update

Knightsbridge Wealth

Dear Friends and Colleagues,

The demand for international wealth management is going from strength to strength, as the asset base of their individuals hits new heights. The global value of high net worth individuals' assets is set to surpass US$100 trillion by 2025, based on current growth trends. This is four times the level seen in just 2006.

Yet, it is increasingly difficult for the international client to manage their funds effectively. A cocktail of increasingly complex regulation, tax legislation across jurisdictions and scrutiny on tax avoidance schemes, is creating challenges and the need for flexible, transparent solutions. This is having a significant impact on the wealth structuring strategies employed by high net worth investors, and their representatives.

Family structures and businesses are increasingly international, operating across multiple borders. For instance, it's not unusual for a high net worth family to have children in school in one country, live in another jurisdiction, with a business in a third – and potentially plan to retire in another country altogether.

Meanwhile, global regulations continue to evolve, and tax and legal requirements do not stand still in each jurisdiction. In the UK, for instance, April brought with it a change to the way many resident non-domiciled individuals are taxed. Governments are taking a closer view on the level of wealth moving across borders, and the level of wealth being passed on to younger generations. As they do so, reporting requirements and the need for transparency are growing. This dynamic is creating stronger demand than ever for specialists, such as Knightsbridge Wealth, who are well versed in cross-border wealth planning.

Investment conditions, too, will soon face a challenge as the period of emergency low interest rates is coming to an end. In the UK, last August – after the EU referendum – the Bank of England halved interest rates to 0.25% and restart quantitative easing (QE). The folly of this panicky move may be starting to sink in. Last month, three of the Bank of England's Monetary Policy Committee members voted to raise interest rates. While rates stayed at 0.25%, the vote was very tight indeed.

Quite right too. The annual rate of consumer price index (CPI) inflation is at a four-year high of 2.9%, above the Bank's predicted peak for 2017. Loose money, along with sterling's rise, is fuelling the jump in inflation, along with a worrying increase in household debt.

Judging by his Mansion House speech this week, the Bank of England's Governor, Mark Carney, is unconcerned. He argued, once again, that rates should stay put until the impact of Brexit is clearer. And a recent slowdown in consumer spending, which comprises the lion's share of GDP, suggests rates could stay where they are.

The bigger issue is that years of quantitative easing and negative interest rates have skewed Western economies beyond recognition, sustaining companies that would otherwise face bankruptcy, and forcing investors into higher risk investments in search for returns. A rate rise by the Bank would be a sign of getting back to normal, so it should boost confidence.

In another sign of 'business as usual,' Greece has received yet another 11th hour credit lifeline. The €8.5bn tranche of its latest bailout package will prevent it defaulting on this month's payments. The left-wing populist government is meeting its fiscal targets and the International Monetary Fund has advocated debt forgiveness to cut Greece's unsustainable debt pile. Germany wants to avoid explicit debt restructuring promises before a national election later this year.

The deal is a typical fudge by the European Union. It will consider extending Greek bond maturities by up to 15 years (the average maturity now is 30 years) and deferring interest payments. But it won't decide on detail until 2018; it's far from clear that the relief will make the debt pile bearable. The lack of specifics keeps Greece in financial limbo. Not for the first time, this problem is being managed, rather than resolved.

The rest of this year continues to present challenges that require proper financial planning. 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.

We look forward to working with you

JD Wade.

Market Report

Bonds

Negative returns prevail

Even if rates remain unchanged, many short to medium term bonds would deliver negative returns. Investors wishing to avoid negative returns are drawn to take real risk for only a lightly positive yield.

European High Yield Bonds now have a Yield-to-maturity of a new all-time low of 3.4%, looking expensive. A mix of High grade bonds and global equities are likely to provide a higher return on a similar risk profile.

US High Yield Bonds have a relatively healthy yield of 6% and improving corporate fundamentals.

Equities

Eurozone in style

Decent economic growth and moderate inflationary pressures have helped equity markets. As both global growth firms and the risk of deflation disappears, several central Banks are taking the opportunity to move further towards a gradual normalization of monetary policy. The US Federal Reserve has increased interest rates and this is likely to be repeated this year and start a gradual unwinding of its balance sheet. This environment should continue to be supportive of 'risk assets'.

Earnings growth of Eurozone countries are likely to catch up with UK firms, supporting higher prices in the region. Solid economic growth and moderate rising inflation should provide a background for Eurozone 'value' stocks to outperform the wider market.

US companies are generally in good shape, having plenty of cash on their balance sheet and enjoying low financing costs.

