



Knightsbridge
Wealth

update

Dear Friends and Colleagues,

The key take away from the US election results is that we're now back to a gridlock situation. Markets tend to quite like this. A split like this makes it hard for governments to push through any big, aggressive changes.

Change – even sensible change which is beneficial in the long run – is traumatic and contributes to uncertainty. We all need change, but it's nicer to have it in manageable doses. That's human nature.

You can see why markets are breathing a sigh of relief. The main implication of the vote is that it'll make it harder for the Trump government to drive through any more tax cuts or fiscal stimulus. You might think that would be viewed as bad news. However, the main thing worrying markets right now is the Federal Reserve and interest rates.

More stimulus would have put more pressure on the Fed to raise rates. And it would also have increased the US deficit. And it would also have pushed up bond yields. So markets prefer the idea that a clogged-up Congress will leave both the bond vigilantes and the Fed feeling more relaxed.

All in all, that rather helped to explain the overall market reaction; the dollar weakened (as you'd expect if the pressure on rates eases), Bonds rose (again, as yields fall, prices rise) and stocks gained too (less fear of higher rates, means happier stock market investors).

And what about Trump? Are his hands tied now? Hardly.

This rising undercurrent in the US of a backlash against the idea that "government is the problem" is intriguing.

He then noted that the one thing most people aren't really talking about anymore is the sheer scale of US debt. He argued that the next crisis could come from that direction.

What if, he said, Trump declares (at a rally, or on Twitter) that the money that the US owes China (in the form of US Treasuries) is effectively null and void, because of China's unfair trade behaviour over the decades? What if his audience applauds that idea? What if he sees this as a big vote winner in the run-up to 2020?

How would markets react to the notion that the US might not be a cast-iron credit risk? Or that certain Treasuries – those owned by China – were now less equal than others? The answer, of course, is "badly". In fact, Lewis reckons it could spur a run on the dollar – which sounds quite likely in that scenario.

Given that the market is still very expensive in the US, this post-election bounce may well be a relatively short-lived reprieve – a final Santa Claus rally before tougher times ahead.

Those looking at alternative ways to invest their money usually include property amongst their options. Popular wisdom holds that house prices always go up, but the current turn in the economic cycle is showing that this adage does not always hold. Prices in places such as Australia, Hong Kong and the UK, are now falling. There are always local factors at play, but tightening global liquidity and greater hostility towards foreign buyers in many countries are both playing a part.

As 2018 draws to a close, we face an exciting outlook for 2019 – a year that will continue to require careful financial planning in an increasingly volatile market. And a crucial year for the UK after Brexit. London's status as the globe's financial hub will continue undimmed, although challenges are inevitable.

We look forward to working with you in 2018.

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Market Report



Bonds

Favour Emerging Markets

Risk-free yields in some major developed markets are near or below zero. Even if rates stay unchanged, many short to medium term Bonds will deliver negative total returns. Investors can preserve wealth by taking profits. More attractive returns can be found in emerging markets, benefiting from sound global growth, reduced new supply and relative attractiveness against other credit market segments.

Commodities

Positive outlook for gold

After the broad decline across the sector from spring into summer, the metal market has become more selective, with inventories sliding and the physical market tightening up. The supply-induced spike in aluminium prices reversed swiftly, whereas nickel and tin prices failed to move higher. The lack of positive news flow on the demand side has softened lead prices further.

The fall in base metal prices should have come to an end. Supply fundamentals are sound and inventory dynamics still warrant a recovery in prices on a broader basis. That said, demand concerns seem plenty in the near term and have yet to ease. This will lead to a very choppy price recovery. Copper has the most upside potential.

Gold prices remain subdued since its safe-haven status hasn't kicked in, partly due to the strength in the US equity market. Investors haven't needed gold as a hedge. The positive outlook on gold hinges on a peak in the USD and investors seeing the value of holding gold in the later stages of the economic cycle, as well as equity market volatility likely to rise as the end of the year approaches.

Equities

Technology suffering

Global equities suffered a setback in October, falling over 6% before recovering in the last sessions. Triggers for the correction include the sharp rise in US Treasury yields as the market prices in a more aggressive pace of rate hikes, as well as a belated pricing in of the potential cost of tariffs on US earnings. However, the economic backdrop remains solid and the good growth momentum in the US should enable the economy to readily absorb higher rates, even if they continue to rise at a moderate pace.

US large caps stocks last 7% with technology especially hard hit. Global indications continue to signal robust economic growth, with US companies expected to deliver 23-24% earnings growth in the third quarter. The Canadian market is looking particularly attractive, whilst Australia is now looking expensive.

