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INVESTMENT NEWS

Investment & Economic Outlook

As we go into summer, I have recently attended a number of economic and investment conferences and would like to share with clients my current views on the investment market.

In A Nutshell

Pretty well every asset class looks expensive but bonds and equities are particularly high. Momentum and Euphoria could well continue to push returns for another 2 to 3 years but it is inevitable that there will be a selloff in asset prices.

Our view is to remain invested but to look to an increase in cash and other defensive measures.

The Second Longest Bull Market Since WW2

The current equities bull market is 109 months old. The average is 97 months. Bear markets take an average of 18 months to end.

THIS IS THE SECOND LONGEST AND SECOND LARGEST BULL MARKET

Bull Markets Since World War II

Bear Market Bottom	Bull Market Peak	Months	S&P 500 Return	Annualized Return
06/13/1949	08/02/1956	86	267%	20.0%
10/22/1957	12/12/1961	50	86%	16.2%
06/26/1962	02/09/1966	44	80%	17.6%
10/07/1966	11/29/1968	26	48%	20.0%
05/26/1970	01/11/1973	32	74%	23.3%
10/03/1974	11/28/1980	74	126%	14.1%
08/12/1982	08/25/1987	60	229%	26.7%
12/04/1987	07/16/1990	31	64%	20.9%
10/11/1990	03/24/2000	114	418%	19.0%
10/09/2002	10/09/2007	60	101%	15.0%
03/09/2009	03/05/2018*	109	302%	16.7%

Source: LPL Research, FactSet 03/06/18

*Bull market is still active

We appreciate these are figures for the S&P 500 but where the US goes others tend to follow.

At present, all asset classes are up and some equity markets look particularly high.

Valuations According To CAPE

The cyclically adjusted price-earnings ratio (CAPE) was developed by Robert Shiller and John Campbell to provide a more reliable way of valuing markets than the simple PE ratio. The CAPE ratio is the real (inflation-adjusted) price of a share divided by a ten-year average of real earnings per share.

April's CAPE valuations were as follows:

Country	CAPE
Ireland	41.9
Denmark	34.4
USA	29.8
Japan	27.4
Switzerland	24.9
Netherlands	24
India	23.2
Finland	22
France	21.7
Sweden	21.7
Mexico	21.6
Canada	21
Germany	20.2
Italy	19.1
Australia	18.3
China	18.3
UK	16.3
Brazil	14.5
Spain	13.8
Russia	6.4

A CAPE of 8 or under is low. The US ratio is at the levels achieved before crashes such as 1929, 2000, and 2007. Japan, like the US, is very expensive. All countries are judged expensive above a score of 24, which leaves the UK reasonably valued however we do have our own problems.

Oil Prices Rise

Oil prices have risen to $80 a barrel, a price last seen in 2014. This isn't viewed as a significant threat however as big producers often increase production to benefit from higher prices. Higher prices mean that North Sea and shale deposits become more economically viable, which should lead to an increase in supply.

Interest Rates And Inflation

The central bank's stance is shifting from quantitative easing (QE) to quantitative tightening (QT) as inflation seems to be picking up. We don't know what effect this will have on markets but it is fair to assume that there will be a reduction in money supply which will most likely dampen consumer spending.

Economist Roger Bootle recently highlighted that inflation is by no means gone from our lives and just because it has been benign in recent years does not mean it will continue so. Many countries want inflation to reduce their debts. In the 60s and 70s inflation was very high (peaking at 17% in 1979), there was disinflation in the 80s and low inflation for the last 20 years. As interest rates respond to inflation, he suggests interests rates will rise to 3% in the US by 2020 and to 1.5% for the UK.

Consumer & Government Borrowing

In 2017, levels of consumer credit in the UK rose to a record £200 billion and is likely to continue rising in 2018. Consumers are now so used to zero level interest rates, any increase in rates is going to come as a shock.

The Labour manifesto seems to offer massive increases to the UK debt whilst the current government seem singularly unable to curtail overspending.

Estimates suggest that the US budget deal will increase next year's budget deficit to around $1.2 trillion and cause debt to rise from around 76% of GDP today to over 90% by 2027.

What Do We Do Now?

Whilst the markets could easily continue their upward spiral for another 2 to 3 years our own view is that based on all the empirical evidence now is a good time to add to cash at the cost of other asset classes. This will reduce the returns on our portfolios but it will also reduce losses in the event of a market correction.

At your annual review we therefore propose to:

- Where clients are taking income we are looking to hold two year's income in cash or cash equivalents.
- Where clients require capital in the next 3 years we are looking to raise that fully or partially now.

For clients where we simply advise on Transact portfolios (now known as Portfolio clients) we will raise our purchase of defensive stock and cash.

For clients where we review their total affairs (now known as Wealth Management clients) we will consider their overall cash and defensive asset position and advise accordingly.