

Trusts In Focus Up Date
What I'm Buying Today
Capital Economics

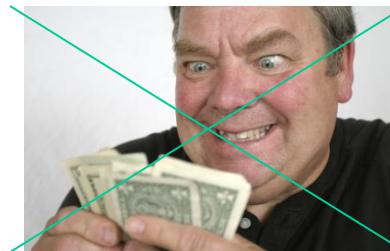
MARKETS NOW 11th OCTOBER 2016

^{Q4 2016}
David Fuller, Tim Price,¹Iain Little, Bruce Albrecht

What is “Markets Now”?

A Lively Forum for Sharing Investment Ideas

1. Big Picture Strategy (DF, BA)
2. “Private client”high quality, long term ideas (IL)



- *Our promise:*
 - INDEPENDENT, GLOBAL INVESTMENT ADVICE
 - NO SALES, NO HYPE, NO MARKETING
 - NO PRODUCT PUSHING
- *Please contribute with:*
 - QUESTIONS
 - CONCERNS
 - IDEAS



What Is The Biggest Risk for Private Investors?

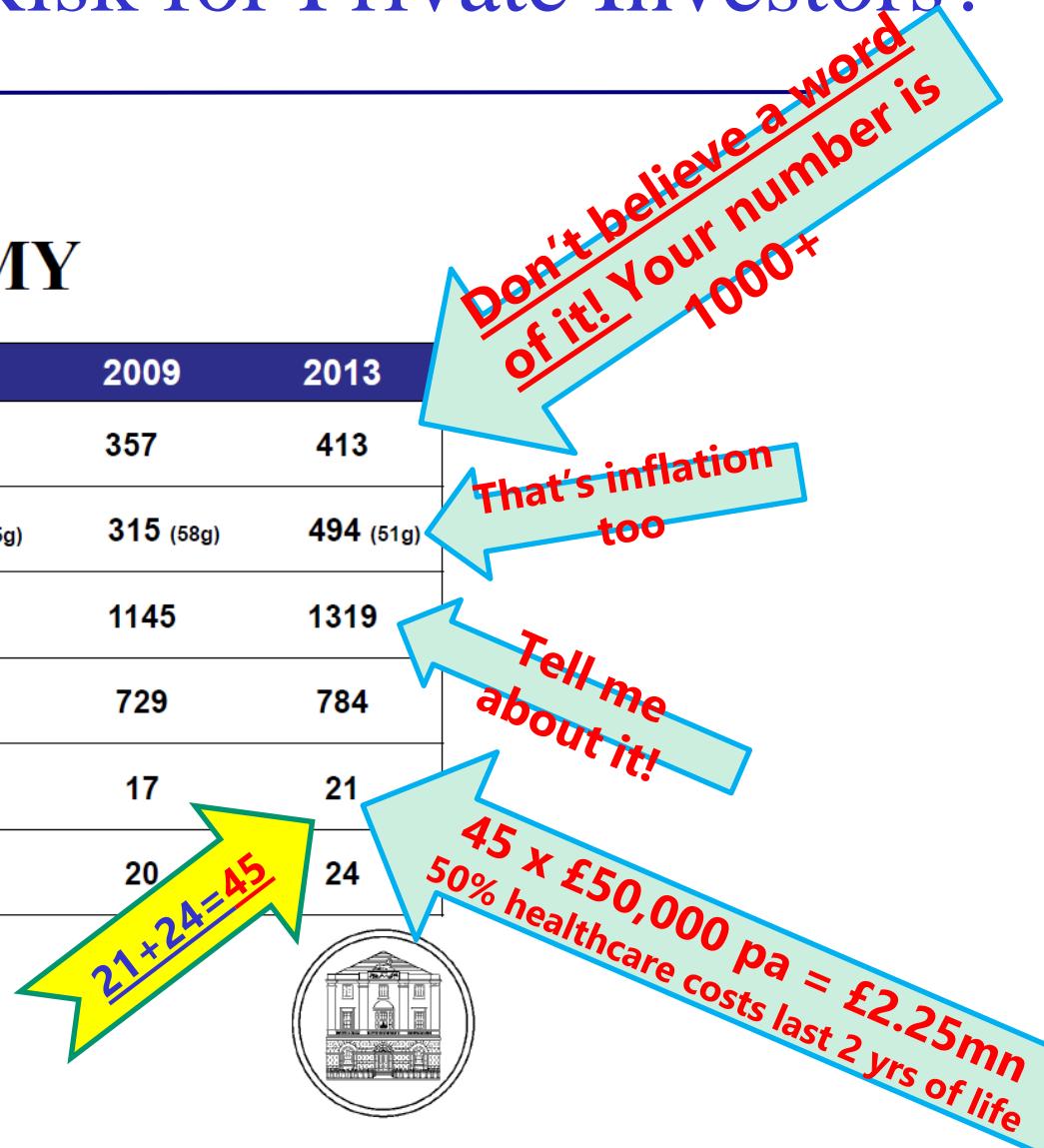
THE ENEMY

	1979	1994	2009	2013
RPI	100	240	357	413
Mars BAR~	100 (57g)	192 (65g)	315 (58g)	494 (51g)
SCHOOL FEES	100	491	1145	1319
HOUSE PRICES*	100	307	729	784
UK LIFE EXPECTANCY (M)	13	14	17	21
AT 65# (F)	17	18	20	24

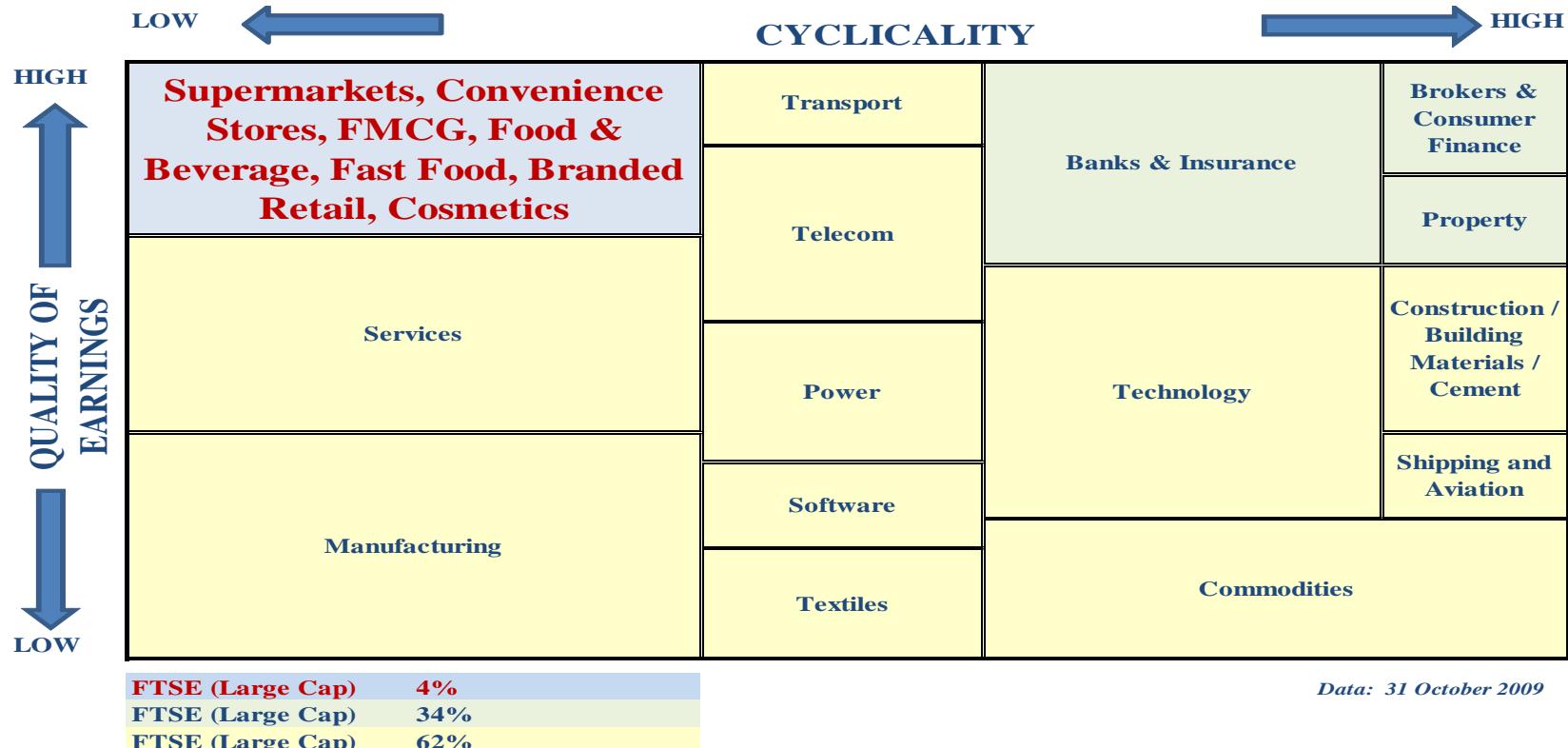
~ Adjusted for weight (g)

* Nationwide Building Society Index

Office for National Statistics



What Is The Perfect Investment (Equities)?



Source: Arisaig Partners

- Quality Private Client investments mainly found Top Left Hand Corner: simple businesses, high cash flow, investor friendly

What Is The Perfect Investment (**Funds**)?

