



Knightsbridge
Wealth

update

Knightsbridge Wealth advises clients all over the world but, for once, it is the British economy that is poised to enjoy its fastest growth in over 70 years, according to the latest Bank of England forecasts. A successful vaccination programme and continued government fiscal support should help GDP expand by 7.25% in 2021, the fastest pace since at least 1949. The Bank also thinks unemployment will peak at 5.5% this year, a big cut from its previous forecast of 7.75%.

British stocks surged on the update, with the FTSE 100 topping 7,100 to hit a post-pandemic recently, before falling back amid last week's global sell-off. The index has gained 6% since the start of the year, while the mid-cap FTSE 250 index is up by 8%.

Let's not get carried away. Strong growth is to be expected as the economy recovers from a 9.9% contraction last year, its biggest decline since 1709. The Bank now expects UK GDP to return to pre-pandemic levels by the end of this year, but that still means that two years of output growth have been lost. This is a rebound, not a boom.

The Bank has held interest rates at 0.1%. It doesn't expect to raise them until the end of next year. At the start of the year the debate was about whether we were heading for interest rates below zero. The Bank is still doing technical work on the idea, but it has turned into a purely academic exercise. Instead, the talk now is about when rates will rise; markets currently price in a 25% chance of a hike over the next 12 months. Negative rates are dead before arrival.

UK income investors have endured a 41.6% fall in dividends over the year since the pandemic began, a loss of £44.8bn. Dividends continued to fall in the first quarter, but the pace of reductions is slowing. Half of UK companies either increased, restarted or held their dividends steady during the first three months of the year. The return of payouts from big banks underlying dividends are likely to grow to 5.6% this year to £66.4bn. Headline numbers will be even better because of special payouts from firms like Tesco and commodity miners.

The UK market has been one of the cheapest in the developed world in recent years and currently trades on a cyclically adjusted price/earnings (p/e) ratio of about 14.5. That discount is finally starting to unwind. The valuation 'gap' with the rest of the) has fallen from 20% in 2020 to 15% now.

The ratification of the post-Brexit trade deal with Europe removes one red flag that has stopped global money managers from buying British. The ongoing rotation away from tech stocks and towards cyclical energy and financial businesses also plays to

London's strengths. UK stocks will not stay cheap for much longer.

Meanwhile, in the US, stocks are among the most expensive in the world, having strongly outperformed international markets over the last ten years. That is not a normal state of affairs. There's no reason for the US to always be the lead market.

One way of dealing with an expensive US market is simply to invest a decent amount of money elsewhere.

In these challenging times, the quality of advice, service and active management from a well-regulated firm has never been more important. The team at Knightsbridge Wealth are committed to help in every way possible and we look forward to working with you.

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.



Market Report



Bonds

Valuations are looking tight

With a short-term spike in inflation looming and economic normalisation on the horizon, volatility has increased. Central banks have stated that they will withdraw stimulus much later than they did in previous cycles as the recovery kicks in. After the strong rally, US rates will move more gradually higher from here as the economy starts normalising.

The current tight valuations in the asset class, and the potential vulnerability to higher long term interest rates, do not present an attractive risk-reward. As such, high quality investment grade bonds look expensive. Emerging economies will eventually bring COVID-19 under control, through the roll out of vaccines, commodity prices will continue to grind higher, and we will see a broad-based cyclical recovery. This scenario implies ongoing support for Bonds in the emerging markets.

Foreign Exchange

Bearish on the Dollar

Among G-10 currencies, it would be wise to remain bearish on the US dollar. US interest rates have collapsed, and the Fed has supplied markets with an unprecedented amount of US dollar cash to alleviate funding issues, easing its policy stance more proactively than other central banks globally. Pro cyclical currencies should benefit. Among them are the Euro, commodity producer currencies and the British pound.

Commodities

Higher prices likely

Heading into the second quarter, the most important narrative for higher commodity prices remains intact: global economic growth and a broader reopening should accelerate as the vaccination roll out gathers pace, particularly in Europe. The expected improvements are not fully priced into markets, cyclical and broadly diversified commodity indices to deliver 10% to 15% returns over the next 12 months.

This backdrop is most supportive for energy and base metal prices. Some residual price strength is likely in agriculture and livestock prices should stabilise. However gold prices should pull back.

