



**Knightsbridge
Wealth**

update

In recent years, investors have had to get used to zero interest rates on their deposits, forcing them to look elsewhere to protect the value of their savings. Zero interest rates are now turning to Negative rates.

In Denmark, some people are receiving mortgage interest payments from their bank. Certain cantons in Switzerland are asking residents not to make monthly tax payments since they will have to pay interest for holding the funds. And in Japan, people have taken to buying home safes for fear of paying interest on their bank deposits.

The unexpected decision by the Bank of Japan to push rates below zero rekindled fears that central banks are running out of ideas to stimulate growth and inflation. While central banks in Europe had taken that route before, the move led to a market perception of desperation – and perhaps helplessness – among policymakers. Investors are no longer just worried about the slow growth; they have also become concerned about the potential effects of negative rates on financial stability.

In the months ahead, negative interest rate policy will present both a key danger and opportunity for investors. The short-term outlook will be driven by the success or failure of such unconventional measures to revitalize growth. Long-term return assumptions are changing, as markets price an increasing likelihood that rates will remain low, or negative, long into the future.

International investors continue to require the highest standards of advice in times of instability. The recent furore over the 'Panama papers' led many to be suspicious of offshore, tax havens. London continues to be a tax-efficient environment, backed by the highest standards of regulation and investor protection.

As global instability continues, London's safe-haven status continues to attract many from all over the world, requiring the highest standard of financial advice. In the past, many were drawn to purchase property. This year, up to 40% of houses for sale in some areas of the capital have cut their asking prices since coming to market.

The pressure on asking prices is largely a result of supply outstripping demand. There are plans to build up to 35,000 high-end properties worth almost £77bn in the next decade – 40% more than in 2014. Meanwhile, demand for these types of new-build properties has slumped.

Higher taxes and low commodity prices have contributed to the slump, with the percentage of overseas buyers falling from about 33% to 20% last year.

In some areas, property is now attractively priced for the long-term, and could well form a part of an investor's financial strategy. More than ever though, no purchase should be considered without detailed tax guidance and independent advice.

The rest of this year present challenges that require proper financial planning – such as Brexit (the potential withdrawal of the UK from the European Union) – and the Presidential election in the US. 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

Another bout of nerves

Stocks made a strong start to the second quarter of this year, but the second half of April proved more nervy. The Japanese market dropped by more than 7% in the course of a week after the Bank of Japan failed to announce further measures to boost the economy. Japanese equities remain an attractive long-term investment, due to the high probability that the central bank will eventually embark on more quantitative easing (which should help buoy share prices), the prospects of economic reforms (good news for growth and profits) and improving corporate governance (leading to a greater focus on rewarding shareholders). But it's likely to be a volatile journey.

Bonds

Ever lower

The average yield across all German government bonds in issue fell to zero in early April. Yields on all bonds with maturity of nine years or less fell into negative territory, while the benchmark ten-year government bond yield dropped as low as 0.09% at one point. Investors should favour the small number of highly rated governments that still pay even modest yields (notably the UK and the US) and view them purely as a safe-haven investment.

Cash

No change

The US Federal Reserve has kept interest rates at 0.5% but many expect it to resume hiking at June's meeting. We would not be surprised if the Fed leaves rates unchanged: there is self-evidently no desire among central bankers to tighten policy until inflation forces their hand.

Precious Metals

Portfolio insurance

Gold has bounced thanks to a weaker dollar and signs that the US Federal Reserve may not raise interest rates by as much as initially expected this year, making gold's lack of income less of a problem for investors. Increasingly negative interest rates elsewhere have fuelled demand for a store of value, as have fears of a rebound in inflation.

Meanwhile, silver has gained a new lease of life. Prices have bounced by just over 20% to a one-year high around \$18 an ounce.

Whilst silver often tracks the gold price, half of overall silver consumption is for industrial use (compared to 10-15% for gold). As China has recovered, silver, used in industries ranging from electronics to medicine, has begun to look more appealing.

Dwindling supply is also a factor in this bounce. At present, miners are cutting back on output following substantial price falls. That means less silver is being produced too. The Silver Institute thinks supply is set to fall by 5% this year, and could fall until 2019.