1. **Long-term** (does better than.....)
2. **Leverage**, but only if needed
3. **Discounts** to real asset value («Leverage at a discount»)
4. **Governance**: proper auditing, proper board, transparency
5. **Know-How proven** over 100+ years
6. **Liquid, but...** (real time trading on SE)
7. **Low management costs** (1/4 to 1/2 the cost of rivals)
8. **New money non-dilutive** (if successful /at discount)
9. **Global** but can be specialist?
10. **Daily** valuations, daily reporting
11. **Yield**. Growing dividend stream *payable out of «Reserves»*
12. **Elected management**, retail participation, proper AGMs
13. **Information inefficiencies**. Hated by brokers

Trusts In Focus (TIF) SERVICE

- Universe c300 closed end (*mainly UK*) investment trusts monitored
- Up to 15 equally-weighted trusts held in **Trusts In Focus (TIF)**
- If we sell an investment trust, we must replace it
- Changes to trusts recorded (1.25% trading costs B/S)
- Research available to «Markets Now» attendees
 - 3rd party adviser research referenced*
 - FullerTreacy Money one of 20+ 3rd party advisers*
 - In-House Cooking/ P&C research*
- Performance review / indecent striptease every «Markets Now»



How Are We Doing: Trusts In Focus? Performance So Far (since 7/3/14)

Name	Ticker	Sector	Core/ Satellite	Date	Price then	Price Now	Pr/(Disc)N AV	Yield (%)	GBP Performance
General equities									07.10.2016
Scottish American Inv Trust	SCAM:LN	General, global	Core	09.05.2014	2.49	3.11	1.0%	3.5%	25.0%
BlackRock Income Strategies Tr	BIST:LN	UK + Rest of Wld	Core	09.05.2014	1.40	1.13	-8.4%	5.9%	-19.1%
British Empire Trust	BTEM:LN	General, global	Core	09.05.2014	4.95	6.08	-12.7%	2.0%	22.8%
Scottish Mortgage Inv Trust	SMT:LN	General, global	Core	09.05.2014	1.93	3.38	2.0%	1.0%	75.5%
European Assets Trust	EAT:LN	Europe (mid/small)	Core	23.02.2015	10.25	10.45	-8.0%	7.2%	2.0%
Baillie Gifford Shin Nippon Tr	BGS:LN	Japanese Small equ	Satellite	10.11.2014	3.11	5.97	2.7%	0.0%	92.0%
Emerging, Frontier, Growth									
JP Morgan Emerging Mkts Tr	JMG:LN	Developing markets	Satellite	07.03.2014	5.05	7.35	-12.7%	1.3%	45.5%
New India Investment Trust	NII:LN	India	Satellite	07.03.2014	2.00	4.05	-11.5%	0.0%	102.8%
Aberdeen Asian Smaller Cos Tr	AAS:LN	Asian smaller cos	Satellite	07.03.2014	8.02	9.75	-13.8%	1.2%	21.6%
Mines, Gold, Res, Hard Assets									
Blackrock World Mining Trust	BRWM:LN	Mining companies	Satellite	07.03.2014	4.92	3.04	-11.3%	5.9%	-38.1%
Alternative/ thematic / sectoral									
Personal Assets Trust	PNL:LN	General, gold bias	Core	09.05.2014	332	396	0.3%	1.4%	19.3%
Polar Capital Technology	PCT:LN	Global technology	Satellite	08.01.2015	5.85	8.16	-3.3%	0.0%	39.4%
Impax Environmental Mkts	IEM:LN	Water and Ecology	Satellite	07.03.2014	1.50	2.13	-12.7%	0.8%	41.7%
<i>Average Yield (not inc in perf):</i>									2.3%
<i>% Performance (before dividends):</i>									33.1%
<i>% Estimated performance (after dividends):</i>									37.7%
<i>% FTSE 100 (7/3/14 to now):</i>									4.9%

TRUSTS IN FOCUS

Trusts In Focus

What I'm Buying Today

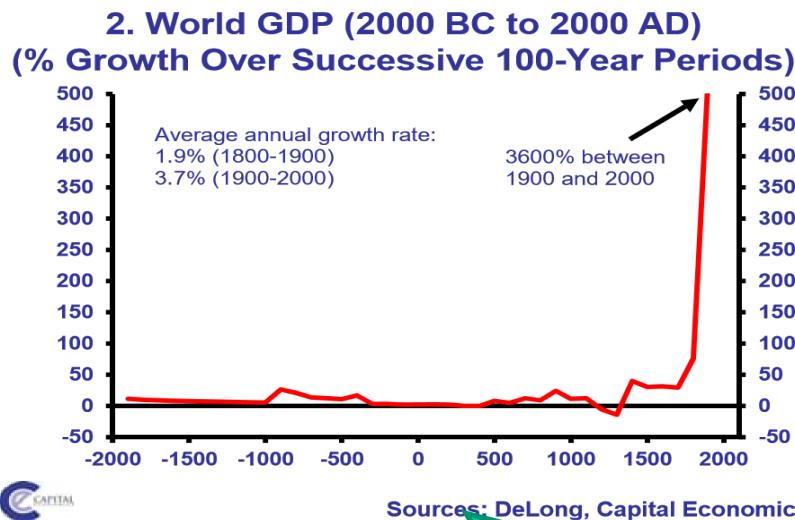
European Assets Trust NV (UK) (EAT LN EQUITY) 1045.00 10.0

2016-10-07



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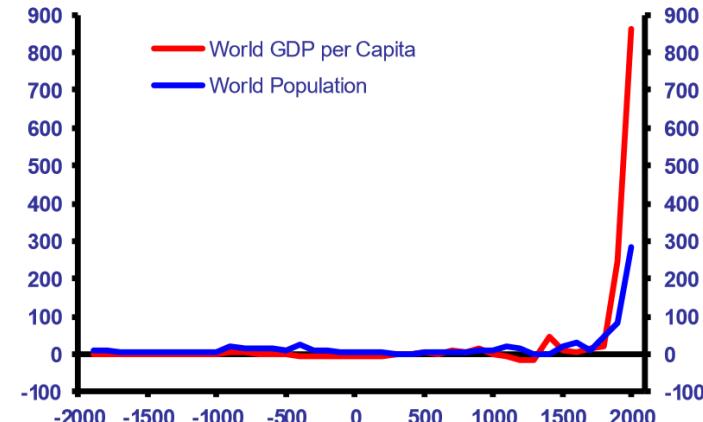


4. Robert Gordon's Three Industrial Revolutions

- 1750 - 1830: Mechanised cotton spinning, steam engines and railroads.
- 1870 - 1900: Advances in electricity, internal combustion engine and telephone.
- 1960 - late 1990s: Computer and internet revolution.



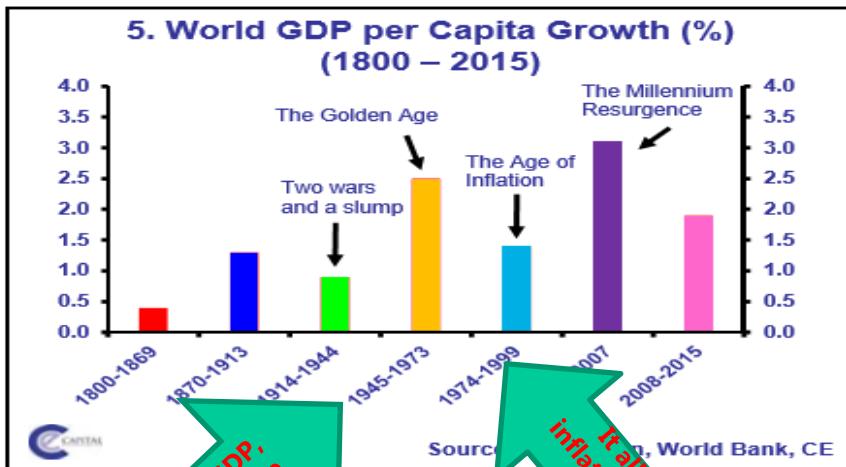
3. World GDP per Capita and World Population (% Growth Over Successive 100-Year Periods)



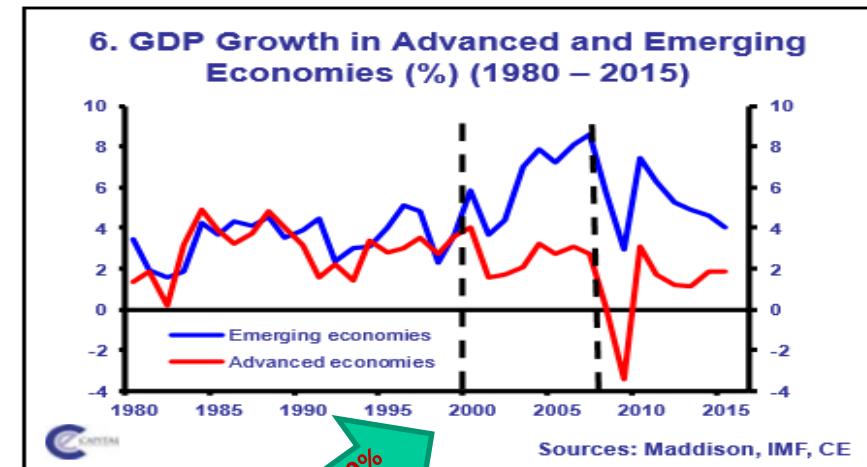
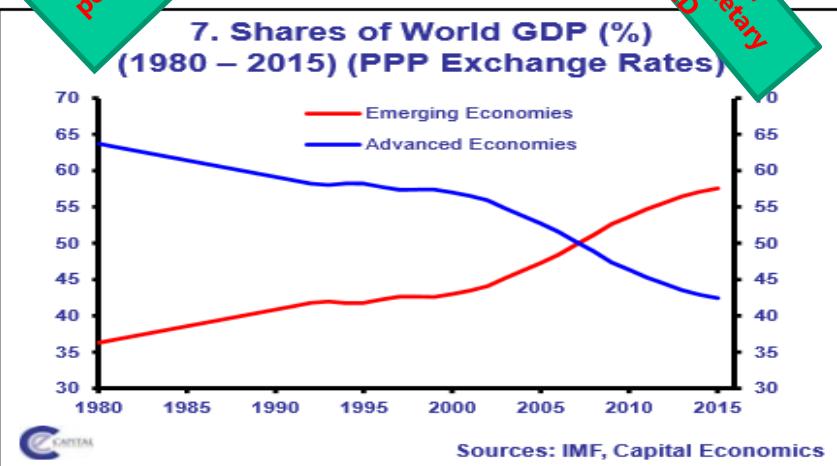
Sources: DeLong, Capital Economics