Oil

Recovery continues

The recovery in demand is stalling in Europe whilst strengthening strongly in the US. With the vaccine roll out gaining pace over the coming months, and mobility restrictions being eased, the oil demand recovery will continue during the second quarter of this year. OPEC and its allies have a cautious approach in bringing back oil production that cut last year. This will add price support. As the bloc will likely only increase output when it seems a firm recovery is in place, through oil market should stay under supplied this year. So, Brent is likely to move to \$75 a barrel in the short term.

Hedge Funds

Useful source of stability

Multi strategy hedge funds are attractive for diversification. strategies that can navigate heightened macroeconomic and geopolitical risk, especially those exposed to tech healthcare and Asia, look attractive. Direct lending into core real estate and infrastructure appears to be a good way to generate income in a diversified portfolio.

In private markets, opportunities should exist through special situation secondary and distressed managers that can take advantage of emerging themes such as digital tech green tech and healthcare.

Equities

Growth expectations improving

With the vaccine roll out now accelerating, reopening approaching, and more fiscal stimulus on its way in the US, growth expectations have improved dramatically. Policy uncertainty is rising as a result, injecting volatility into equity markets. However central banks will maintain easy financial conditions.

Markets are transitioning to a more mature phase of the recovery trade. The initial stage was characterised by unprecedented policy intervention which saw real interest rates collapsing and market expansion supporting equities. With profits now accelerating, higher bond yields should not derail the positive equity performance. As such there is further upside in the coming 6 to 12 months driven mainly by the cheaper segments such as cyclical and value stocks. Emerging markets are most preferred as their valuations are attractive.

Euro-zone equity valuations keep trading at a premium to historical norms, whilst the Japanese market rally has slowed down. However, there is modest upside potential due to the weaker Yen and on the economy reopening once the vaccination takes speed.

While UK equities are still trading at a large discount of global equities, the FTSE-100 is on track to reach its 7200 goal for the middle of this year.

The future of money

The rise of cryptocurrencies and a move to cashless payments during the pandemic have left states and central banks playing catch-up. Are new forms of money on the cards?

What's a "central-bank digital currency"?

It's a state-backed, digital-only currency that is issued and overseen by a central bank. Only one central-bank digital currency (CBDC) is actually in operation so far, a small-scale rollout in the Bahamas last October. But more than 50 central banks, in countries or blocs representing the bulk of global GDP – including China, the US and the UK – are exploring them.

A digital currency is simply one that never takes physical form: it remains on a virtual network and is stored and exchanged digitally. Thus, it is different from the "electronic currency" that today makes up the vast majority of the money supply (for example, the money held in bank accounts that could be withdrawn as physical cash). And a CBDC is different from bitcoin, or other cryptocurrencies, which are decentralised "permissionless" currencies that are not managed by any central authority. CBDCs are issued by central banks on behalf of governments.

What's the point of them?

For users, app-based CBDCs would offer a cheap, fast and efficient form of digital legal tender. For governments, the idea would be to take back control and adapt to technological change. The rise of decentralised digital currencies, and the rise of digital payments systems more broadly, pose a long-term threat to states' ability to regulate financial markets and execute monetary policy. These two functions of government have traditionally been carried out via banks. But if payment systems developed by tech giants and crypto-disruptors pull transactions out of the banking system, governments are stuck. The sense of peril and urgency, started by Facebook's planned Libra currency, ramped up due to the decline in cash usage during the pandemic. In just two years we have

seen a dramatic change in the way people and authorities think and talk about money.

So who's planning what?

Sweden, long a leader in the switch away from cash, is running a pilot scheme. Countries with active plans to introduce a CBDC include India, Pakistan and Thailand. In March, the European Central Bank president Christine Lagarde said the eurozone could launch a digital currency by around 2025 if policy makers give the project the green light this summer. Countries conducting research and feasibility studies include the US, UK, Japan, South Korea, Switzerland, Norway, Uruguay, Egypt and Australia. But the leader (after the Bahamas) is China.

Beijing began working on its plans for a digital yuan in 2014 and is currently conducting tests involving 500,000 consumers in 11 regions. It's also working on a transnational platform for the currency in conjunction with Thailand and the UAE; some analysts expect a national rollout within 12 months.

Is the West playing catch-up?

It's being more cautious due to the risk that CBDCs will destabilise banks and become too powerful for their own good – or for the good of businesses and citizens and consumers. For authoritarian surveillance states, such as China, this power isn't a downside – it's potentially a crucial tool in terms of social control as well as monetary policy.