Oil

Stunning turnaround

Crude has recently plunged about 22%, since closing at a four-year high of \$76 last month.

It's a stunning turnaround considering, just a few months ago, some analysts were warning that \$100-a-barrel oil could be just around the corner, especially given the Trump administration's crackdown on Iran.

With Iranian production falling fast, spare capacity is likely to a fall to a 10-year low as OPEC nations ramp up productions to fill the gap.

Meanwhile, the more the Saudis pump to cover the production shortfall, the lower overall spare capacity falls and the more market players grow concerned

at how long the Kingdom can sustain its production level.

Brent oil is expected to trade at \$85 a barrel and continue to see prices tilted to the upside. Investors with a high-risk tolerance can sell the downside risks in crude oil or add long crude oil exposure.

Hedge Funds

Useful source of stability

Hedge funds are a useful source of return and stability in a multi-asset portfolio, especially during times of market volatility. They offer superior risk-return compared to many other asset classes and access to uncorrelated investment opportunities, which provide downside protection and diversification benefits.

The current global environment of heightened stock dispersion, low cross-asset correlation, rising interest rates, moderately higher volatility, and diverging monetary and economic policies is supporting performance. Annual growth, in US Dollars, is predicted for the asset class as a whole at between 3 and 6%.

Foreign Exchange

Safe havens strengthen

The recent rise of US rates has not yet lifted the US Dollar relative to the Euro. Whilst the Dollar is likely to continue to appreciate in the short term, a 6-12 month view is positive for the Euro. Dollar, Swiss Franc and Japanese Yen are all supported by their 'safe haven' standing in these volatile times.

Sterling will remain volatile as the moment of Brexit truth approaches, and negotiations in Brussels reach a close. Whilst the risk of a 'cliff-edge' Brexit remains, any confirmed deal will lead to an immediate rebound for the Pound.

Landlords turn to incorporation

The hostile tax environment has driven many landlords owning UK property, to register as a company, rather than as individuals. Nearly half (44%) of buy-to-let mortgage transactions are now made by limited companies.

The simple explanation behind more landlords choosing to incorporate is that they want to pay less tax. Before 6 April 2017, landlords could deduct mortgage interest from rental income before paying income tax. But this tax relief is gradually being phased out, and from 2020 relief for financing costs will be restricted to the 20% basic rate of income tax. This will affect the profits of higher earners who previously qualified for relief at 40% or 45%. New affordability checks have also made it harder for landlords operating as individuals to borrow as much against a property as they could previously.

Landlords can avoid the increasingly punitive tax situation by setting themselves up as limited companies, as these benefit from favourable tax treatment of profits. Landlords who pay higher- or additional-rate tax, and who have a mortgage, tend to benefit most from incorporating. If you hold a property in a company, profits are liable for corporation tax at 20% – potentially halving your tax bill. Incorporated landlords can also continue to deduct all their costs, including finance, from rental income for tax purposes. Setting up a limited company is straightforward. You'll need to register at Companies House, which can be done online for £12. You'll need a company name, an address, at least one director and details of any shareholders. After

you've established your business, you have three months to register it for corporation tax.

Buying properties as a limited company is also fairly simple. The main caveat is that you'll need to find a mortgage lender that lends to limited companies. You may find interest rates are higher than on mainstream mortgages.

Transferring properties you already own to the limited company is trickier, as effectively you need to sell the property to the company. This means you'll personally be liable for capital-gains tax on any increase in the property's value since you purchased it, while your company must pay stamp duty on the purchase. In some cases, it may be possible to transfer properties subject to their existing mortgages, but if not, you'll need to pay off the mortgages and take out new ones in the company name. This process may trigger early repayment charges to redeem an existing mortgage, plus associated fees.

Running a limited company involves a lot of paperwork. Most company directors take income as a combination of salary and dividends. In general, it's a good idea to take both tax and mortgage advice before incorporating, to check it makes financial sense.

'Help to Buy' scheme capped

Last week's Budget confirmed that the Help to Buy equity-loan scheme, which offers taxpayer-backed loans worth 20% of the purchase price of a new-build house, will be extended until 2023. But from April 2021 it will only be available to first-time buyers. Buyers will also

only be able to purchase properties worth up to 1.5 times the "current forecasted average first-time buyer price" for the region, with a maximum of £600,000 for London. This will mean buyers in the north east will only be able to buy houses worth a maximum of £186,100, while those in the north west will be able to spend up to £224,400.