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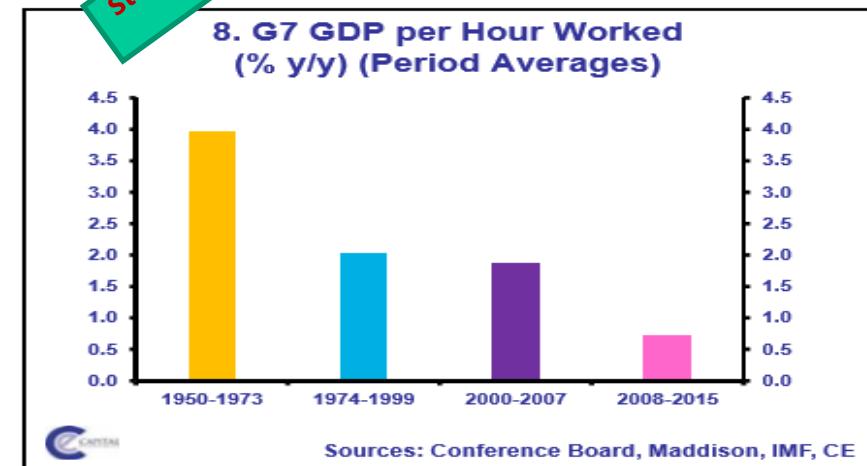


It all goes right: GDP, pop, tech, USA, trade, barriers etc



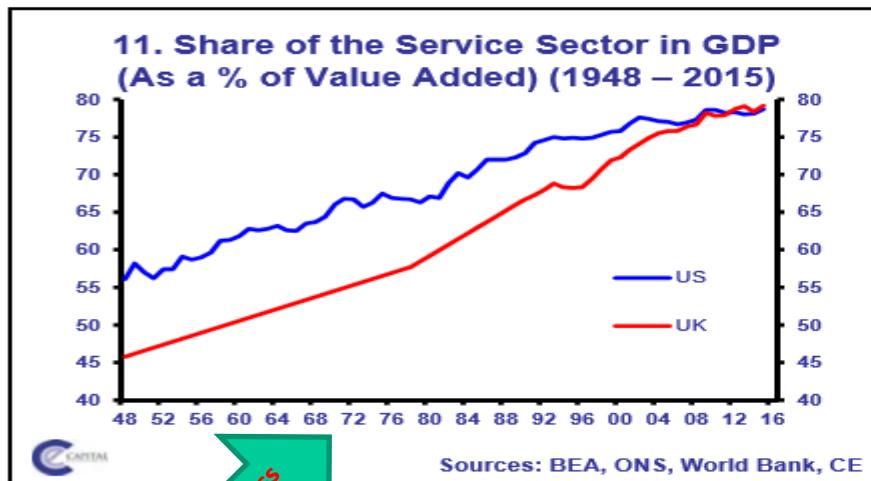
It all goes wrong: oil, inflation, unions, monetary chaos, less R&D

Steady $(60\% \times 4\%) + (40\% \times 2\%) = 3.2\%$



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Do services produce less growth?.....

12. Sluggish growth in the euro-zone and Japan

- Comparing 2000-2015 with 1980-1999, slow growth in the euro-zone accounts for half of the slowdown; Japan for another sixth.
- But slower Japanese growth is a long-term supply problem. It is here to stay.
- And growth in the euro-zone isn't about to rebound any time soon.



Unless.....

13. Measurement issues

- Are quality improvements fully captured?
- Some internet services are free and may not be given full value in the national accounts.
- Many digital innovations save time and increase the quality of leisure for consumers, but the effect will not show up in official GDP.



14. How large is possible under-recording?

- Sir Charles Bean estimated that for the UK between 2005 and 2014, it could be 0.3% to 0.6% of GDP growth per annum.
- On this basis, mismeasurement could explain about three-quarters of the slowdown in GDP per capita in the UK since 1980-1999.
- But can we believe these estimates?
- Is it GDP that is under-recorded, or welfare?



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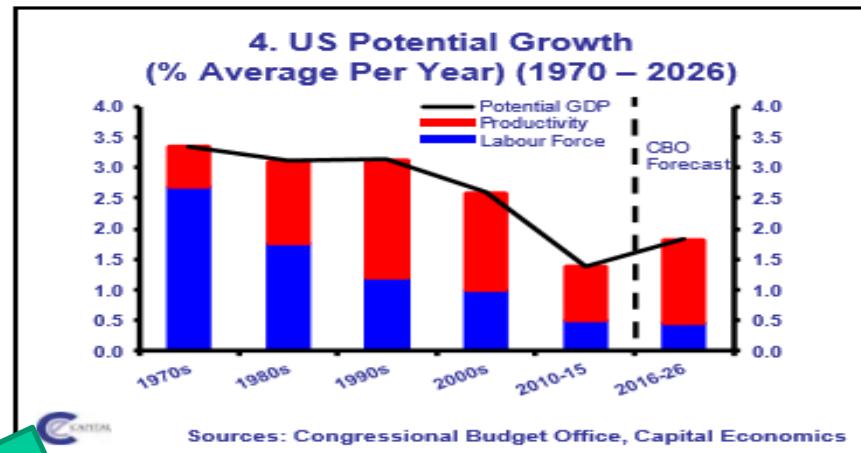
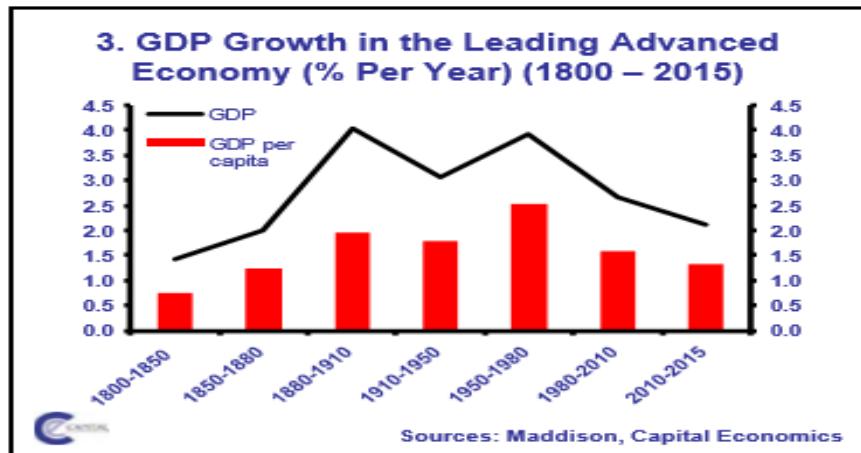
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15. Conclusion

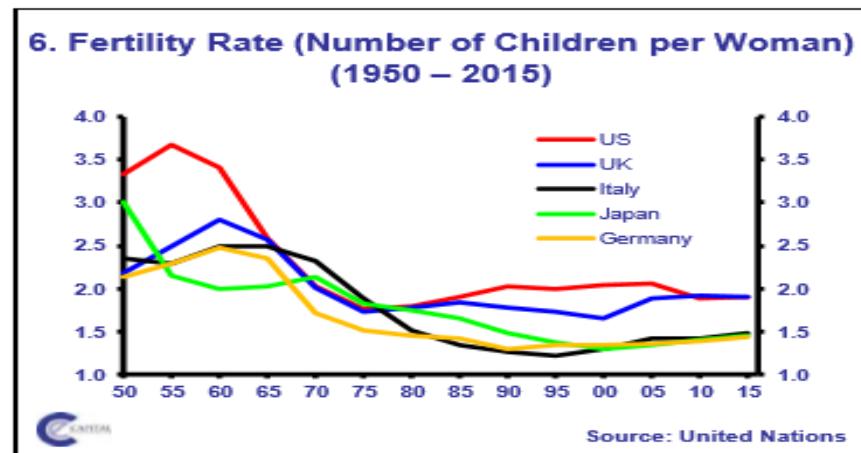
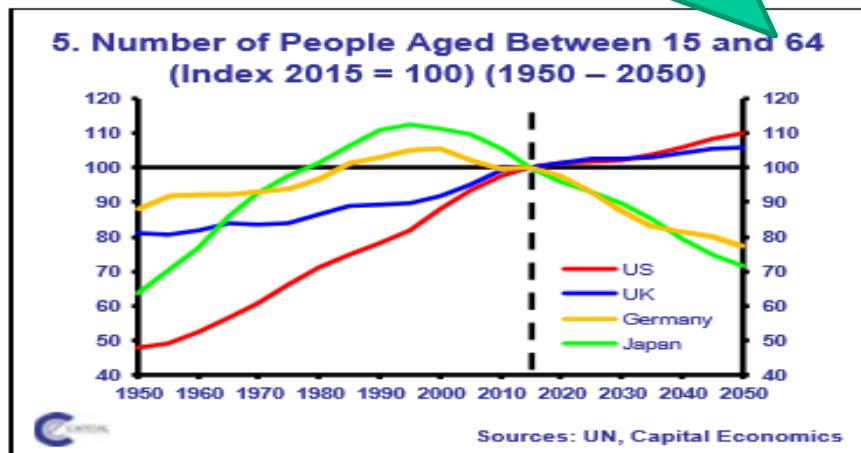
- **The Golden Age was exceptional and won't be repeated.**
- **Rapid growth in the EMs in the early 2000s offset a sharp slowdown in the advanced economies.**
- **Half this slowdown was due to slower growth of the working-age population, half to slower prod. growth.**
- **Could world GDP growth bounce back?**
- **We need to look at demand and supply potential, and at both the advanced and emerging economies.**