Given all this, it's no wonder investors have rushed into the silver market, driving prices up quickly. The backdrop remains encouraging.

Property

Commercial Property peaking

The UK commercial property market has delivered excellent returns over the last few years but, despite record levels of investment in sectors such as London offices, the overall UK Capital Growth All Property index has yet to pass the highs it reached on the eve of the global financial crisis.

The index, which measures prices for office, retail, industrial, warehouse and leisure sectors across the country, remains around 20% below its peak.

Now, there are signs that the market may be peaking. The latest figures show a slight decline in prices, the first drop for more than three years. The Royal Institute of Chartered Surveyors reports softer demand from both investors and tenants.

A crash seems unlikely, but the next few years may be more muted than investors expect.

Currencies

Down Under Downgraded

Our strategic partner, UBS, continue to recommend over-weight positions in the US Dollar, and under-weight positions in the Euro and Australian Dollar.

The British Pound will remain under pressure until the EU Referendum campaign is out of the way although rate hike expectations should re-emerge in the second half of the year.

The prospect of a US rate hike strengthens its outlook, whilst continued monetary easing in Europe should keep the Euro weak throughout the summer.

Brexit – Still too close to call!

The latest polls suggest that the outcome of the EU referendum vote will be incredibly close. A recent ICM poll of 2,000 voters show 45% backing Leave, 44% backing Remain and 11% undecided. However, the undecided is likely to go to Remain thanks to a campaign based on promoting Fear. The latest odds from Betfair's betting exchange put the odds of leaving at just 31%.

Nevertheless, investors are taking positions to guard against the financial impact of Brexit. That's because leading equity strategists believe a Leave vote would lead to a sharp fall in the value of Sterling.

If Brexit does happen, however, it will be a major global event. No country has ever left the EU before, and Britain is one of the three major economies within it – its economy has been a rare EU success story. Here are four trends to watch if Britain votes to leave the EU.

First, there may well be a fresh debt crisis in the peripheral Euro-zone. It will be a lot

easier to be the second country to leave the EU than the first. The British example will encourage politicians in Greece, Spain, Portugal and Italy who want to get out. After all, it is not as if they are exactly thriving as members.

The Italian economy, extraordinarily, is now smaller than it was all the way back in 1999. The Greek economy has shrunk by more than a quarter since the euro crisis began. If a Brexit starts to increase support for getting out, then bond yields will start to creep up and very soon we could be back to the crisis of 2011.

