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update

Knightsbridge Wealth

Dear friends and colleagues,

The UK's status as the world's pre-eminent safe haven for global wealth was, briefly, threatened by the prospect of a break up of the nation. Had Scotland voted to become independent, it would have been followed by a troubled time for Sterling, as the full consequences of separation were managed. This would have inevitably damaged confidence in the UK's brand across the world.

And the importance of the UK, particularly London, as a global financial centre has never been more evident. Global uncertainty is on the increase and clients need to make financial decisions based on the foundation of well-regulated financial advice and planning. Very few UK firms target their expertise specifically at the international sector, and Knightsbridge Wealth continues to grow its team and its reach, with a thorough and comprehensive schedule of overseas visits, for those unable to come to London.

Investment conditions have been quite startling this year and some assets (such as London property and US stocks) are now looking expensive. What should an investor do? Well, as ever, value is key. Investors should avoid countries that seem expensive, or where they are not quite priced for the sorts of political risks that might be out there. Hold some cash. If you are a risk-taker, you could invest in markets which look cheap, like China and Russia.

As for the rest, buy assets in markets where prices remain reasonable. With the promise of printed money to underpin them, Europe and Japan look attractive.

Wherever and whenever you invest, you need to work with a firm that understands your unique requirements and delivers the right team to ensure all areas, including tax planning, property planning and legal advice. In early August, for instance, a new rule was unexpectedly announced which had a significant affect for non UK nationals having l oans against overseas properties, and remitted to the UK. Later this year, significant reform is likely to be announced for the Tier 1 Investor Visa scheme.

Knightsbridge Wealth only works in the offshore market and, no matter what changes we face – from new nations emerging, to others suffering – we will focus on providing the highest quality of UK regulated, independent advice.

We look forward to working with you in the remainder of 2014.

Market Report

Property
A crash looms?
The red-hot UK housing market finally appears to be cooling. According to data from Nationwide and Hometrack, prices are up 11% over the last year, but barely moved over the summer. In London, prices were flat and are spending more time on the market. The percentage of properties getting their full asking price has fallen from 99.2% in June (at the height of the boom when many good properties went to sealed bids, taking prices way in excess of what was asked) to 96.4% just three months later.

We don't yet know whether this is a pause or a turning point but, either way, it may be prudent to stay away. Houses remain overpriced, and history shows that when the trend changes, prices tend to fall rather than plateau.

Energy
Staying calm
Oil prices have slid from $115 a barrel in June to about $100, despite the geopolitical upheaval around the world, which usually causes the oil price to strengthen.

US air strikes mean jihadist incursions into southern Iraq less likely. Russia's oil exports are unlikely to be affected by sanctions, and any shortage would be offset by lower demand within Russia as sanctions dent growth. The global market looks well supplied, with US stockpiles at a record high. Prices are likely to move sideways or further down.

US natural gas is a different story. It is entering a structural bull market as industries and households are encouraged by stringent regulations to switch to the cleanest burning fossil fuel.

Precious metal
Hit by strong Dollar
Gold's appeal has been dented as the global economy continues to recover. The US and UK look set to raise interest rates soon which is bad news for an asset that pays no interest and thrives on economic upheaval. But inflation could make a come back if central banks raise rates too slowly. Many asset markets are looking overextended and, with Europe faltering, another financial crisis cannot be ruled out. It remains appropriate to keep 5-10% of many portfolios in gold as insurance. Silver is more risky – volatile and unpredictable. It tends to magnify gold's move – up or down –and is also affected by the outlook for global industry, which makes up half of its total demand.

Bonds
Artificially high
This year, Government Bonds have defied expectation by actually rising in value – meaning the yield, or income, they give has fallen. Central bank quantitative (QE), or money printing, has artificially inflated prices because the newly created money finds its way into the economy through buying bonds.

QE has also inflated prices of corporate bonds, especially junk bonds, by prompting investors to chase riskier assets. All bonds are wildly overvalued and extremely vulnerable to a turn in the interest rate cycle, or rising inflation.

The only investors to whom a significant bond holding may be appropriate are those requiring a hedge against deflation within a diversified portfolio.