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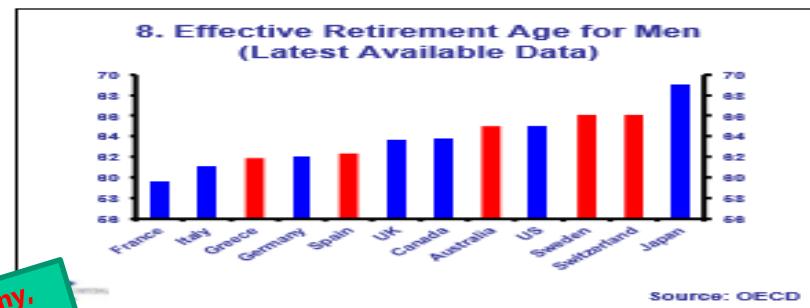


USA / UK good,
Germany, Japan bad

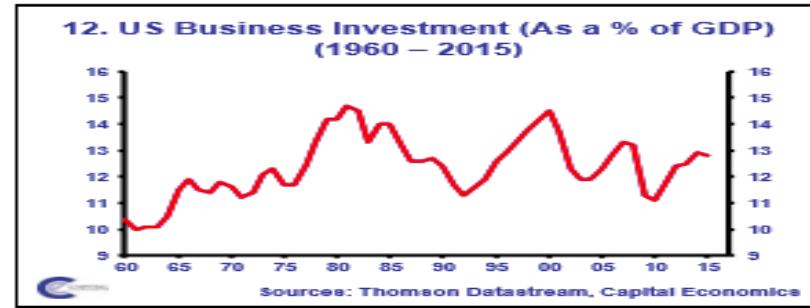
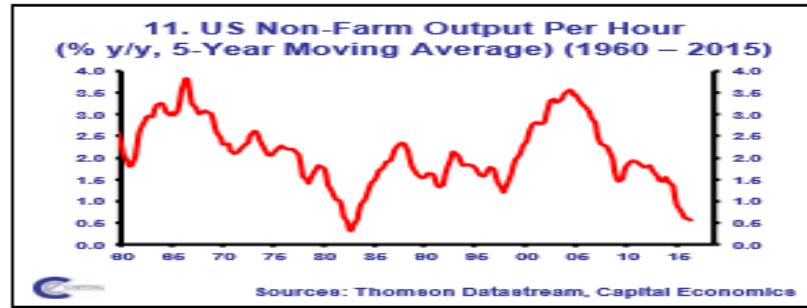
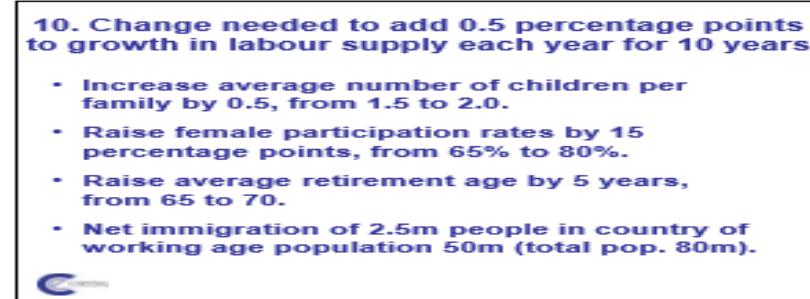
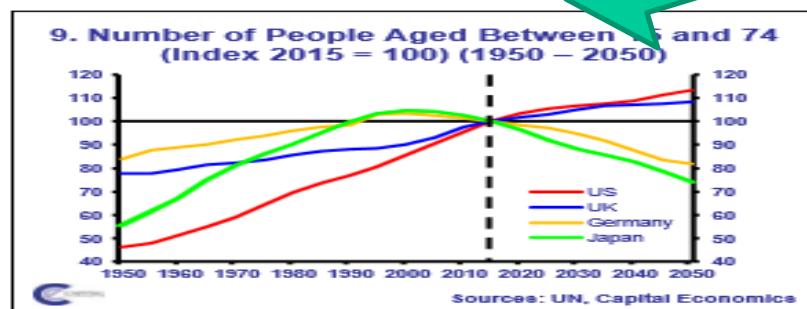


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US, UK good, Germany, Japan bad



What's Interesting Today

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13. Reasons for productivity slowdown

- Cyclical factors (labour hoarding).
- Legacy of financial crisis.
- Fading boosts from globalisation.
- Fading boosts from new technologies.



Prod down but don't worry

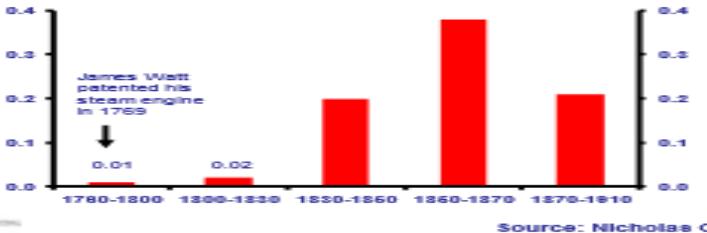
14. The impact of robotics

- Used in manufacturing since 1950s ...
- ... but many wider applications only now becoming practical.
- What happens to the workers who are replaced by robots?
- Who benefits?



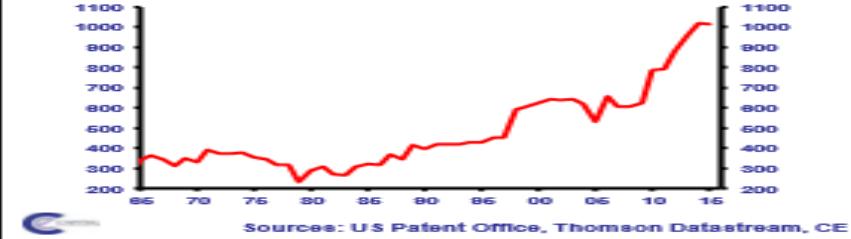
Symptom or cause
4th Indus rev?

15. Contribution of Steam to British Labour Productivity Growth (% per year) (1760 – 1910)



Source: Nicholas Crafts

16. US Patents Issued per Million Population (1965 – 2015)



Sources: US Patent Office, Thomson Datastream, CE

17. Conclusions

- Demographic headwinds can be reduced.
- Pessimism about productivity mostly overdone.
- Potential growth in advanced economies has indeed slowed, but need not collapse.
- New average might be 1.5%, rather than 2.5%.
- 2% in economies (such as the US and UK) with better demographics, 1% or less in others.



Is there a shortfall of demand?



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1. Agenda

- Has demand been weak?
- Is this still a hangover from the crisis?
- Structural reasons for demand being sluggish.
- Will there be a rebound in demand?



2. Has demand actually been weak?

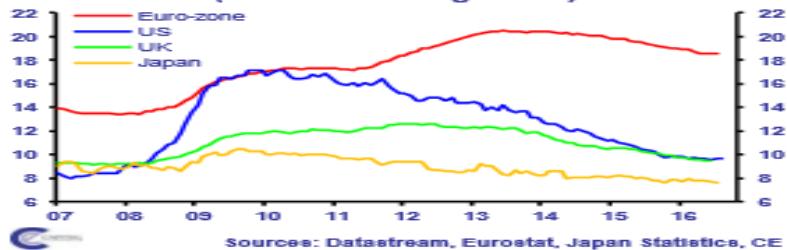
- Low unemployment rates.
- Increases in household spending.
- Record equity prices.



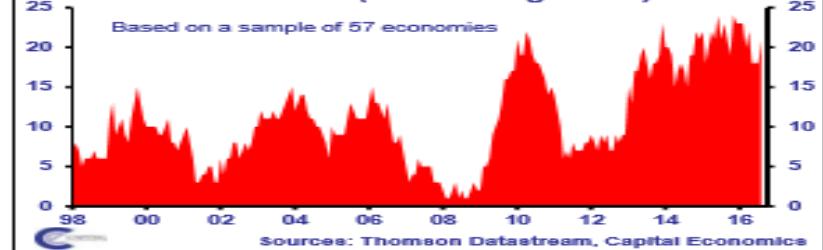
Policy response
GLOBALLY?



3. Broad Unemployment Rate (%) (2007 – Jul./Aug. 2016)



4. Number of Economies with Core Inflation Below 1% (1998 – Aug. 2016)

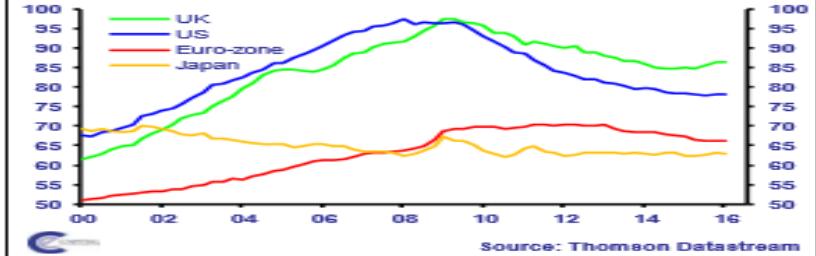


5. Is this just a hangover from the crisis?

- Households paying down debt.
- Governments implementing austerity.
- Banks rebuilding capital buffers.