In the UK, the Treasury and Bank of England announced a joint taskforce to examine the creation of a sterling CBDC last month, though didn't set a timetable. There are, however, reasons to be sceptical of the whole thing. Stodgy central bankers are not known as fintech innovators and may yet end up shying

away from the huge policy headaches involved – issues around data, privacy, liability, democratic oversight, and the risks of bypassing banks in a way that shatters revenues. Moreover, if the history of paper money is any guide, a digital currency will initially be more likely to prove a force for inflation and other economic woes at just the wrong time for the world economy.

What's the more optimistic view?

Those digital currencies are coming, and we need to embrace them. Just as we moved from barter to metal, and from metal to paper, so we are now moving from paper to little pulses of electricity. China is leading, but the challenge is to offer the world a rival model, one more rooted in the traditions of personal freedom, private property and privacy. No country is better placed to devise such a model than the UK – home to the world's greatest financial centre, a unique concentration of fintech expertise and a common law system that might have been specifically designed to encourage innovation in this area.



A new dawn for Hong Kong

China has once again moved to tighten its control over the former British territory and global financial centre. What will remain of the old Hong Kong's attractions?

China's ultimate decision-making body, the Standing Committee of its rubber-stamp Parliament, recently passed sweeping reforms that further strengthen Beijing's tight political control over Hong Kong. The measures slash the proportion of elected seats in the territory's legislative assembly from 50% to 22% and require all would-be MPs – as well as all other public officials – to be vetted for their “patriotism” by a pro-Beijing committee. The move prompted a further wave of arrests and convictions of dozens of pro-democracy politicians and activists. One of seven people convicted last week – over a peaceful demonstration in 2019 – was Martin Lee, the 82-year-old barrister known as the “father of democracy”. Lee once helped draft the Basic Law that underpinned Hong Kong's relative freedoms after 1997. He now faces up to five years in jail for unlawful assembly.

So, it's now “one country, one system”?

It's certainly a further decisive step on the road to a Hong Kong that is much more tightly integrated into mainland China – both politically and economically. The convictions of both Lee and media magnate Jimmy Lai are likely to set a precedent for several upcoming trials on similar charges of illegal assembly and protest. The year 2019 saw a wave of street protests and sit-ins in Hong Kong sparked by anger at a new law making its citizens liable to summary extradition to the mainland. Last year, Beijing forcefully signalled its patience was at an end and imposed a wide-ranging new national

security law on Hong Kong, aimed at eradicating “splittism, subversion, terrorism, and any behaviour that gravely threatens national security and foreign interference”. In effect, it's an anti-secession law that gives Beijing very broad, greater powers to stifle dissent, and it's the first time that a mainland criminal law has been introduced into Hong Kong's semi-autonomous legal code.

The Hong Kong government has long taken pride in the perception of its economy as one of the most liberal and open in the world – an international business hub with low tax rates and open ports. For 25 years it topped an “Index of Economic Freedom” published by the Heritage Foundation, a conservative US think tank, though last year it slipped to second place after Singapore. A few weeks ago, however, the Foundation took Hong Kong (and Macau) off its list completely. The move amplified the sense that the territory's status as a global financial hub is now in real peril.

Hong Kong is crucially important to global markets as a key Asian financial hub and a unique conduit between China and the West. Last year the Hong Kong Stock Exchange ranked as the world's second largest initial public offering market, raising a total of HK\$389.9bn (£36bn) from 140 listings, according to KPMG, and beaten only by New York's Nasdaq. In 2019 around US\$10trn of US dollar transactions flowed through its bank-to-bank payments system. Some 420 hedge funds (80 more than Singapore) are based there, managing more assets than Singapore and Japan combined. It's home to the global or regional HQs of 1,500 international firms. And, crucially, it is by far the pre-eminent dollar-funding centre in Asia.

There's no sign of it fading as a financial hub yet, and a surge of global capital seeking to reach Chinese markets has drawn even more investment to Hong Kong over the past year. In a long-established annual survey of global financial centres, updated last month, Hong Kong actually climbed a place from fifth to fourth, behind New York, London and Shanghai. Singapore came in fifth and Beijing sixth, while Tokyo dropped three places from fourth to seventh. The Global Financial Centres Index (GFCI) report cited the popularity of Hong Kong's stock-market for new listings, as well as the many cross-border trading schemes with the mainland, as key reasons for the territory's ranking.