The current iteration of the equity-loan scheme has been widely criticised for pushing up the price of new builds, as it widened the pool of people who could suddenly afford new-build properties and fuelled demand. So, it follows that a price cap might push prices down somewhat by tempering demand, perhaps to the point where the original Help to Buy borrowers could have afforded to buy without the scheme.

Buy-to-let borrowers in demand

Mortgage lenders are offering attractive deals to buy-to-let landlords, in a bid to win the business of those who haven't left the increasingly unprofitable sector. The past few years haven't been kind to landlords, as the government has brought in various taxation and regulatory changes in an attempt to slow the expansion of the buy-to-let market. In the first half of this year, landlords spent £12.1bn on new buy-to-let purchases, which is 30% lower than the amount spent in the first half of 2015.

So, buy-to-let lenders are competing for fewer customers, and adjusting their offers accordingly. Last month the average five-year fixed buy-to-let rate had fallen to 3.4%, the lowest level since 2011.



What price a passport?

When Roman Abramovich had problems renewing his British visa, he turned to Switzerland. It rejected his residence application, however, after Swiss police said he posed a “reputation risk”. (He denies wrongdoing.) The colourful Russian billionaire and owner of Chelsea football club now has an Israeli passport, allowing him visa-free travel to Britain, and is converting a former hotel into his Tel Aviv pad.

Israel offers nationality to any Jew who asks for it. Other oligarchs have to pay for the privilege, but they are spoilt for choice. Citizenship and residence-for-sale schemes, typically charging between \$100,000 and \$2m, are booming. An industry of lawyers, bankers, accountants, consultants and estate agents has sprouted up to serve well-heeled “investment migrants”.

About 100 countries offer a ‘residence by investment’ programme. Over a dozen offer citizenship—including five Caribbean island-states, Vanuatu, Jordan and, within the EU, Austria, Cyprus and Malta. The latest entrants to this market are Moldova and Montenegro. The modern business tends not to mention one of its pioneers, the Kingdom of Tonga in the South Pacific, which in 1983 began selling passports for a few thousand dollars with few questions asked. Those advising on residency and citizenship prefer to trace its ancestry to a law passed in 1984 in tiny St Kitts and Nevis, offering citizenship to foreigners who made a “substantial” investment. Today, its population is about 50,000. Half as many outside the country hold passports.

Even more important to the industry’s scale, in 1986 Canada introduced a residence-by-investment programme. It proved a magnet for Hong Kongers nervous at the impending handover to China in 1997. Canada withdrew its federal scheme in 2014, but, at the provincial level, Quebec continues to offer one. These days, mainland China remains the main market for most schemes.

The idea of selling passports repels some people. Citizenship is a sacred bond, they argue, and should be granted only to foreigners who prove themselves



worthy. Why should the rich be allowed to jump the queue? Especially since some of the queue-jumpers are crooks or tax-dodgers, who want a new home in which to hide or launder their loot.

There are legitimate reasons for wanting a second passport. Travelling business-folk can face endless visa hassles unless they have one. Others seek an extra passport as insurance against instability or persecution. More than a third of rich Chinese would like a foreign bolt-hole (which may mean flouting China’s ban on dual citizenship). Countries meeting this demand gain a straightforward benefit: easy money to spend on public services. For hurricane-hit Caribbean states, passport-flogging has been a lifeline.

Regardless of who gains, a principle is at stake. Countries have every right to reserve citizenship for people who try to become like the native-born population, for instance by learning the language. But they also have the right to sell it, if voters agree. Citizenship is a basic matter of national competence.

Its sale should not be unconstrained, however. Member states of the European Union need to agree on common principles governing whom to admit, since a passport from one gives access to live and work in all. Tiny states that sell lots of passports face another risk. If they overdo it, native

voters could eventually be outnumbered by citizens of convenience. Some states may therefore wish to restrict voting rights to those who forge a deeper connection with the place, for instance by residing there for a minimum period each year.

All citizenship-sellers, large and small, should do more to weed out undesirables. Too often, their programmes open a back door to dirty money; think of the ill-gotten Russian gains that have been laundered through Cyprus, one of the EU’s most enthusiastic hawkers of passports. The industry talks a good game, emphasising recent improvements in client-vetting. But it has moved too slowly.

Stricter “know-your-customer” rules are now on the horizon, together with the blacklisting of countries that offer havens for migrants with dirty money. Stiffer rules are also likely to thwart passport-buyers whose aim is to evade tax on money that was lawfully earned. In the United Arab Emirates, for instance, foreigners are buying residence and using it to secure tax residence too, which allows them to block the flow of data to tax authorities elsewhere.