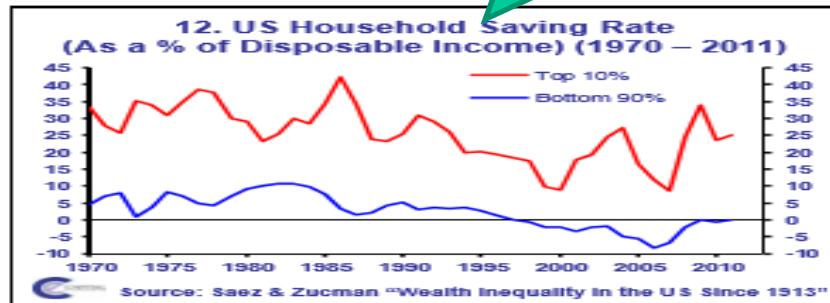
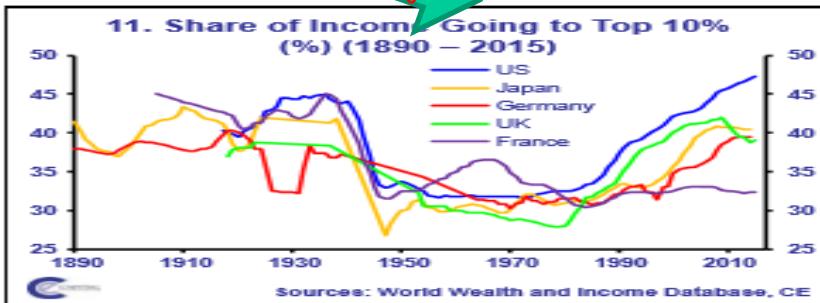
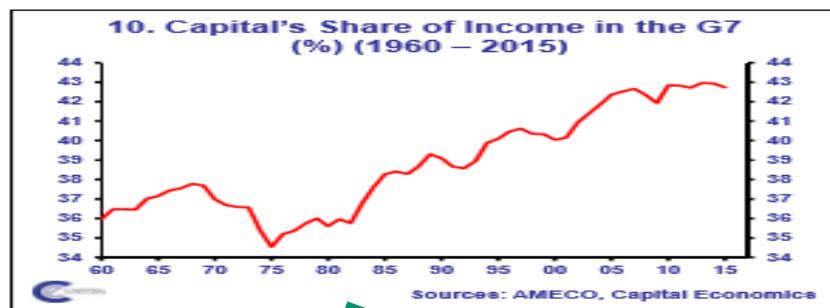
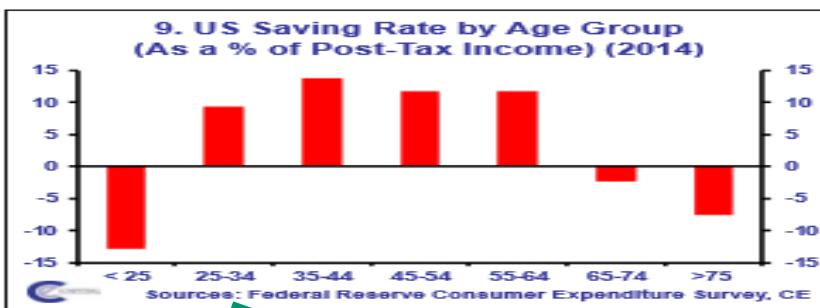
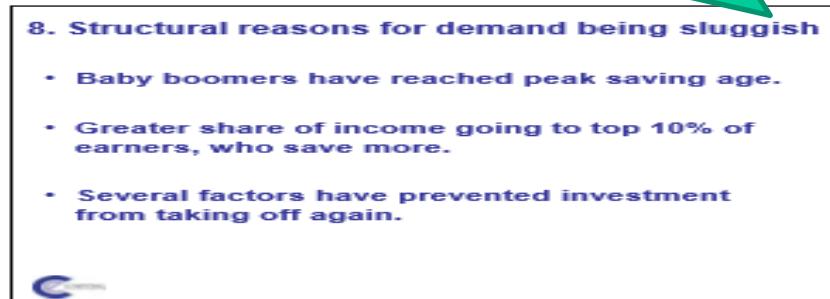
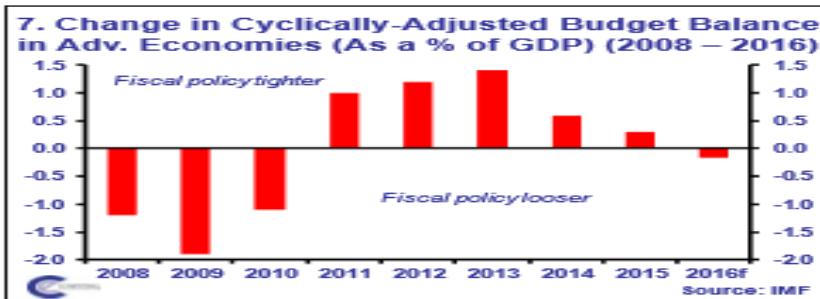
6. Household Debt (As a % of GDP) (2000 – Q1 2016)



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Look around
this room!



Low growth,
low sharing %

Trump?

What's Interesting Today

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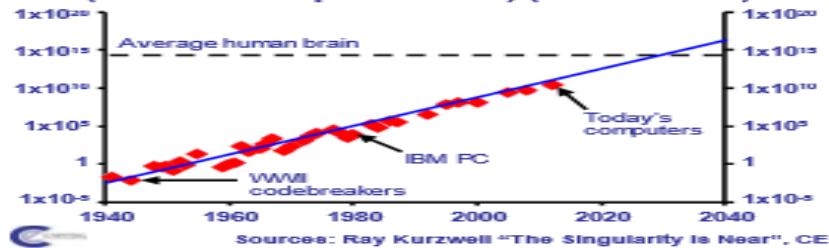
13. Reasons why investment is subdued

- Low potential growth.
- Animal spirits dampened by the crisis.
- Short-termism.
- Falling cost of capital goods.

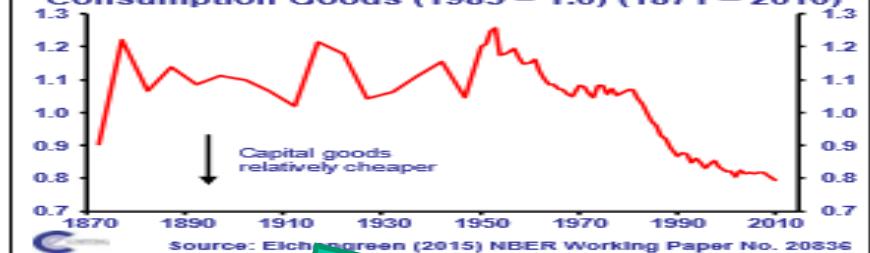


Human brain goes out of business in 2030?

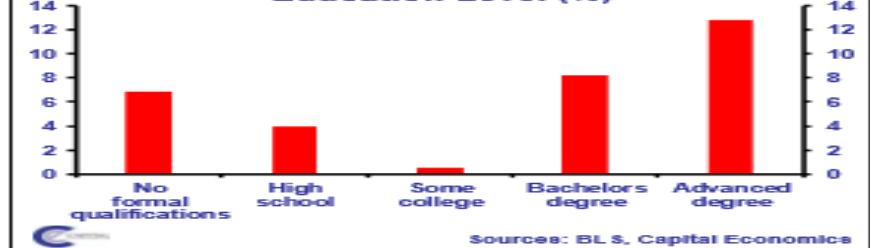
15. Processing Power of a \$1,000 Computer (Instructions per second) (1940 – 2040)



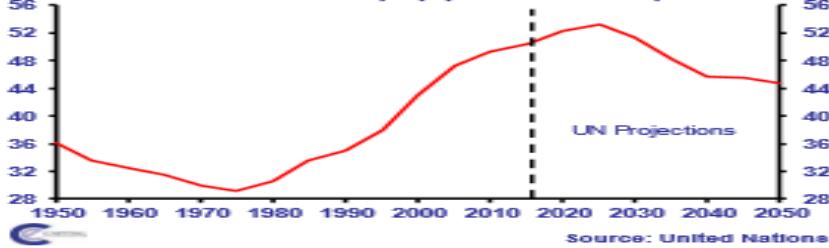
14. Price of Capital Goods Relative to Consumption Goods (1985 = 1.0) (1871 – 2010)



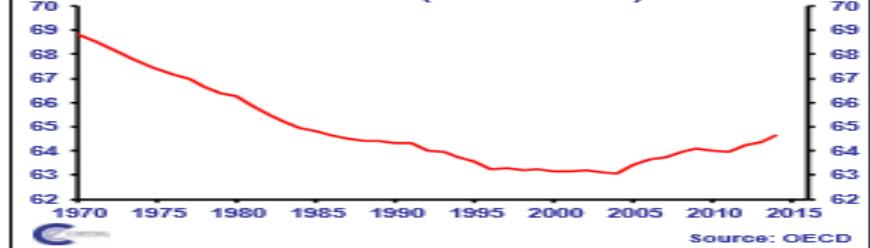
16. Increase in US Jobs by 2024 by Education Level (%)