Alternative investments

Hedge Funds resilient

The US Federal Reserve has started to hike interest rates. Based on historical data, most hedge fund strategies are resilient to rising interest rates, whilst high grade bonds have performed poorly. Investors looking for an alternative to their high-grade bond exposure should consider a diversified hedge fund portfolio, characterised by low directional exposure to both fixed income and equities.

Foreign Exchange

Euro improving against Dollar

In recent years, the US Dollar has been highly over-valued. The Euro's appreciation against the US Dollar has further to go, given the Euro's undervaluation and the growing 'catch up' potential of Eurozone economic growth and monetary policy.

The Canadian economy is recovering well from the oil-induced weakness, and the currency is looking attractive whilst the Australian Dollar is struggling with structural changes and a disinflationary environment.

Gold

Asian demand to grow

Gold prices are expected to trade at around $1,250/oz over the coming months, which is slightly lower than current prices. Financial market players are under-pricing the possibility of a third Federal Reserve rate hike later this year, which could cut the net length of futures held by speculative accounts. That said, rising US real interest rates should be offset by a weaker US dollar and better Asian gold demand. On the plus side, political risks should remain elevated in the coming months, supporting demand for safe-haven assets.

Asian demand for gold was weak in 2016. Better growth is likely in 2017 as wealth in the region increases and investor affinity for the metal rises.

Oil

Opec and Russian supply capped

OPEC's efforts to cut oil inventories and support prices have been stymied as prices trade below $50 a barrel, the lowest level since last November. OPEC and Russian supply is capped, giving scope for US to release more of its inventory to market. Thus, prices are likely to edge back towards $60 a barrel in coming months.

Oil production has fallen sharply, by nearly 1.7 million barrels per day this quarter, compared with a year ago. This supply deal is likely to remain in place until early next year. Supply growth should remain muted. In addition, the substantial capital expenditure cuts by energy companies – as a result of lower prices – should constrain supply growth in coming years. Another positive factor is emerging Asia.

Roughly half of the world's population lives in emerging Asia, but the region accounts for just one-quarter of worldwide oil demand. This should help offset the major negative factor for crude oil – namely from ongoing improvement in energy efficiency and battery technology developments, with electric cars eventually capping oil demand.

Elusive safe assets

The first question many ask when investing is: how should I divide my wealth between risky and safe assets? This, though, runs into a problem – that safe assets are in fact hard to find.

Strictly speaking, a safe asset is an inflation-linked bond that matures when you need the money. So, for example, if you expect to need money in 2026 an index-linked gilt that matures then is safe, as it offers guaranteed real purchasing power when you'll need it. However, in current times, the guarantee is of a loss: UK government bonds maturing in 2026 has a real yield of -2%. £100 invested in it will give you only £83 in today's money in 2026. But a guarantee of a loss is still a guarantee.

Few of us, however, need spending power only on a specific future date, so this isn't helpful. Nevertheless, bonds are safe in two other ways. One is that they do something which cash doesn't. Back in 2007, cash deposit rates were decent but they plummeted when the financial crisis hit us. Locking up money in a gilt protected investors from that slump in cash returns – protecting us against reinvestment risk. Think back to March 2007. Ten-year gilts then offered a nominal return of almost 5% per year, and index-linked ones a real return of 1.2% per year. In retrospect, these were great offers as you wouldn't have got such high returns if you'd kept your cash in the bank.

You might think that with cash rate now near rock-bottom that reinvestment risk is low. True. But it's not non-existent. In the event of another downturn, rates could turn negative. And bonds will outperform cash if rates don't rise as much as markets expect. One reason why investors are happy to hold index-linked gilts despite their negative real return, is that they want to buy insurance against this danger.

Bonds offer another form of insurance – a hedge against some forms of equity risk. If shares fall because of a fall in appetite for risk, or a worsening in the economic outlook, gilts could do well. For example, between October 2007 and March 2009 the All-share index fell by almost 40% but gilts returned almost 16%. In really bad times, therefore, gains on gilts can cushion our equity losses.

Cash doesn't have this virtue. Quite the opposite: interest rates get cut in recessions.

In the 1980s and 1990s, shares and bonds quite often fell together. Cash protects us from such falls. It protects us against correlation risk – the danger that previously uncorrelated assets will fall at the same time. You might say here that gold also has some of these virtues. It tends to do well when interest rates fall and, on average, it has low correlations with gilts and equities. These virtues, however, are offset by a gold's intrinsic volatility.

Cash and bonds are both much-maligned. But they have their virtues. Although there is no such thing as a single safe asset for most people, a mix of cash, foreign currency bonds and gold can roughly replicate one.