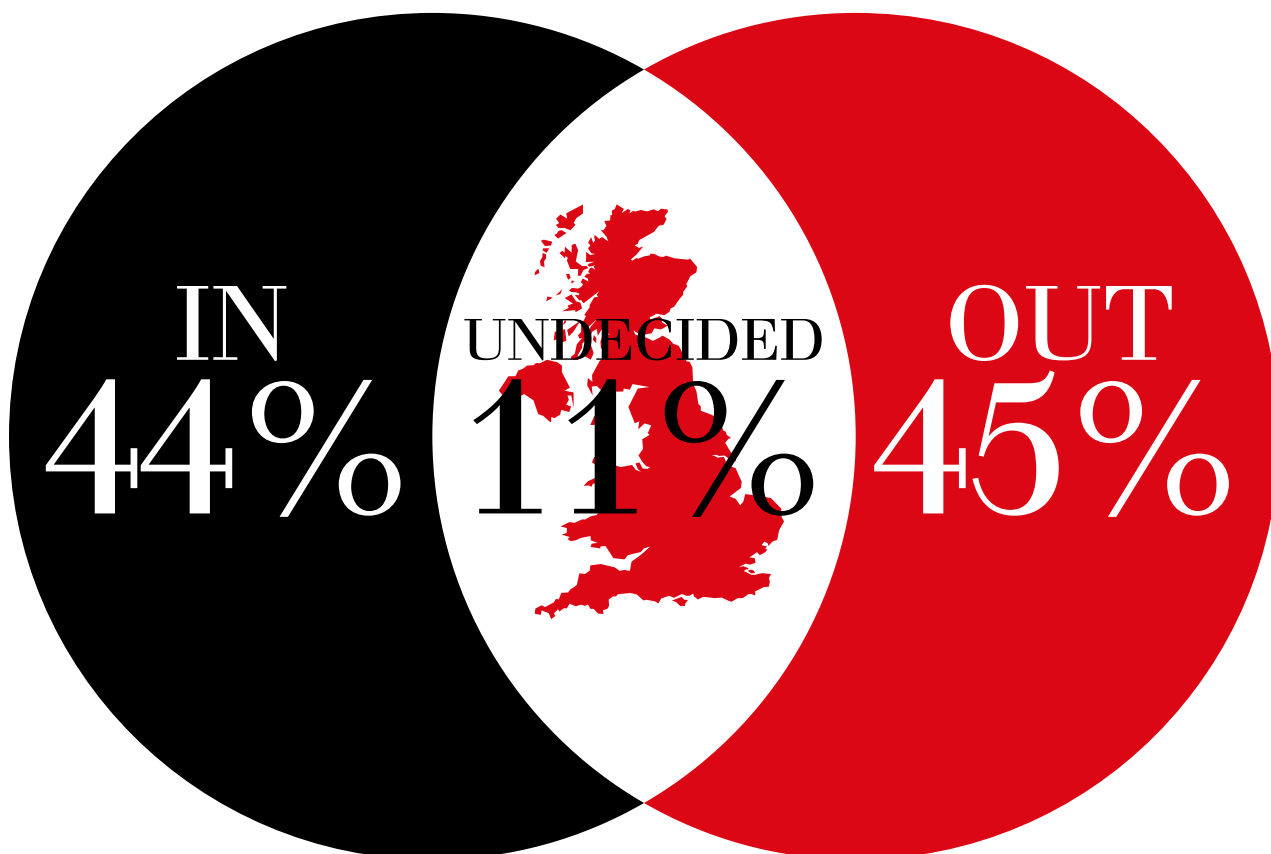
Second, financial turbulence. All the continent's banks have a lot of exposure to this country. If sterling takes a major hit, and the exit negotiations go badly, banks will be the first to suffer.

Third, there will be a slump in specific countries and industries. Because it is a much larger economy overall, UK trade is not that significant for the EU as a whole. It matters, but it is not crucial though it is important for certain industries and

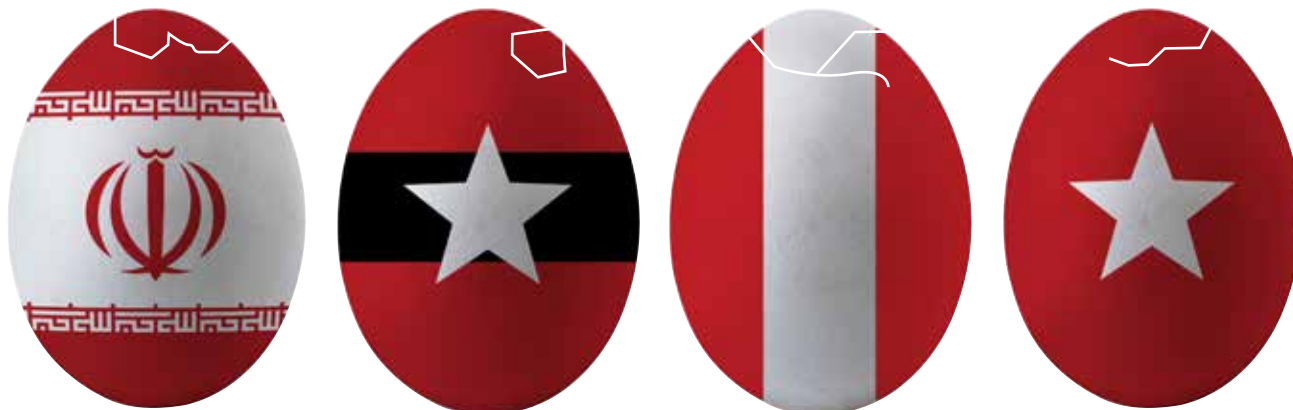
countries. For example, 15% of Irish and 10% of Dutch and Belgium exports go to the UK. Any doubts over the deals that are struck after a Brexit will hit those economies very hard.