17. Share of Population Aged 35-64 in Advanced Economies (%) (1950 – 2050)



18. Effective Retirement Age for Men in OECD Countries (1970 – 2014)



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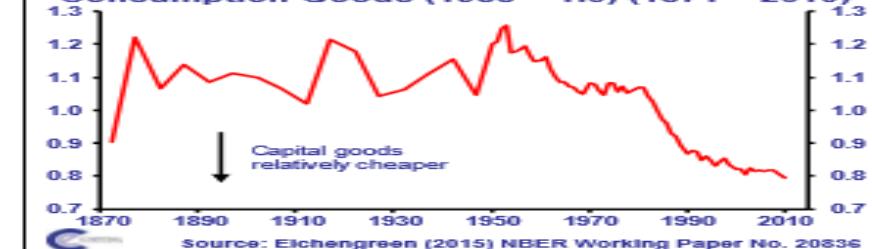
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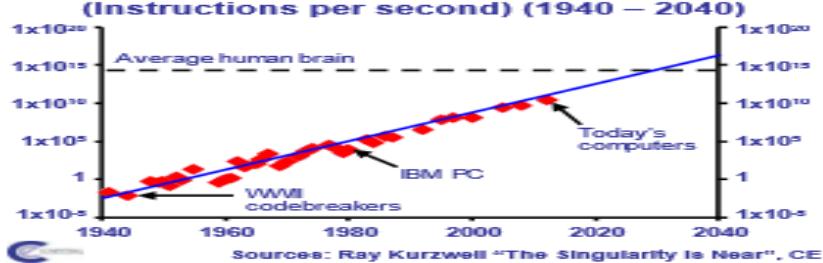
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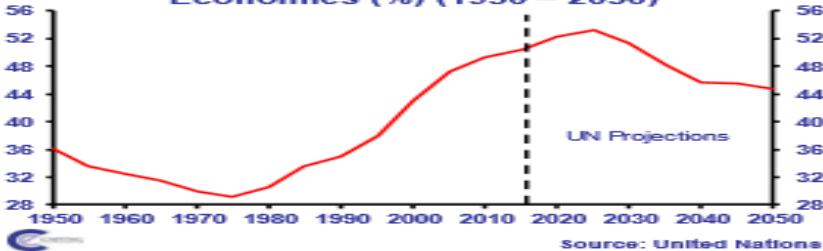
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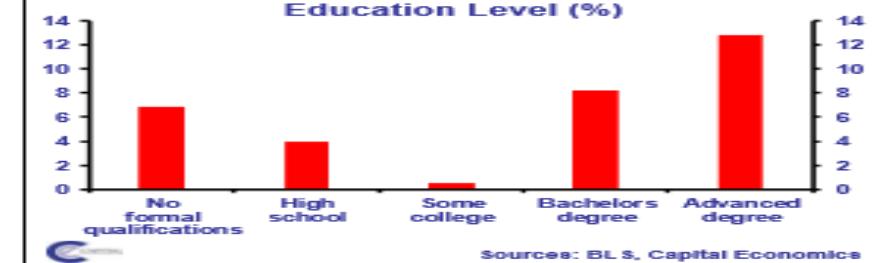
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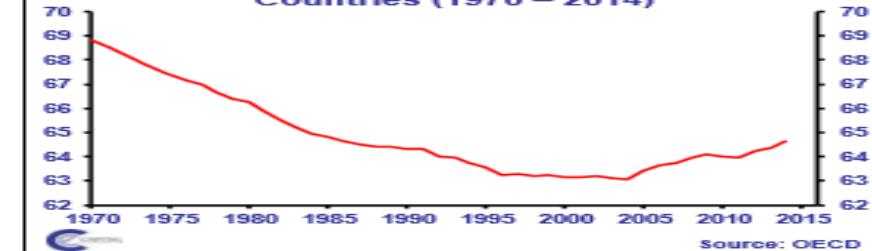
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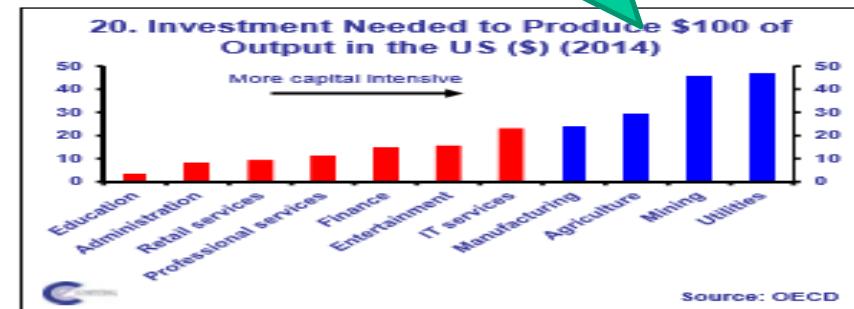
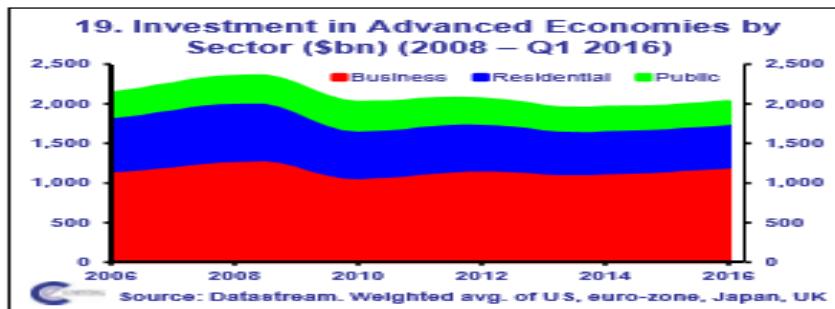


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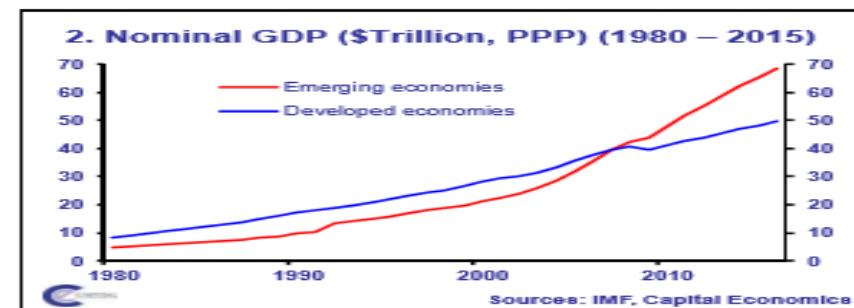
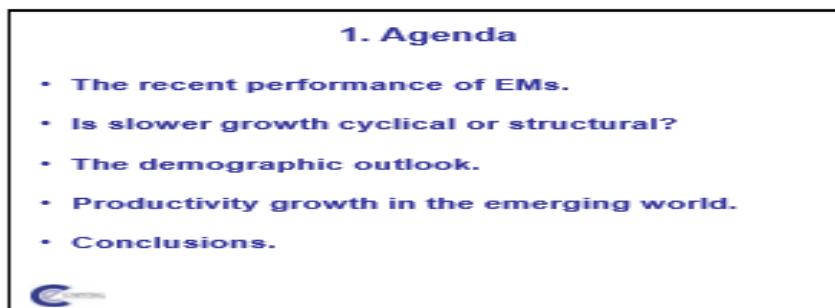
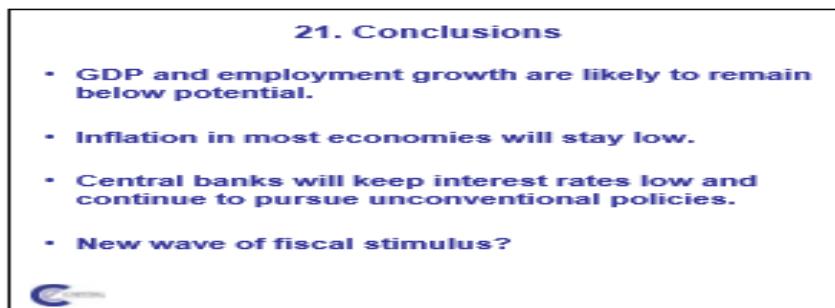


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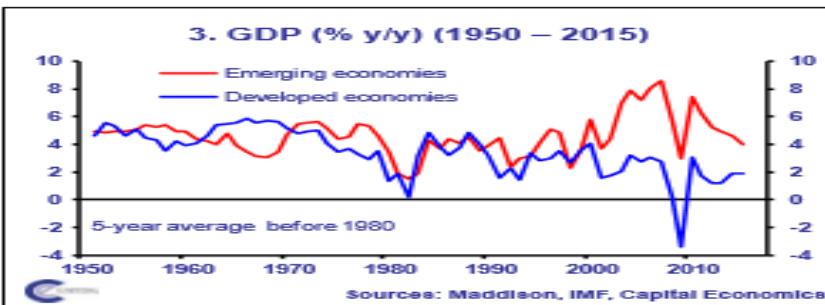


Jobs created services
not sunset indus



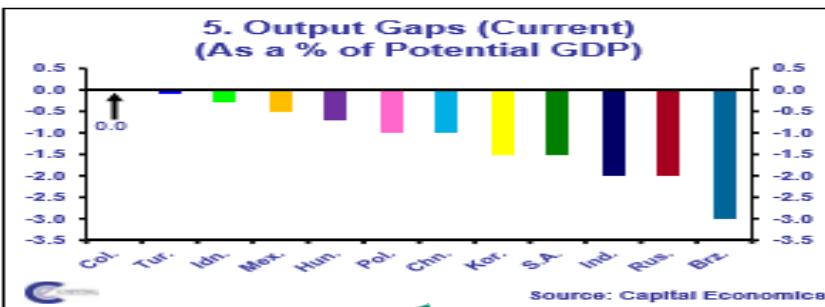
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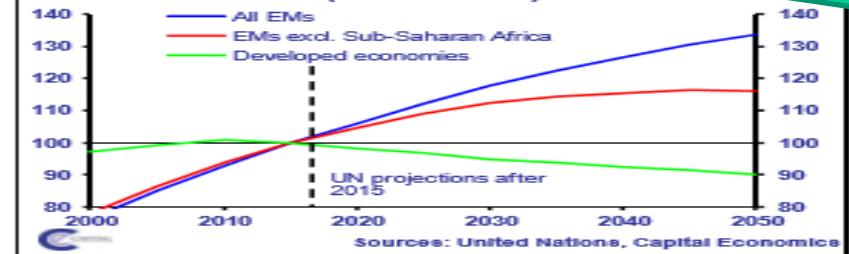


4. Cyclical headwinds to EM growth

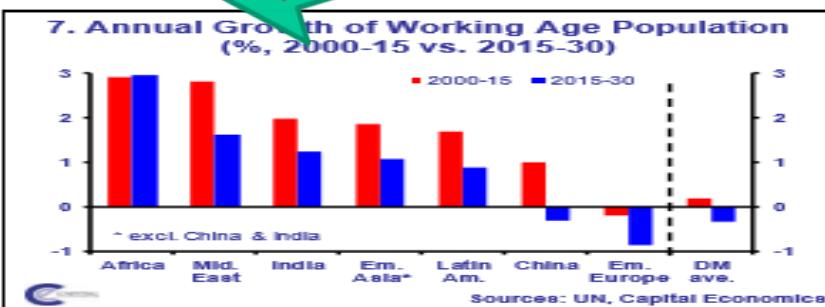
- Deleveraging after unsustainable credit booms.
- Weak demand for EM exporters.
- Lower export prices for commodity producers ...
- ... but many EMs should have benefitted too.