Indian stocks still defy gravity

India's stock-market capitalisation recently crossed $2trn for the first time, making it the ninth largest equity market in the world. With an annual growth rate of 7%, the country is now the world's fastest-growing major economy, while foreign direct investment is also at a record high.

Over the last few months, confidence has grown in Prime Minister Narendra Modi's reform agenda and in his ability to take tough decisions for the long-term health of the economy. In November, the government abruptly withdrew 87% of the currency in circulation by scrapping 500 and 1,000 rupee notes, the two highest denominations, as part of a crackdown on corruption.

The demonetisation led to the closure of many cash-dependent businesses, but the economy coped relatively well. What's more, banks are now flush with liquidity and interest rates have fallen, which has encouraged savers to move into financial assets – this is one of the factors helping push stocks to new highs. Growing enthusiasm for emerging markets among international investors has also helped.

Sceptics say the rally ignores growing risks, especially in the banking system. Indian bank stocks have rallied 23% in US dollar terms this year, outperforming those in other emerging markets such as China and Brazil. Indian banks now look overvalued.

However, a brutal market bust seems unlikely, not least because the changing savings habits of ordinary Indians are also driving a structural shift. Rising domestic inflows into equities have outpaced foreign inflows since 2014. This means the Indian market is less affected when foreigners sell. Note also that investors held their nerve through Modi's recent currency experiment. That implies that they will also probably look past any disruption caused by the rollout of a new national sales tax. So even if the short-term fundamentals don't quite stack up, gravity-defying valuations may be here to stay.

The global citizen

Diversifying your nationality

Having a second passport has been a key requirement for entrepreneurs around the world, who live in developing countries – often with regimes that could become un-favourable. A passport gave holders the right to escape, if needed, and enable family members to enjoy higher standards of education, political freedom or the chance to build their business away from their home country.

However, it is not a trend limited to residents of emerging countries. Immediately after the UK vote to leave the European Union, the Irish embassy in London and post offices in Northern Ireland received 4,000 queries with from British Nationals about how to obtain an Irish passport – up from the normal figure of 200 a day.

This rush to apply for a second passport doesn't make much sense. It is likely to be two years before Britain 'Brexits'. However, getting a second passport for an EU country before late 2019 could make sense since we don't yet know how the UK's exit from the European Union will be played out. Some need un-fettered access to the Single Market and the right to live and work throughout the EU and an EU passport will assure that during this time of risk. It's a great insurance policy.

And a second passport doesn't have to be about ensuring you will always be able to work in the likes of Spain. It could also be about claiming visa-free travel to as many countries as possible. The UK has one of the best passports in the world (visa-free travel to 173 countries). But it might be nice to top it up with one that offered visa-free travel around much of Latin America, for instance. It could also be about the wider impact of your nation's foreign policies: for example, it might be nice to be Irish rather than American when you visit the Middle East.

A second passport may also be handy if your government gets too controlling of capital flows, or if it restricts travel.

In Russia, for example, it is increasingly hard to travel abroad. After the collapse of the Soviet Union, the new constitution gave Russians the right to leave and return freely. They left in droves and not all returned. By the early 2000s it seemed impossible that travel restrictions would ever return. They did. In 2010, Federal Security Services staff were banned from travelling. Then so were debtors (including anyone who owed taxes); then various other civil servants, down to firemen and police officers.

Some 5% of Russia's population is now thought to be unable to travel abroad. Dual nationality may be attractive to many of those.

The West is not immune to this either. The US government can withdraw the passport of anyone accused of a felony (Edward Snowden's was cancelled before he could leave Russia). Committing a felony in the US is pretty easy. In his book Three Felonies A Day: How The Feds Target The Innocent, Harvey Silverglate noted that US laws are so vague and so complex that it is all but impossible to get through a day without doing something illegal. Add it all up and having a second passport is a perfectly reasonable 'political diversification' strategy – and one that could come with tax benefits and nice weather as part of the deal.

So how do you get a new passport, and which are best for which purposes?

Citizen-by-investment schemes allow pretty much anyone to gain citizenship of a range of countries by making an exceptional economic contribution. The place to start in the EU is Cyprus. When Cyprus launched its 'buy a passport' programme, it cost €28m. There weren't many takers (the odd Russian oligarch aside). So the price has fallen: from €10m to €5m to €2m to the current €500,000. Buy a property, prove you have no criminal record and are in good financial standing, and that's it – an EU passport and Visa-free travel to 159 countries (including Canada, Hong Kong and Singapore); and the ability to work, live and study anywhere in the EU – regardless of what happens in the UK, for you and your children. Simple, fairly fast and (relatively) cheap.