Commodities
Unfashionable again
This year, raw materials had their best first half since 2008, gaining 7.1% by late June, as measured by the Bloomberg commodity index. Since then, most of that gain has evaporated. We have tepid demand growth (weakness in China and Europe has countered strong US growth) and supply is healthy, with very few exceptions. However, mining stocks remain relatively inexpensive and worth buying.

The outlook for agricultural commodities remains bright in the long term, as rising populations reduce the world's supply of arable land. "Soft" commodities are extremely volatile so buying stocks in fertilizer or farm-equipment remains the best way to access this sector.

Equities
Buy cheap markets
Signs that the Eurozone recovery is faltering spooked the markets, with $3.5bn flooding out in the week to 13th August 2014 – the largest outflow in four years. European equities look attractive since stocks are reasonably valued and a policy of quantitative easing is now being adopted, which tends to be good for stocks. Japan is a buy for similar reasons.

Emerging markets are on track to beat their developed counterparts for the second quarter in a row. They should benefit from the ongoing recovery, while many investors think they can also cope with higher US interest rates, which will draw money away from riskier assets. Markets with little commodity exposure and promising internal economies should be on the buy list, in addition to Brazil and China.

Feature: Eastern Europe

In May, we reported on our website that the Brussels think tank, Bruegel, declared Warsaw, Prague and Braislava were wealthier than Vienna. Continued economic reforms and low labour costs mean that the underlying health of the region remains robust, with most of the countries in eastern Europe and the Baltic growing faster than their western neighbours. Best of all, their stock markets remain cheap, both in terms of short and long term measures. The three most interesting countries – Poland, Hungary and the Czech Republic – can be accessed by funds, individual stocks and Exchange Traded Funds (ETFs). The Discretionary Fund Managers that Knightsbridge Wealth works with increasingly see Eastern Europe as a key part of a portfolio's growth strategy, for clients with the appropriate risk appetite.

Poland

After the 1989 election, the new government embarked on 'shock therapy' of rapid and radical reform to boost productivity. By the mid 1990s, the economy recovered lost ground, vindicating the reformers' approach.

Poland joined the EU during the first wave of eastwards expansion in 2004. However, it retained its own currency which meant it could avoid the Eurozone recession. Ironically, Poland also benefited from the relative lack of sophistication of its banking system. While financial institutions elsewhere speculated in subprime mortgages, Polish banks stayed focused on the boring business of taking in deposits and making loans. This removed the need for expensive bailouts.

Poland's entry into Europe encouraged a large number of people to leave in search of higher wages, including workers the country desperately needs to retain. However, the good news for Poland is that an increasing number of global firms are taking advantage of lower wages and the high level of education by relocating there. Plenty of middle-management roles have been created as well as simpler back-office jobs. Already, more than 110,000 people work in the outsourcing sector, and the number is growing rapidly.

The medium-term economic outlook suggests that Poland will continue to catch up with the rest of Europe. Although growth slowed last year, the economy still expanded by 1.6%. The central bank has indicated that it is prepared to slash interest rates to stimulate demand, and the government is aiming to cut its deficit. Total growth his year is likely to be a very healthy 3.4%, with a further increase of 3.65% in 2015.

Hungary

Even before the first free elections in 1988, the Hungarian government had already begun to experiment with some market reforms. Because of this, the first non-communist government was able to push through a rapid transition to the private sector. The country was growing rapidly by the mid 1990s, joining the EU in the first way of accessions.

Hungary suffered during the financial crisis, as exports plunged and the deficit expanded. However, thanks to EU financial support and a new wave of fiscal reform, the government has been able to slash the deficit. The fact that Hungary did not join the Euro means the country's' debt to GDP ratio is now falling and the economy has started to grow again, at around 3% this year and expected to continue in 2015.

Thanks to its location, excellent transport links to the continent, and cheap labour, Hungary has become an increasingly important centre for car production in eastern Europe. The sector provides more than 100,000 jobs, makes up to a fifth of the country's exports, and accounts for 10% of Hungary's GDP. In the last year alone, production rose by over 25% as foreign firms such as Audi, Mercedes, Suzuki and Opel, continue to expand their presence there.

Hungarian industry isn't just limited to car assembly. Thanks to its education system, Hungary always produced a large number of scientists and engineers. Many university science departments are now working much harder to make sure that this expertise directly benefits the economy.