Finally, and on the upside, some countries may benefit. If the UK were outside the EU, it would be free to negotiate its own trade deals around the world, and open up its markets.

The impact of a Brexit might not be that great in the UK, whatever Project Fear says. We will lose a bit of foreign investment and some exporters will suffer, but trade with Europe is declining anyway and a few new deals may open up some new markets. Overall, it may not make much difference. But it could have some huge knock-on effects elsewhere. Markets have hardly even begun to think about those – but as the vote draws closer, they certainly will.



Emerging markets rebound



Emerging-market stocks represent decent long-term value but they also face strong challenges – a stronger US dollar, higher US interest rates and lower commodity prices among them.

However, many big hedge funds now think that the US dollar might weaken rather than strengthen and that US rates might not rise very much at all. Commodity prices have stabilised and even rallied sharply.

As a result, emerging-market assets including equities, bonds and local currencies have rebounded. According to Bloomberg, one index of 20 emerging-market currencies has just put in its best performance in 18 years, while the MSCI emerging-market benchmark index has had an incredible start to 2016. It rose 9.31% in the first three months of the year – a big turnaround from 2015 when it fell 15%, having fallen in the three previous years too (in 2012 it slid 18%).

Investing in countries at an early stage of development is fraught with risk.

Away from the well known ‘emerging’ markets (such as India or Brazil) are the so-called ‘frontier’ economies (such as Vietnam, Nigeria, Myanmar and Iran).

The path of progress from being an impoverished rural economy to industrialised, urban, capitalist nations is neither straight nor one-way. Many countries get stuck at one stage or another and some even regress. But the rewards for those who invest early in the success stories can be huge.

That’s the appeal of frontier markets due to factors such as demographics, political instability and liquidity (the ease of buying and selling assets). Despite their classification, many of these countries offer investors several very attractive features – large working-age populations, abundant natural resources, fast-growing urbanisation, and increasing investment in infrastructure.

Myanmar and Iran are both prime examples of frontier markets that have recently opened up to foreign investment. Myanmar’s newly liberal government (following decades under military rule) allowed foreign banks into the country for the first time in October 2014, including the Australia and New Zealand Banking Group. In January of this year, the government approved the “Condominium Law”, which allows foreigners to buy property in the country for the first time. And it finally launched its stock exchange last month – currently hosting just one member, conglomerate First Myanmar Investment.

As for Iran – its economy is already larger than Australia’s, but it is only now, with international sanctions lifted, that outsiders are able to take advantage of this potential. Iran’s stock market has more than 300 listed companies, with a collective market cap of around \$100bn – and since January, it has already gone up by 28%. The population is young, entrepreneurial and well educated (60% are under-35, and the literacy rate is over 85%). “Iran is a G20 country in waiting,” says Bart Helg of Iran-focused investment firm ACL.

But investing in frontier markets is, of course risky. Stocks are often illiquid, and volatility and corruption can be problematic. Myanmar is ranked 147 of 167 in the world for corruption, and the political situation, though much-improved, remains unstable. There is also no guarantee Myanmar won’t close itself off to foreign investment in the future. Iran, meanwhile, could easily face further economic sanctions should relations freeze again, and accessing the market isn’t easy – many Iranian companies publish financial statements only in Persian, for example.

Among the funds that our investment partners use to gain exposure to these markets is Blackrock’s Frontier Investment Trust. It has just under a third of its portfolio invested across Argentina (which has come back into favour with investors following the election of a more business-friendly government), Pakistan and Romania, and significant holdings in Bangladesh and Kazakhstan.

Oil – the only way is up?

Over the past two years the oil market has been turned upside down. By summer 2014, oil prices had spent the best part of three and a half years above \$100 a barrel. Almost everyone – analysts, economists, pundits, and oil companies – expected it to stay that way. Yet within just six months, prices had halved. After a brief respite and recovery in early 2015, a second slide saw prices crash below \$30 a barrel, levels not seen since 2004. Since the start of this year, prices have made another comeback. But can this rally last? There are plenty of factors behind oil's slide – from the glut of US shale oil, to concerns over Chinese growth, to worries about rate hikes in America.