Next in the EU, there's Malta. This will cost about €1m. To get your passport you need to make a €650,000 'donation' to the development of Malta, and buy €150,000 of government-approved stocks and bonds. You must also rent or buy a property (at a cost of €16,000 a year for five years or €350,000 up front). You might think that's a bit steep. Others don't. Malta has raised €1bn from the scheme since 2014. It isn't the cheapest or quickest passport to get: it takes a year, during which you need to be resident, and you'll need to budget for €60,000-odd in legal fees, to say nothing of the charitable contributions to prove a 'genuine link' to the island.

The Maltese and Cypriot passport schemes don't oblige you to have been resident in the run-up to application, just during its processing.

Cyprus and Malta are also good for tax residency. In Malta, the top rate of income tax is 35%, and there is no inheritance tax, gift tax or wealth tax. In Cyprus, income tax also tops at 35%, and again there is no estate tax. There is also the possibility of paying a special rate of 5% on pension income (including public-sector pension income). However, if it is paying as little tax as possible on your pension that matters, look at Portugal. Getting a passport there takes time. But you might enjoy the wait. Register with the government as a non-habitual tax resident and all income from foreign pensions is tax-free for ten years.

Finally, if you are very well off (and it's all about tax for you) you might look at Monaco, which has no income tax. You don't have to 'invest' or donate anything to get residency, but you do have to prove you have enough money to support yourself, and to rent an apartment there (big enough for your family). That's pricey: a three-bedroom flat in a fairly nasty-looking high rise can easily cost €20,000 a month. Turning residency into citizenship then takes ten years.

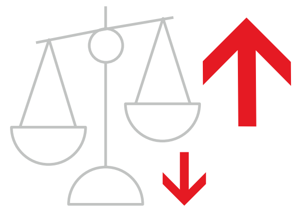
Political diversification

If it is just another passport you, look at the Caribbean. Grenada gives you visa-free access to EU (Schengen), UK, Singapore, Hong Kong and China, but also eligibility to apply for a non-immigrant visa to the US. It is also cheap and fast – about three months – and you don't even have to visit to pick up a passport. You must pay a $200,000 non-refundable contribution to Grenada's National Transformation Fund, or spend $350,000 on property from a government real-estate project, which you then have to own for at least three years (everyone advises going for the donation). There are also fees which usually amount to around $70,000.

Otherwise look to Antigua and Bermuda. You have to show up for five days to get the passport, but it is slightly cheaper than Grenada: a contribution of up to $250,000 to the National Development Fund plus fees. Similar deals are available for St Kitts and Nevis ($250,000 to the Sugar Industry Diversification Foundation), Dominica ($100,000 all in) and St Lucia ($400,000). These are also low-tax environments – no income, capital gains, inheritance or gift taxes in St Kitts and Nevis – an advantage should you choose to live in your new country.

Tax, residency and citizenship are complicated – things change constantly and individual circumstances make huge differences. Knightsbridge Wealth have teamed up with exceptional accountants and lawyers to ensure clients received the best advice, based on their unique circumstances.

UK property – getting taxing



The UK residential property sector has roughly the same value as all of the companies listed on the UK Stock Exchange combined. It is therefore one of the two major asset classes for investors. The market is diverse and 'buy-to-let' investments have become very popular.

However, recent UK tax policy has been designed to temper growth in the private rental sector through charging higher stamp duty land tax on buying, and more than halving the income tax relief on landlords' bank borrowings. Further restrictions have been made to bring foreign-owned property within the scope of inheritance tax. Despite this, landlords still see the future of property investment as attractive, with the shortage of housing in the medium term supporting the trend of growth in rents.

People have been letting property for hundreds of years and the UK's housing stock is said to be collectively worth over £6 trillion, with over one quarter of that value accruing within the past three years alone. The majority of the 23m residential dwellings are in private owner-occupation, either as the main or second home, but growth in the private rented sector now means that around 20% of the value of housing is owned by landlords.

The market is comparatively deregulated, allowing access to the private rental sector for most foreign nationals looking to inwardly invest, typically into cities such as London, Manchester and Birmingham. Growth in new housing numbers currently runs at approximately 0.7%, or 175,000 new units a year against established targets of 220,000 a year.

Tax now has such a significant impact on returns that investors need to understand the key taxes and how it impacts on investments.