At the same time, Hungarian entrepreneurs are starting to develop a domestic technology sector that has already produced several start-ups including video streaming from Ustream and remote networking company, LogMeIn.

The Czech Republic

Both Poland and Hungary have made substantial material progress from their communist days. However, the Czech Republic is by far the closest to completing its transition from an 'emerging' economy to a mainstream one. Its inflation-adjuested per capita GDP is now very close to the EU average, and ahead that of either Greece or Portugal. Successive governments continued to reform the economy's structure, including changing the tax system, labour laws and education.

The OECD noted that attempts to make it easier for employers to hire workers on a flexible basis have led to an increase in the labour participation rate, with the number of part-time workers reaching record levels. The Czech republic also scores highly in surveys of the business environment and quality of governmental institutions.

Thanks to its business-friendly environment and a skilled workforce, it has become a magnet for foreign firms and investors. Czech exports have also surged, with the OECD estimating that 70% of the economy is directly integrated into the global value chain. This means that it is more integrated than almost all economies in Western Europe or Scandinavia.

The Czech Republic is unlikely to join the Euro in the near future. This monetary independence helped it to weather the financial crisis with only a brief recession ins 2009. While fiscal tightening produced another slow down in 2012 and 2013, it also brought the deficit under control. The latest forecasts suggest the country will grow by 2% and 3% for the next few years.

So all three countries have performed well since 2009. Looking ahead, security concerns are understandable, but these countries are all protected by Nato and should carry on growing for years to come.

China falters

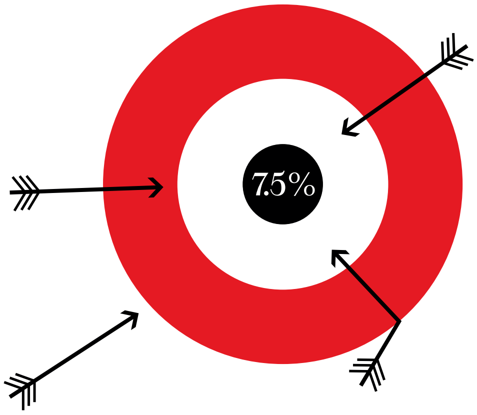
China's economy us cooling unexpectedly fast. The economy is now expected to miss its 7.5% GDP growth target for 2014.