But the biggest factor is arguably the actions of Saudi Arabia. The wealthy oil state says it is planning for a future beyond oil.

Saudi Arabia has huge influence on the oil market. It accounts for around a fifth of the world's reserves, and its defacto leadership of oil producers' cartel the Organisation of Petroleum Exporting Countries (OPEC) only increases its power. Between them, the cartel's 13 members account for around 40% of oil production and 80% of proven reserves. However, advances in 'fracking' technology has unlocked US shale oil, enabling America to become a top producer too.

OPEC's grip on the market has slipped. After prices started to slide in 2014, most analysts assumed that OPEC would slash production. Instead, the Saudis raised output, against the wishes of many fellow OPEC members. It seemed odd, but it was a simple recognition of reality – the last thing the Saudis wanted to do was to cut down on their own supply and encourage America to boost production further. The decision has taken its toll on US shale producers, whose production costs are higher than the Saudis'.

The number of crude oil rigs deployed in America is down by almost 70% from its peak, expansion plans have

been mothballed, and several shale producers have gone bust.

But it's not just about staving off Western rivals. Saudi Arabia sees itself as the centre of both the Middle East and the Muslim world. Iran strongly disagrees. This conflict has its roots in the centuries-old dispute between two different branches of Islam (Saudi Arabia is mostly Sunni, Iran mostly Shia), but has acquired a new urgency in the past five years, as a result of the 'Arab spring'. Neither Iran nor Saudi Arabia – both highly authoritarian – welcomed the pro-democracy protests that gripped the Middle East following the revolution in Tunisia in late 2010. But that didn't stop them from exploiting the chaos in order to advance their own interests, resulting in a proxy war between the two across the region.

Prince Mohammad, the Saudi defence minister, is known for his aggressive anti-Iranian stance. Not only has he played a key role in Saudi Arabia's Yemen campaign, but last month he overruled Saudi's oil minister to veto a deal that would have seen OPEC producers join Russia to freeze production at January's levels. Why the veto? Because the deal didn't include Iran. Meanwhile, a fortnight ago, the prince outlined a dramatic new economic policy that would see Saudi Arabia slash welfare spending, and end its 'addiction to oil' by diversifying the economy. Mohammed has even promised to eat a small stake in state-owned oil giant Aramco, and create a huge sovereign wealth fund. Most ominously for other oil producers, the report pledges that the reforms will go ahead, even if the oil price falls below \$30, suggesting the Saudis are planning for prices to remain low.

Keep pumping oil to hang on to market share, while quickly diversifying away from a dependence on it sounds like a good plan – on paper. But it's unlikely to work in reality. The Saudis have been talking about diversification for nearly two decades now, but have made little or no progress.

The fact is that for all the bravado, cheap oil is playing havoc with the Saudi economy. Oil revenues account for 90% of government revenue, so falling prices have caused the deficit (the gap between annual income and spending) to explode to \$98bn, equivalent to 15% of GDP.

The war in Yemen is also proving expensive. As for cutting spending – budget cuts look good in theory, but getting them past a hostile population is a different matter. Saudi faces potential unrest from both its Shia minority and its youthful population, meaning that any attempts at austerity are likely to spark popular protest. Tentative efforts towards modest tax rises and subsidy cuts have already proved extremely unpopular.

The financial situation is so unhealthy that credit-ratings agencies recently downgraded Saudi bonds, while the International Monetary Fund warns that Saudi could conceivably run out of financial assets within five years. One sign of just how hard cheap oil is hitting Saudi Arabia comes from the construction business. The Saudi Binladin Group, the largest builder in Saudi, red around a quarter of its workforce – 50,000 workers. The staff were mostly expatriates from Asia, and the Binladin Group claims they were paid off in full, but there have been protests nevertheless, some of them violent.

Finally, Saudi's policy of pushing down prices is alienating its Arab allies, including those in the Gulf.