6. Working Age Populations (2015 = 100) (2000 – 2050)



Africa
where it's at



8. Drivers of medium-term growth

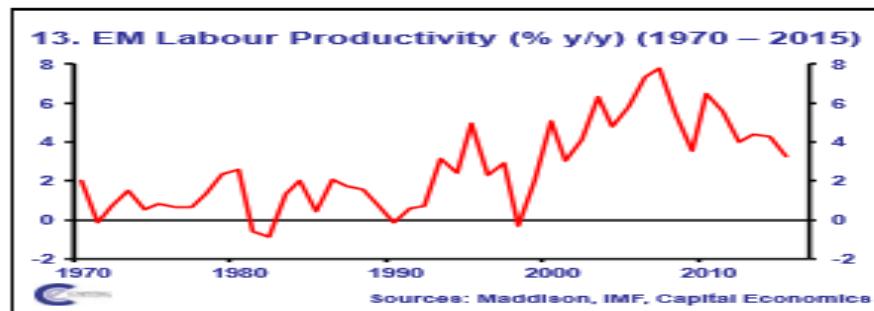
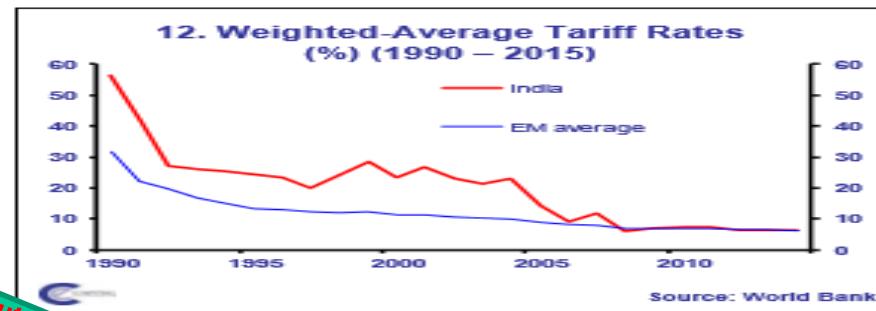
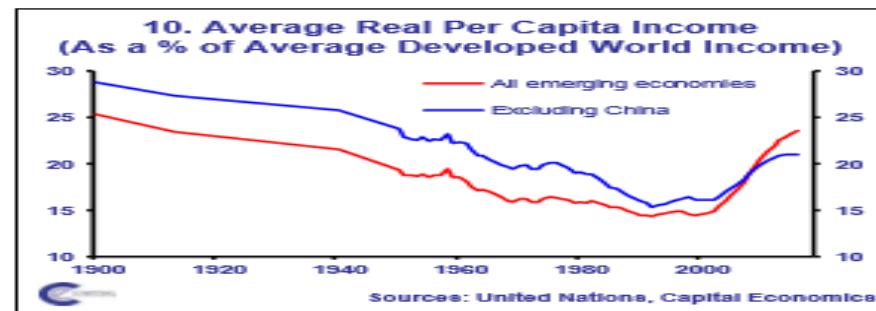
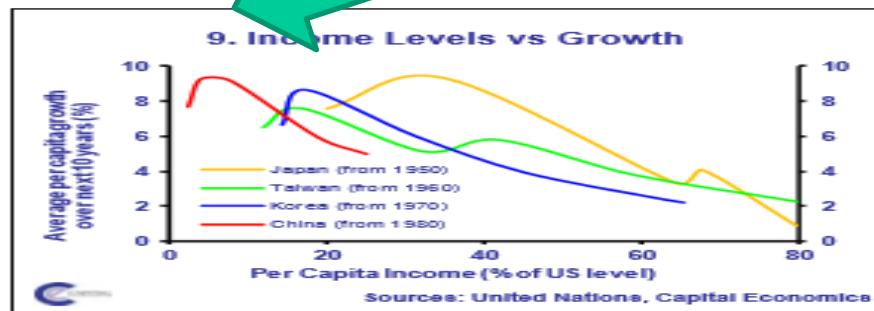
- Increasing number of workers.
 - Working age population for EM world still rising.
 - But workforce growth is set to slow nearly everywhere.
- Increasing output per worker.



Africa
where it's at

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As you develop, growth down, per cap inc up

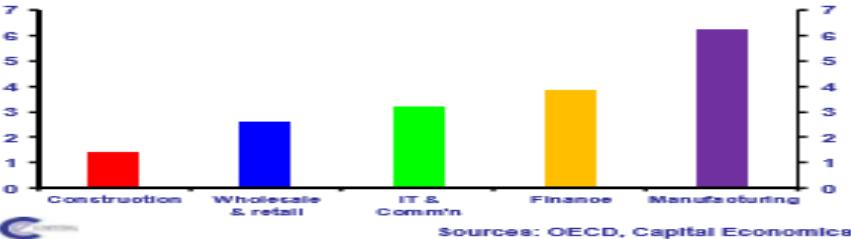


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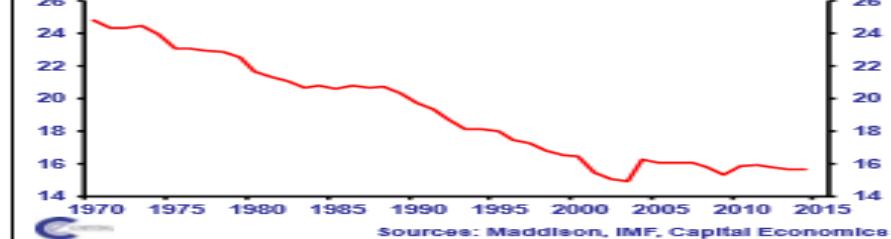
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EM 4% not recent 6%

15. Annual Labour Productivity Growth in EMs (%) (2000 – 2015 Average)



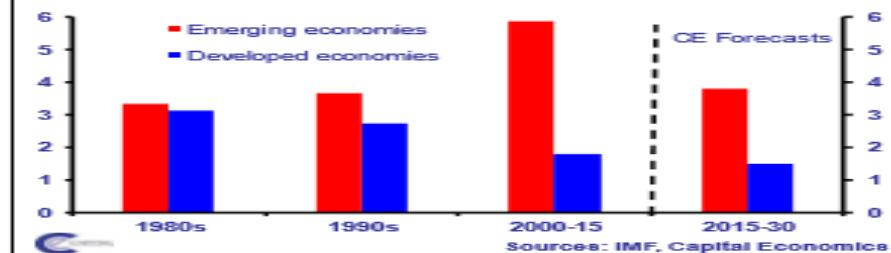
16. Manufacturing (As a % of Global GDP) (1970 – 2015)



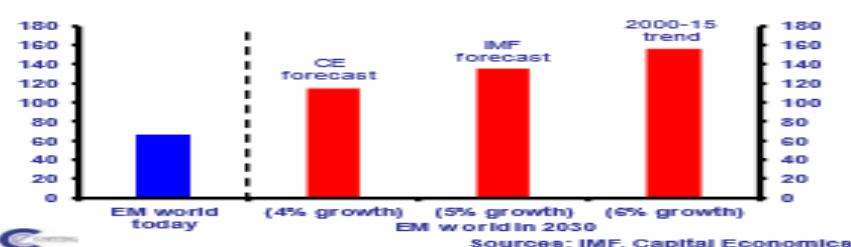
17. The outlook for EM growth

- Little space for cyclical rebound.
- Demographics turning less favourable.
- Productivity growth likely to remain much weaker than in recent past.
- Expect growth to average 4% over medium term, rather than the 6% achieved since 2000.

18. Annual GDP Growth (%)



19. Real GDP (\$Trn, 2015 Prices, PPP)



20. Conclusions

- Rapid EM growth since 2000 was the result of one-off integration of major EMs with world.
- EMs will continue to outpace DMs and remain main contributor to global growth.
- But EM growth likely to revert to 20th Century trend of 4%, compared with 6% since 2000.

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What does this all mean for asset prices?

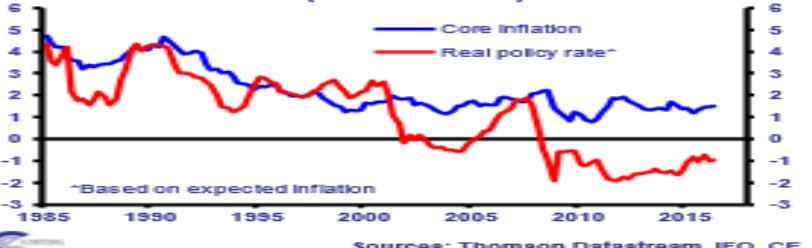


2. What have we heard so far?

- Potential economic growth has slowed.
- There has been a structural deficiency of demand.
- Potential growth is unlikely to pick up much.
- Structural forces will continue to curb demand.
- All this means that equilibrium real interest rates are likely to have fallen ...
- ... and are likely to remain lower than they have been in the past.