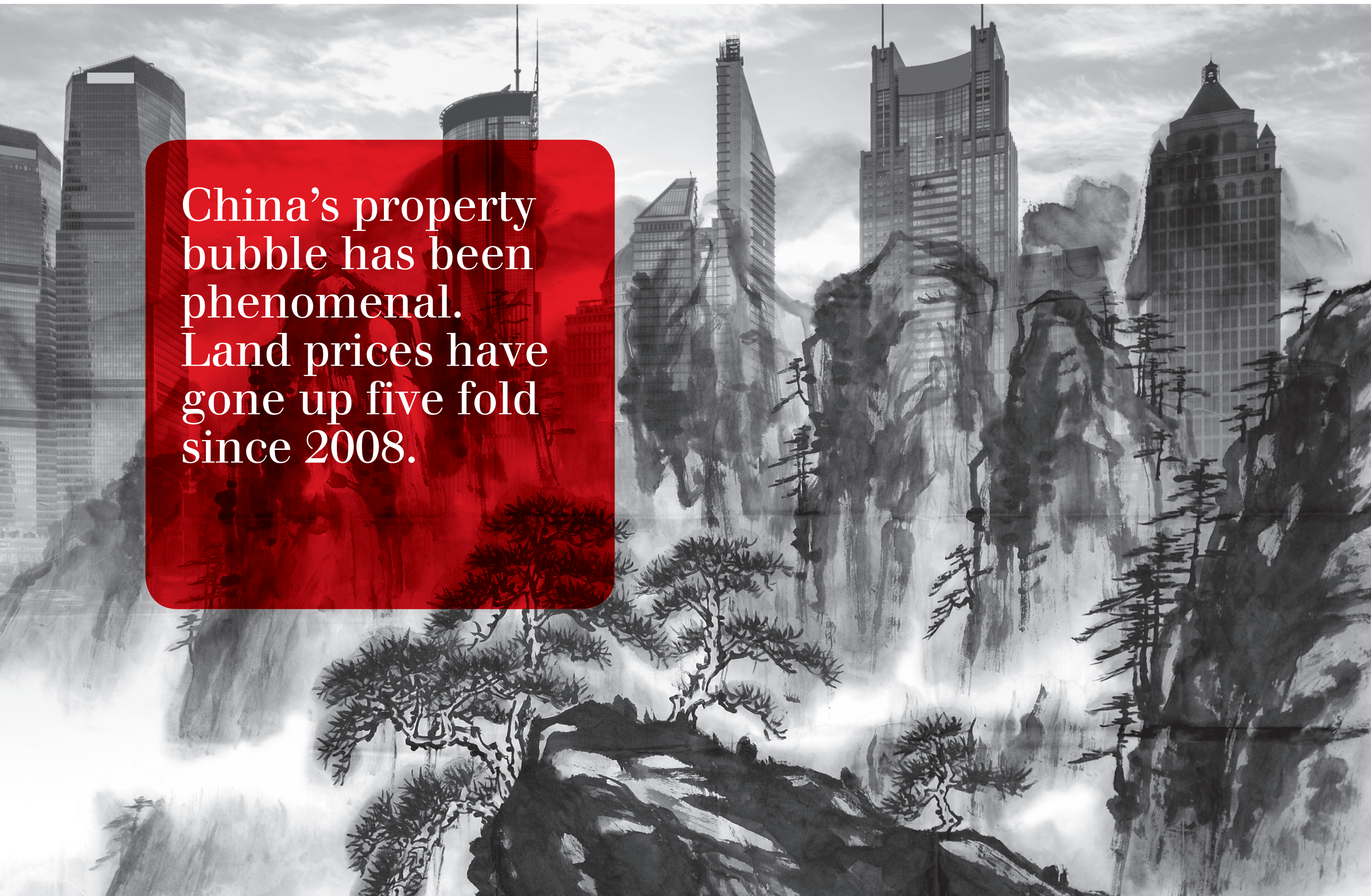
China's real-estate market seems to have reached a turning point said Zhu Habin of JP Morgan. In June, prices fell in 55 of the largest 70 cities. In July, prices fell in 64 cities – the worst monthly reading since records began in 2005. Developers are retreating from new investments.

China's property bubble has been phenomenal. Land prices have gone up five fold since 2008. Shanghai's house price-to-income ratio has hit an incredible 22. Nine out of ten urban households already own at least one house.

Jamil Anderlini, from the Financial Times, said that China has "simply built too much." Floor space currently under construction is enough to meet four years worth of demand. In some areas, there is seven years worth of supply. Developers are supplying 15 million new units a year, even though there is enough stock for every household to own their own house. Many new developments are simply ghost towns.

The government is trying to engineer a soft landing by easing restrictions on property sales and encouraging banks to lend. Those efforts have not yet been very successful. Yet even if the government doesn't find a way to gently deflate the bubble, a collapse seems unlikely. The state owns the banks and can force them to keep lending. Several years of subdued growth, as bad loans gradually work through the system with state help, seems likely. In any case, the stock-market looks cheap enough on a cyclically adjusted price/earnings ratio of 11.8. That looks attractive based on long-term prospects.





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London property: who's buying?

Dan McCrum has a regular Alphaville blog in the Financial times. In it, he recently noted that, at the peak of the Japanese property bubble in 1990, a new flat in Tokyo would have cost 18 times the average, annual income.

Fast forward to London in 2014. In Kensington and Chelsea, the average house now costs 32 times average income, whilst Westminster is above 20.

Tokyo in 1990 and London in 2014 are, of course, worlds away. However, McCrum notes that "it seems prudent to at least ponder the comparison, given that Japan's bust was followed by two decades of falling prices.

By 2004, prime "A" property in Tokyo's financial districts had slumped to less than 1 percent of its peak, and Tokyo's residential homes were less than a tenth.

London's market has been supported by foreign buyers through the recent recession. Last year, overseas buyers accounted for half of all sales of 'prime property.' In 2014, so far, it is down to 40% according to estate agent Knight Frank. Who are the biggest spenders?

6.7% Italians

Italians snapped up the biggest proportion of top-end central London homes in the seven months to July, up from just 2.7% last year. Italians spent an average of £4.4m, favouring Knightsbridge, Chelsea and South Kensington.