So how high could prices rise if Saudi does agree to cuts? Most economists agree that the government needs prices to rise to around \$100 a barrel to enable it to balance the budget. US shale oil means that it is highly unlikely to happen. Instead, Capital Economics expects a rise to around \$60-\$65, the level at which the majority of the US shale industry becomes viable again.

Opportunities return in China



The Chinese market has suffered a fairly dramatic 18 months, which may have convinced many investors to steer clear of the region entirely. China's key benchmark index, the Shanghai Composite, went up by 60% between February and June last year, then dropped sharply in August when the Chinese government devalued the renminbi by 3%. Now, even though fears over an imminent and significant devaluation have faded, the market has struggled to regain the highs of last year.

But looking beyond the short-term volatility, a shift in China's economic focus should provide long-term growth opportunities for investors. The country has seen rapid development in recent decades, but if it wants that to continue, it realises that it has to look beyond the low-wage, low-cost manufacturing-driven business model, and towards

being driven more by internal demand from consumers. Quite apart from anything else, with wages rising fast in China, other emerging nations in the region have been competing with China for the 'offshoring' dollar for sometime.

So China is now going through a period of transition from being an investment-led economy to a consumption-led one. Its 13th five-year plan (China's grand strategy for social and economic development initiatives) brought with it the abolition of the one-child policy, but also a focus on social services, such as health care and pensions. This should help the shift towards consumerism – people who are less worried about putting away every penny for their old age or for when a medical disaster strikes will be more inclined to spend on today's little luxuries. On going urbanisation and the continued rise of the country's service industry should also fuel growth.

Several sectors in particular are already benefiting from the rise in consumerism. China is already the world's biggest car market and the cinema and e-commerce sectors have also seen significant jumps in revenue, with e-commerce company Alibaba seeing annual Chinese revenues grow to ¥63bn in 2015, up 40% from the year before. International firms continue to expand in the region: PepsiCo opened a Quaker Oat plant on the mainland in October.

There is, of course, another side to this growth story. Demand for smartphones is beginning to slow for some companies, such as Xiaomi (once thought of as China's answer to Apple), and the luxury goods market saw sales drop by 2% year-on-year in 2015 (partly due to an anti-corruption drive). The large supply of labour that has contributed to recent urbanisation will soon start to retire, meaning that the supply of working-age people will be smaller (not helped by the legacy of the one-child policy). This means wages are likely to continue to rise, which would affect corporate profits. And there is obviously a chance the government could implement policies that slow this trend. But, ultimately, the move towards increased consumerism looks as though it is here to stay.

New appointments

We are pleased to welcome **Daniel Hawes** and **Krishna Gaglani** to the Knightsbridge Wealth team, having been appointed Client Relationship Officers.

Daniel has worked in financial services for two years. He is being trained to become a 'para-planner,' preparing and researching the in depth reports that accompany the high quality advice we give to our international clients. Krishna is a maths graduate from the University of Bath. He has experience in the pension transfer market, which is particularly relevant to our UK resident clients, to explore the particular tax advantages that investment in pension schemes provide. Krishna and Daniel will work alongside the partners, documenting advice and recommendations and, in time, hope to become regulated advisers.



Daniel Hawes



Krishna Gaglani

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.



Adam Young

is the team's Senior Strategic Financial Planner. He previously spent 25 years at Dragonfly Planning and Trust Services, the last three years as Managing Director.



Chris Salacinski

is Strategic Financial Planner and brings to us a high level of technical experience. He is particularly interested in pension planning and is responsible for writing many of our technical articles.



Kelly Kular

is Personal Assistant to the Partners. She previously worked with HSBC for 27 years, latterly as Personal Assistant to the Regional Director for Central London Region.



Kellie Lewis

is our Client Relationship Manager. Before joining us she worked for HSBC for 26 years and has extensive banking and wealth management experience. She spent eight years as a Premier Relationship Manager, looking after a portfolio of High Net Worth Clients.



David Barnard

spent 35 years at HSBC before leaving in 2011. He is our Office Manager, and works closely with our compliance support and partner companies to ensure our rigorous standards of advice are maintained.

UPDATE

Contact us

If you require further information about our services or would like to discuss your financial situation with us, then please call us on the number below, or send us an email about how and when we can contact you.

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