4. G7 Core Inflation & G7 Real Policy Rate (%) (1985 – 2016)

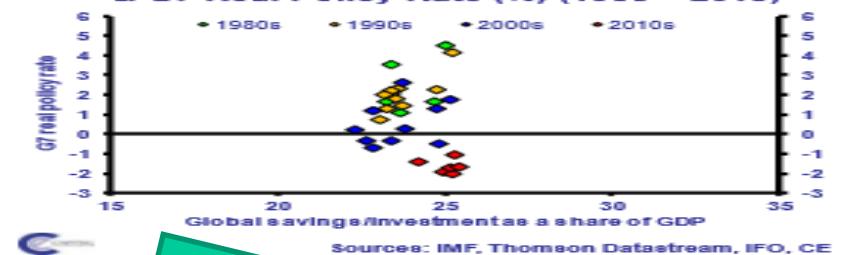


1. Agenda

- What have we heard so far?
- Implications for interest rates?
- Implications for government bonds?
- Implications for "riskier" assets?
- What if deflation takes hold?
- Conclusions.

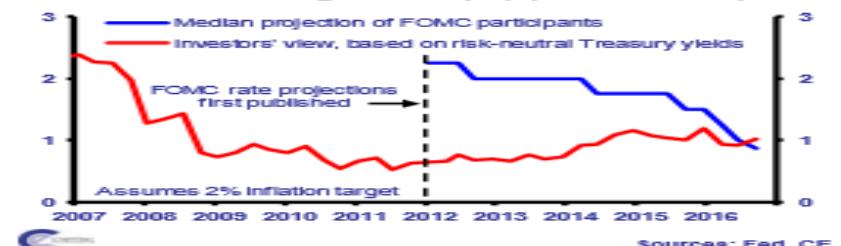


3. Global Savings/Investment as a Share of GDP & G7 Real Policy Rate (%) (1985 – 2015)



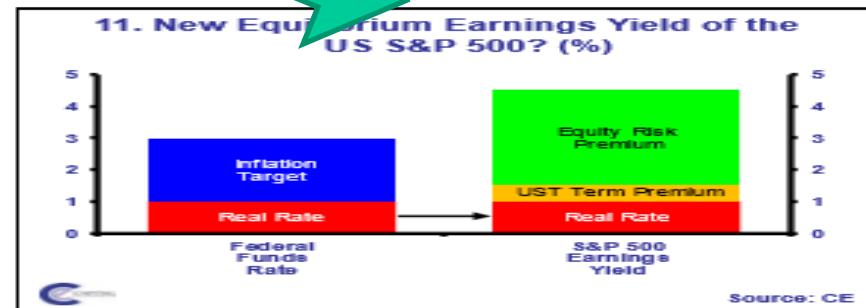
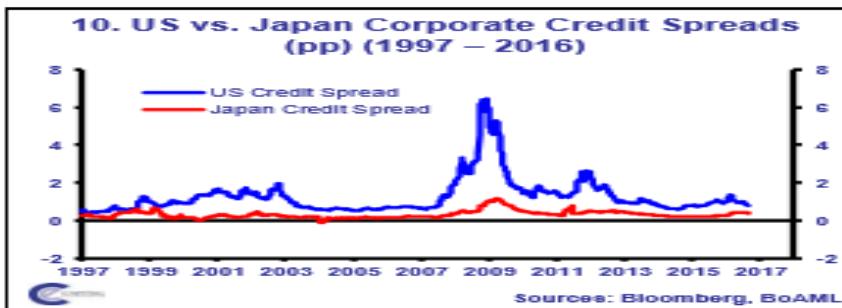
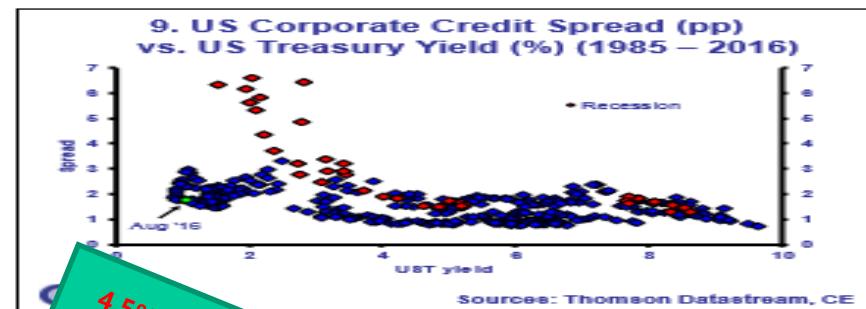
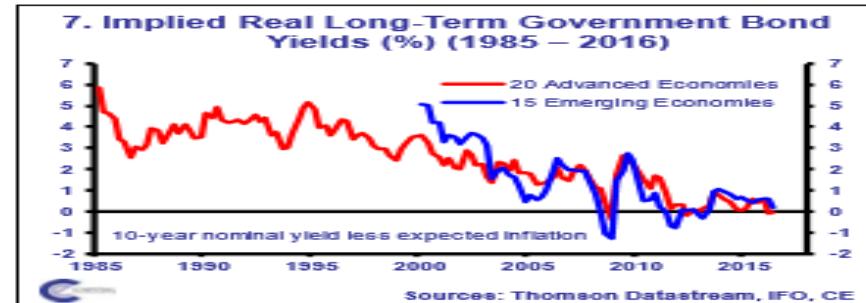
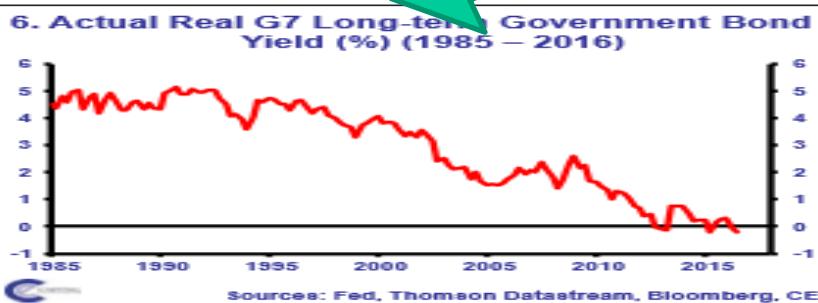
Low and staying low

5. Assumptions about the Real/Fed Funds Rate in the Longer Run (%) (2007 – 2016)



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But who makes money here at 0%?

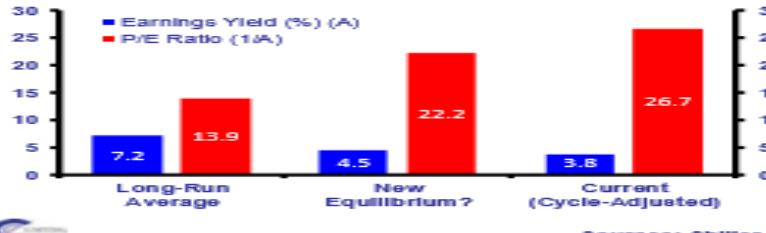


4.5% EY => PER 22x

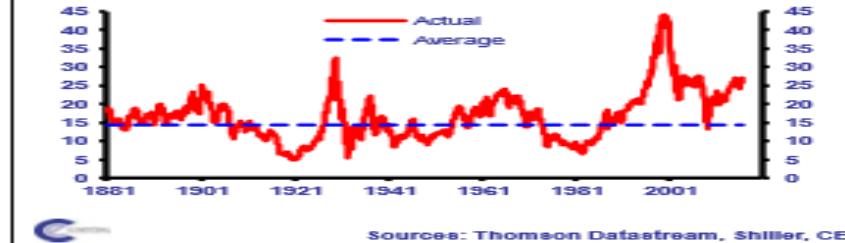
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12. Earnings Yields & Price/Earnings Ratios of the US S&P Composite



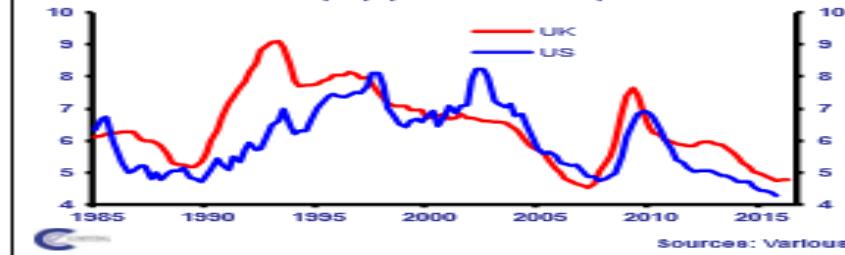
13. Shiller's "CAPE" of the US S&P Composite (1881 – 2016)



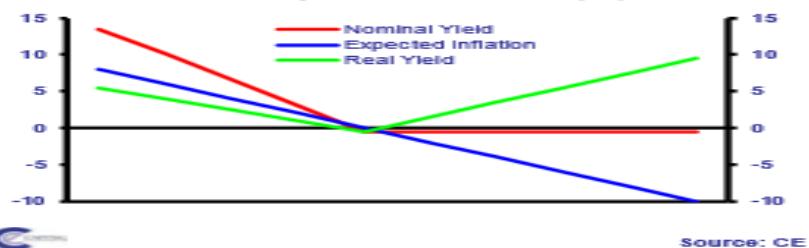
14. Developed vs. EM Equity Valuations (P/E 12m forward ratios) (2007 – 2016)



15. US & UK All-Property Initial Yields (%) (1985 – 2016)



16. Nominal & Real Yields under Different Rates of Expected Inflation (%)



17. Policy and market implications of deflation

- If real interest rates started to rise, fiscal policy would have to do more of the heavy lifting.
- Fiscal stimulus could be accommodated by, a complement to, or even a substitute for, monetary stimulus.
- Accommodating fiscal stimulus by monetary stimulus would do most to boost demand.
- If adopted, we suspect that bond yields would remain low, currencies weaken and equities rally.

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PER for S&P 26-27x

18. Conclusions

- **Real interest rates have fallen and are likely to remain lower on average than in the past.**
- **The same applies to required real returns on assets.**
- **Equilibrium asset valuations are therefore higher than they were in the past.**
- **We think the valuations of bonds, equities and property are not especially high relative to their new equilibria.**
- **Deflation would change the story, increasing the onus on fiscal policy to support monetary policy.**



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