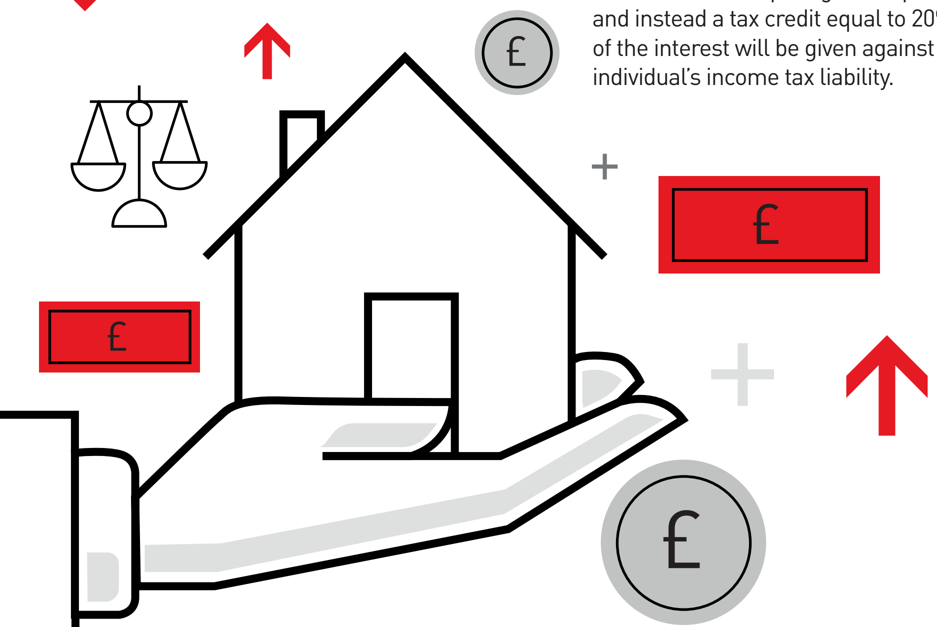
In April 2016, Stamp Duty was again increased, with a 3% supplementary rate added for an acquisition of an additional residential property. The rule is quite harsh, and catches an individual who has only a small interest in an existing property, via an inheritance for example.

Income tax

Income tax is payable at an individual's marginal income tax rate. The rents can be reduced for tax purposes by allowable annual costs such as insurance, internal and external repairs, safety checks, letting agent's fees and mortgage interest. Replacement furniture can be deducted from the rents if a property is let furnished.

The mortgage interest relief restriction does not apply to properties qualifying as 'furnished holiday lets', commercial properties and companies. Thus, demand for these assets have been boosted recently.

When the new measure takes full effect, the interest cost will be completely disallowed in computing rental profits and instead a tax credit equal to 20% of the interest will be given against an individual's income tax liability.



As the interest cost is completely disallowed, it means the individual will have higher overall taxable income.

Capital gains tax

The main rate of capital gains tax was reduced with effect from April 2016 to 20%, but for residential property the previous 28% rate was retained.

Inheritance tax

UK residential property is expected to contribute over half of all UK inheritance tax receipts in 2017-18. The tax is charged at 40% and the value of property left in deceased estates is expected to be worth in excess of £45bn, but outstanding mortgage debt and the inheritance tax nil-rate band worth £325,000 will reduce the eventual inheritance tax collected by HMRC.

A new 'main residence' nil-rate band worth £125,000 from April 2017 and gradually increasing to £175,000 from April 2020 means that individuals who own homes will eventually each have an inheritance tax exemption worth £500,000. This additional exemption was introduced to protect rising property values, particularly in southern England, from inheritance tax.

Another way in which to reduce the impact of inheritance tax is to make gifts of an interest in let property to younger generations. Capital gains tax has to be considered first because gifts other than between spouses and civil partners are chargeable.

There is always going to be demand for property. The UK remains a small island with high population density. Preserving and protecting areas of outstanding beauty and greenbelt between our towns and cities will provide challenges to how we build houses in the future. Tourism, industries, culture and our universities are a great magnet for visitors and a growing percentage of the population will look towards a competitive rental market to deliver housing needs. The long-term future looks bright for commercially astute landlords but the importance of the highest quality of advice to guide investors, has never been so evident.

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 20 years at HSBC, consistently recognised as one of its most accomplished advisers. He has over 24 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
Senior Strategic Financial Planner

Kellie Lewis
Client Relationship Manager

David Barnard
Office Manager

Chris Salacinski
Strategic Financial Planner

Kelly Kular
Personal Assistant to the Partners

Daniel Hawes
Relationship Officer

Declan Doolan
Financial Planning Manager

Heidi Witham
Paraplanner

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.

Knightsbridge Wealth Ltd,
45 Pont Street
London SW1X 0BD
United Kingdom

Contact us to make an appointment on

+44 (0)20 7407 3032

or send an email to:

info@knightsbridgewealth.co.uk

Knightsbridge Wealth

www.knightsbridgewealth.co.uk