So long as Hong Kong retains a stable business environment, the free flow of capital, low tax rates and a reliable legal system based on English common law, it's likely to keep its status as a global financial centre. But if the US were to target the dollar-payment system, or China's communist party to destroy the independence of Hong Kong's courts, judiciary and financial regulators, Hong Kong's allure could fade fast. Moreover, Hong Kong is gradually becoming a centre of Chinese finance, rather than a global one. The share of mainland firms listed on its stock-markets has risen fast, now accounting for 75% of overall market capitalisation. Last year more than 2,000 mainland mutual funds invested in Hong Kong, a jump of 268% in a year. And Chinese investors brought in net inflows of HK\$672bn (£63bn) through an investment channel called “stock connect”, 170% up on the year before.

Beijing is clearly betting that Hong Kong's role as an Asian financial centre will mean it remains attractive to Western financial institutions, whatever their governments have to say. Any change is likely to be gradual and its importance as a gateway into China will remain, barring some big upset. Most banks with a presence in Hong Kong will also have a base in Singapore but doubts that a sudden exodus is imminent. Beijing is determined to rebuild Hong Kong. The old Hong Kong is gone. Judge Xi's China by what it builds in its place”.



A commodities supercycle?

Is the world at the start of a commodities supercycle? Surging global demand for “appliances and electronic goods” during the pandemic has powered a boom in prices. Copper and iron-ore prices have both hit all-time highs. The latter, used to produce steel, has more than doubled since early 2020, breaking through \$200 a tonne for the first time ever. Brent crude oil is up by more than 30% so far this year.

A supercycle is a prolonged period of rising prices owing to structurally higher demand. The last one started after China’s accession to the World Trade Organisation in 2001 and lasted until the early 2010s. The red metal is white hot

Copper certainly looks to be heading for a long bull market. An electric vehicle contains four times as much copper as an internal-combustion car.

Onshore wind turbines likewise need four times as much copper per megawatt generated compared with traditional power plants. On the supply side, the constraints in copper are the worst they have ever been. Relatively little new supply is being added and it can take six to eight years to get a new mine up and running.

There are some signs of excess emerging. US steel prices have tripled this year to hit a record high: many mills stopped running last year, creating a huge shortage. Yet with the prospects for demand for steel unclear, some analysts think things will end in tears.

Not all industrial metals are glowing white hot. Zinc is up by 9% so far this year; lead 10%. That makes them comparative laggards: copper has more than doubled since its Covid-19 lows last year. Neither zinc nor lead is likely to benefit from the push to

go green. Indeed, lead’s exposure to the car market could see it lose out. The two metals are likely to be left behind again, just as they were during the last supercycle.

The jury is still out on whether the commodity bump is the start of a supercycle or just post-pandemic normalisation. Fully fledged supercycles are rare: there have been just four in the last 150 years. But when one gets going it can last for years. The “green metals” (copper, nickel, aluminium, platinum) certainly have a good shot.

Governments are encouraging green energy. One-third of Joe Biden’s ‘Jobs Plan’ will be spent on transport infrastructure and electric vehicles. Raw-materials stocks tend to pay handsome dividends that compound over time. A prolonged boom could make a generation of investors rich.

The global property bubble

Forget equities. The real post-pandemic action has been in property. This larger and slower-moving market is still the place where most wealth is to be found. Even in America, a land of compulsive stock-market investors, real-estate wealth amounts to \$44,349 per adult, compared with \$34,008 in stocks and bonds.

Property prices plunged globally after the 2007 financial crisis, but this time round banks are in much better health and more willing to lend. Prices are up in almost every wealthy country over the past year. In New Zealand they surged by 21.5% in the year to February. It’s been more than a year since the housing market closed as the pandemic took hold, for a short period, you could snap up multimillion-pound central London property at a 25% discount as sellers panicked. Yet, by the summer, the stamp-duty holiday was driving a new boom that has continued ever since. Sales have outpaced supply at the fastest rate in 14 years, according to the Royal Institution of Chartered Surveyors.

Global superstar cities such as London and New York were the big property winners of the past decade. No longer. Prices in

Manhattan fell by 4% last year. In the US, prices are now rising fastest in suburbs within commuting distances of big cities but offering more space. If remote-working endures post-Covid-19, then that trend will not fully reverse. The pick-up has been broad-based: US house prices are up 11% over the last year; German prices rose by 9%. Across 25 rich countries only in Japan have prices retreated over the past 12 months.