4.1% French

Economic woe at home seems to be at least one obvious driver of prime-property purchases from Eurozone buyers. As well as Italy (in recession) and France (close to it), Irish, Greek and Spanish buyers have been well represented in this year's sales figures. The core area of demand from the French community is South Kensington and Fulham.

3.7% Russians

In 2013, Russians were the top London buyers. Knight Frank now ranks them in third place. Concerns over interest rate hikes, the general election and the impact of new and potential tax changes are all cooling demand.

What makes a quality investment?

In the current market, those investing in equities have a choice.

You could buy cheap assets – value stocks.

You could buy wildly volatile assets – momentum stocks.

You could invest in stocks whose prices don't move much – low volatility stocks.

Or our fund managers now talk about investing in 'quality stocks.' What does that mean?

"Quality: A distinct equity factor" was published in July by Standard and Poors by three renowned financial commentators. Broadly speaking, high-quality firs aim to generate higher sales and cash, and enjoy more stable growth, than the average company. They "seek to adopt a conservative, yet effective, capital structure that allows them to grow." Finally, they are usually "run by managers who tend to exercise prudence in the administration of the companies' affairs." These traits help to protect them from the vagaries of the economic cycle, making them slightly more immune from downturns when they arrive.

The Discretionary Fund Managers that we work with try hard to identify 'quality' stocks. Knightsbridge Wealth asked them how they identify the best quality stocks, and they have three key features:

1. Return on equity compares profitability against all capital used in a business. If a firm has decent return on equity, then it is highly profitable and usually has a competitive advantage, such as superior branding or intellectual property value. In short, a company that has been unusually profitable in the past is likely to remain so in the future.
2. Balance sheet accrual ratio sounds dull but is very simple. The more cash there is in a business, the less error prone are their financial statements.
3. Financial leverage is about how much debt a business has and weather that debt could lead it to trouble.

Standard and Poors research concluded that stock selection based on these three principles made a significant difference to return, more than doubling the return between 2000 and 2013 compared to general market performance. In growth markets, the return slightly lagged but, in negative markets, they provided a degree of protection.

At present, 'quality' stocks appear focused in health care, consumer staples (based around brands), energy and IT. Utilities and telecoms are under represented.

Indonesia booming

Jakarta's Composite index is one of the best-performing emerging markets, with growth over the past year of 25%. The reason for this optimism is the incoming President, Joko Widodo. The hope is that this former furniture business owner, with a reputation as a 'hands on' manager during his two years in charge of Jakarta province, will finally get to grips with the country's long-standing problems.

Indonesia's macroeconomic position has improved vastly in the past two decades, with inflation now in single digits and public debt significantly reduced. However, corruption and red tape has hampered growth, and fuel subsidies paid to low-income households take up huge sums.

A fifth of the entire budget for next year ($30bn) is earmarked for subsidies. Widodo's ability to push through sensible but unpopular reforms will be carefully watched in his early months in office.

Reducing subsidies will free up more cash for infrastructure, which is urgently needed. Better ports, airports and railway will entice more foreign investment.

However, in the past decade, only 3-4% of GDP has been spent this way. Widodo has signalled that he will start to reduce subsidies in his first month in office. Investors will be watching closely. Any fall in valuations will be a buying opportunity, given Indonesia's long-term potential. The population is huge, half is under 30 and house-hold debt is very low, ensuring consumption continues to offset the lower exports of the country's resources.

Indonesia remains a key part of many of our clients' Far East exposure.

New appointment

Knightsbridge Wealth is growing its support team to provide continually improving research and support to its growing client base.

Richard Cook
Richard joins us as a Financial Planner and works alongside the partners, documenting advice and recommendations, and providing technical assistance for high-net worth clients. He has an excellent track record in the financial services profession for a number of years and is a welcome addition to the team.

Knightsbridge Wealth's senior team and support staff have over 250 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 Financial Planner. He previously spent 25 years at Dragonfly Planning and Trust Services, the last three years as Managing Director.

Chris Salacinski
is Customer Relationship Manager 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.

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.

Shana Patel
is our Client Relationship Manager. Before joining us, she worked at HSBC Bank for 26 years, most recently as a Senior Wealth Manager dealing with high net worth clients.

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
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