chinese levels, Vietnam will continue to take a significant share of global production – in the last five years alone, starting from almost zero, it now accounts for a world-beating 1.6% of production of low-end goods and 3% of electrical goods (only behind China, with a 5.5% share). Despite the bad press globalisation has been getting, there are still a few clear beneficiaries – and Vietnam is the largest.

The fund managers we work with are increasing their exposure to Asia where appropriate, to ensure our clients profit from the region's growth, targeting economies with low wealth and wages, but great demographics and pro-growth leaderships.



Knightsbridge Wealth's senior team and support staff have over 200 years experience in the world's largest Banks

Alexander Wade

Alexander is one of the most experienced London advisers in the international market, specialising in this field over the last 17 years at HSBC, consistently recognised as one of its most accomplished advisers. He has over 21 years' experience in financial services. He is particularly interested in the Middle East market and understands the specific issues which are relevant there.

Stuart Poonawala

Stuart has worked in financial services since 1998. In 2003, he helped to found HSBC's specialist London arm advising international clients which quickly became one of the bank's most successful UK divisions. In 2009, he launched Kubera Wealth, our sister company, focussing on providing quality advice to the UK market.

Graeme Cowie

Graeme is responsible for building our professional connections with international lawyers and accountants, as well as co-ordinating our relationship with key fund managers at a number of international Private Banks and Discretionary Fund Managers. He has spent over 20 years in financial services and investment management, most recently spending more than six years at UBS where he led the Strategic Partnership team.

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