Australia has been enjoying yet another boom. A cocktail of low interest rates and housing undersupply saw prices advance by 2.8% in March, the biggest monthly gain since 1988. Prices are up by 6.2% on the year. Goldman Sachs thinks Australian property could rise by another 15% over the next two years as people seek more space to set up home offices.

Perhaps nowhere has the boom been more frenetic than in Canada. Exceptionally generous pandemic stimulus saw the country run a deficit of about 19% of GDP last year. Now house hunters have cash to splash. In Vancouver the price of a detached home surged by 13.7% in the year to February. In Toronto the equivalent index soared by 23.1% over the same period.





Ready for take-off

Aviation is bouncing back from Covid-19. But, since mass international travel spread Covid-19 across the globe, the airline industry has borne the brunt of governments' restrictions on movement during the pandemic. This has affected all parts of the sector, with some airlines going bankrupt, others being forced to seek state bailouts and most carriers having to make large numbers of staff redundant.

Still, recent signs that vaccines could bring the virus under control have fuelled optimism, with the share prices of many airlines higher than they were a year ago. But will the bounce endure?

The recovery is likely to be slow and painful, even in the short term. Governments have adopted a fragmented approach to travel restrictions, with most countries requiring some form of self-isolation and some effectively banning both incoming and outbound travel to prevent the spread of new variants.

Countries that have managed to vaccinate most of their population are understandably wary of allowing travel to and from those that have been less successful in reducing the number of cases. In the worst case, these weakest links could end up making it impossible for international travel to recover.

The number of passengers could return to its pre-pandemic peak within the next two years. Even European countries that have seen their vaccine programmes disrupted by supply problems are likely to have immunised most of their vulnerable

population within the next two to three months, which should allow restrictions on both in and outbound travel to be lifted, or relaxed. What's more, once people are given the green light to travel, leisure travel should return quickly as people take advantage of the opportunity to go on foreign holidays.

The desire for holidays isn't the only factor that will fuel a recovery in passenger numbers. The increasingly globalised nature of family life means that demand for travel is now also partly fuelled by the need to keep in touch with family and close friends in a way that cannot be replicated by Zoom or WhatsApp. Demand for both types of travel will be further boosted by the fact that many households have saved a lot of money during the lockdowns.

Data from the US Transport Security Administration provides strong evidence that an effective vaccination programme can help travel recover quickly. The numbers of people going through airport security fell by 95% in only two months, at the start of the crisis. However, in the first half April, the average daily total had rebounded to 1.43 million. That is still 40% down from April 2019, but that rebound is almost entirely through domestic travel, which is much closer to pre-pandemic levels. And given that more than half the US population has received at least one jab (and nearly a quarter have received both), numbers will increase further.

America isn't the only air-travel success story, with China providing further evidence

that it may be more resilient than people are predicting. China's vaccine rollout has been relatively slow, but last month its domestic passenger numbers had recovered to about 95%-98% of pre-Covid-19 levels. While international numbers are still impaired, this gives an indication of what could happen across the rest of the world – at least in domestic markets – once restrictions are lifted.

Business travel is likely to take some time to recover and may be permanently reduced by the rise of Zoom so, from an investment perspective, airlines that make most of their money from short-haul leisure travel look more appealing than those skewed towards long-haul business travel.

Flying aeroplanes, or even building them, isn't the only way to make money from air travel. Even those airlines that decide to upgrade their fleet still need to make sure that their aeroplanes are regularly maintained to a very high standard.

A niche area likely to receive more attention from all part of the industry in the future is hygiene. In the past, price-conscious consumers were willing to accept that they would be exposed to other people's germs, with catching the occasional cold or flu considered as much a fact of travel as jet lag.

However, Covid-19 has changed all that, with airlines forced radically to increase their level of cleanliness. Already, the big manufacturers, such as Boeing and Airbus, are working on systems to improve the quality of recycled air.

COVID-19 CORONAVIRUS

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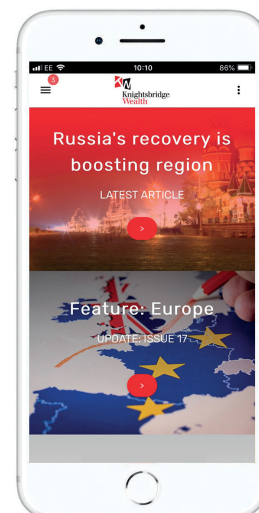
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Alexander Wade

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.



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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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