There are many sound reasons to grant residence or citizenship to foreigners who are prepared to pay for it. Abetting criminals is not one of them.

Rate rise puts bull market on borrowed time

GDP in the US expanded at an annual rate of 4.3% in the second quarter. Meanwhile, the unemployment rate was at its lowest level since 1969. "It's a remarkably positive set of economic circumstances," according to Federal Reserve chairman Jerome Powell. "And there's no reason to think it can't continue for quite some time."

But if the US economy is that strong, then why are there widespread concerns America's financial markets could soon collapse?" Liam Halligan in The Sunday Telegraph, explained the reason is that we're still in a "post-crash Alice-in-Wonderland world" where "good news is bad news".

Signs of economic strength mean central banks could curtail their ultra-loose monetary policy sooner rather than later. That, in turn, spooks financial markets – bloated after years of interest rates nailed to the floor and having gorged on the drip-feed stimulant that is quantitative easing. Given investors have borrowed heavily since 2008, financial markets are now highly leveraged.

The US is the world's most important economy and the interest rates at which the US government can borrow over a certain period – represented by the bond yields – set the tone for markets worldwide. In addition, higher US yields strengthen the dollar as the yields on US assets become more appealing.

That exacerbates the developing headwinds for US earnings and it will worsen the squeeze on emerging markets, which always suffer as money leaves risky assets and returns to the US.

The medium-term trend is clear. More Fed rate rises amid a strong economy will raise long-term rates, depressing bond prices and undermining confidence in stocks as dearer money makes corporate debt pricier and hampers earnings. And look out for a sharp jump in US inflation now wage pressures are rising. Rising prices would imply unexpectedly rapid interest-rate increases to squeeze out inflation, giving the overleveraged world economy a very nasty surprise.

Retiring in the Algarve

When the financial crisis hammered Portugal's economy, hundreds of thousands of its people left, taking advantage of the European Union's rules on free movement to find work in countries that were hit less hard. Now Portugal is welcoming older people going in the other direction, not for jobs but for a warm, cheap retirement. Many retirees are flocking to Lisbon, Sintra and the Algarve, drawn in part by Portugal's tax exemptions on foreign income. Under its non-habitual-residency scheme, pensions from abroad can be drawn tax-free for a decade.

Bilateral double-taxation agreements are intended to ensure that income does not end up being taxed twice. But some countries, seeking to boost domestic demand by luring wealthy immigrants, have arranged matters so that they can avoid paying any tax on income earned outside their country of residence, such

as pensions, capital gains and rent. To qualify, foreign pensioners who move to Portugal need only stick around for six months a year and register as tax-resident.

Portugal is not the only EU country where foreign pensioners can find a sweet deal. France taxes some pensions taken as a lump sum at 7.5%; with judicious use of private health insurance, pensioners can also avoid paying the social charges of 9.1% normally levied on pensions. Malta exempts pensions of up to €13,200 (\$15,200) from tax altogether, with a flat rate of 15% above that. State pensions are often excluded from generous exemptions but Cyprus taxes all

pensions at 5%, making it particularly attractive for retired civil servants. It also allows people to withdraw their entire pension pots as a lump sum tax-free.



China's small recovery

The CSI 300 index has tumbled 21% this year and in October alone it fell by 8%. But it has since staged a small recovery. A key trigger for this tentative rebound in Chinese shares was a signal from Beijing in the beginning of November that it planned to introduce further stimulus measures in response to persistently weak economic data. Government measures to boost the economy have always given Chinese stocks – and their global counterparts – a fillip: witness the worldwide rallies in 2011–2012 and 2015–2016.

In recent months China has adopted a series of policies to prop up growth, including cuts to bank reserve requirements and increased fiscal spending. The scale of stimuli, however, has so far been modest.

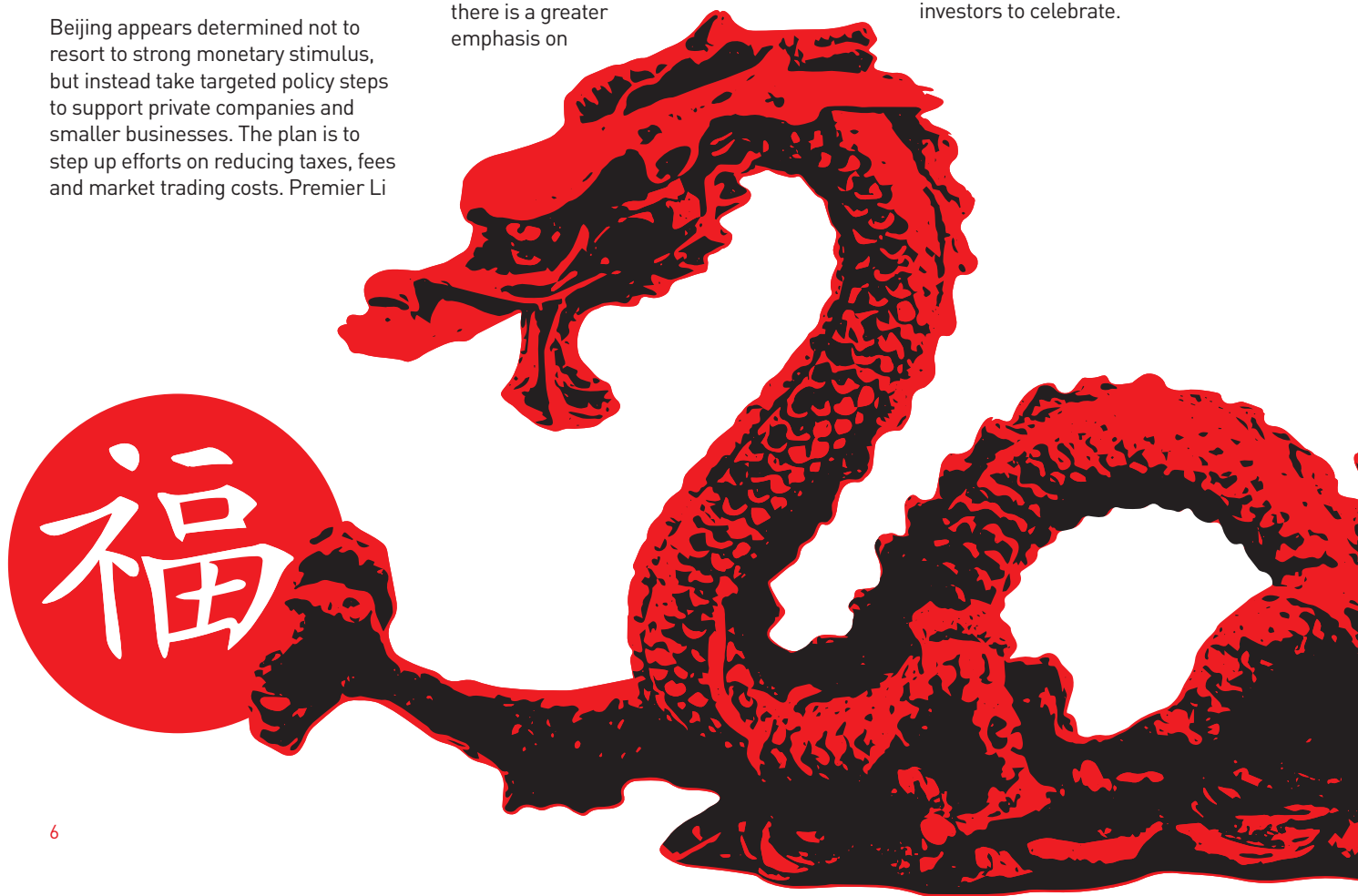
Beijing appears determined not to resort to strong monetary stimulus, but instead take targeted policy steps to support private companies and smaller businesses. The plan is to step up efforts on reducing taxes, fees and market trading costs. Premier Li

Keqiang said China would continue “to open up its financial markets”. All very well, but hardly the sort of broad-based jolt we have seen in the past. The trouble is that the authorities are walking a tightrope. They need to keep credit flowing to support growth, but at the same time they are wary of adding to the country's huge debt pile. Indeed, the country is trying to reduce reliance on credit. The ‘debt hangover’ from previous spending and building sprees dilutes the impact of any further credit, as well as limiting the scope for it.

Another difference between current-stimulus policies and previous ones is what they focus on. Earlier stimulus was investment-led, targeting the construction of factories, housing and infrastructure. This time, there is a greater emphasis on

consumption, which accounted for 78% of GDP growth through the first nine months of this year, compared with an average of only 55% between 2008 to 2017. Income-tax reductions will come into force in 2019, while a levy on car purchases may be halved.

China's small measures could still bolster global growth, but the effect would probably be felt less in sectors traditionally closest to China, such as energy and metals, and more in sectors serving consumer demand, such as luxury goods and agricultural commodities. On balance, however, investors shouldn't count on Beijing giving global stocks a major boost. A return to Beijing's old stimulus playbook may put a floor under falling markets, but there is little else for investors to celebrate.



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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.



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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UPDATE

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