



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

MARKETS NOW 11th OCTOBER 2016

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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

Q42016 **IDEAS**



What Is The Biggest Risk for Private Investors?

THE ENEMY

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

~ Adjusted for weight (g)
 * Nationwide Building Society Index
 # Office for National Statistics

Don't believe a word of it! Your number is 1000+

That's inflation too

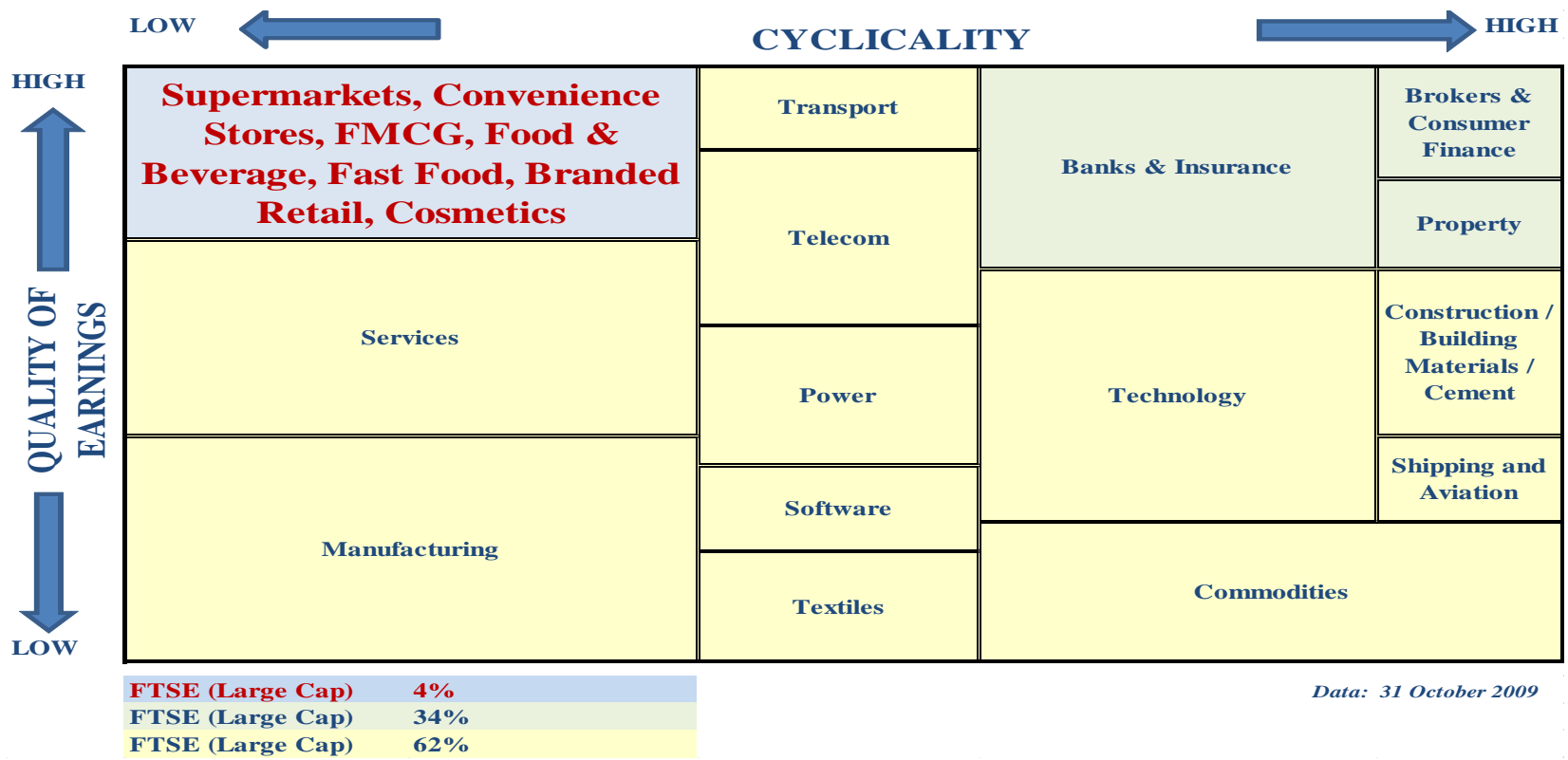
Tell me about it!

21+24=45

**45 x £50,000 pa = £2.25mn
 50% healthcare costs last 2 yrs of life**



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)

<u>Name</u>	<u>Ticker</u>	<u>Sector</u>	<u>Core/ Satellite</u>	<u>Date</u>	<u>Price then</u>	<u>Price Now</u>	<u>Pr/(Disc)N AV</u>	<u>Yield (%)</u>	<u>GBP Performance</u>
						07.10.2016			
<u>General equities</u>									
Scottish American Inv Trust	SCAM:LN	General, global	Core	09.05.2014	2.49	3.11	<u>1.0%</u>	3.5%	25.0%
BlackRock Income Strategies Tr	BIST:LN	UK + Rest of Wld	Core	09.05.2014	1.40	1.13	<u>-8.4%</u>	5.9%	-19.1%
British Empire Trust	BTEM:LN	General, global	Core	09.05.2014	4.95	6.08	<u>-12.7%</u>	2.0%	22.8%
Scottish Mortgage Inv Trust	SMT:LN	General, global	Core	09.05.2014	1.93	3.38	<u>2.0%</u>	1.0%	75.5%
European Assets Trust	EAT:LN	Europe (mid/small)	Core	23.02.2015	10.25	10.45	<u>-8.0%</u>	7.2%	2.0%
Baillie Gifford Shin Nippon Tr	BGS:LN	Japanese Small equ	Satellite	10.11.2014	3.11	5.97	<u>2.7%</u>	0.0%	92.0%
<u>Emerging, Frontier, Growth</u>									
JP Morgan Emerging Mkts Tr	JMG:LN	Developing markets	Satellite	07.03.2014	5.05	7.35	<u>-12.7%</u>	1.3%	45.5%
New India Investment Trust	NII:LN	India	Satellite	07.03.2014	2.00	4.05	<u>-11.5%</u>	0.0%	102.8%
Aberdeen Asian Smaller Cos Tr	AAS:LN	Asian smaller cos	Satellite	07.03.2014	8.02	9.75	<u>-13.8%</u>	1.2%	21.6%
<u>Mines, Gold, Res, Hard Assets</u>									
Blackrock World Mining Trust	BRWM:LN	Mining companies	Satellite	07.03.2014	4.92	3.04	<u>-11.3%</u>	5.9%	-38.1%
<u>Alternative/ thematic / sectoral</u>									
Personal Assets Trust	PNL:LN	General, gold bias	Core	09.05.2014	332	396	<u>0.3%</u>	1.4%	19.3%
Polar Capital Technology	PCT:LN	Global technology	Satellite	08.01.2015	5.85	8.16	<u>-3.3%</u>	0.0%	39.4%
Impax Environmental Mkts	IEM:LN	Water and Ecology	Satellite	07.03.2014	1.50	2.13	<u>-12.7%</u>	0.8%	41.7%

TRUSTS IN FOCUS

<u>Average Yield (not inc in perf):</u>	<u>2.3%</u>
<u>% Performance (before dividends):</u>	<u>33.1%</u>
<u>% Estimated performance (after dividends):</u>	<u>37.7%</u>
<u>% FTSE 100 (7/3/14 to now):</u>	<u>4.9%</u>

Trusts In Focus

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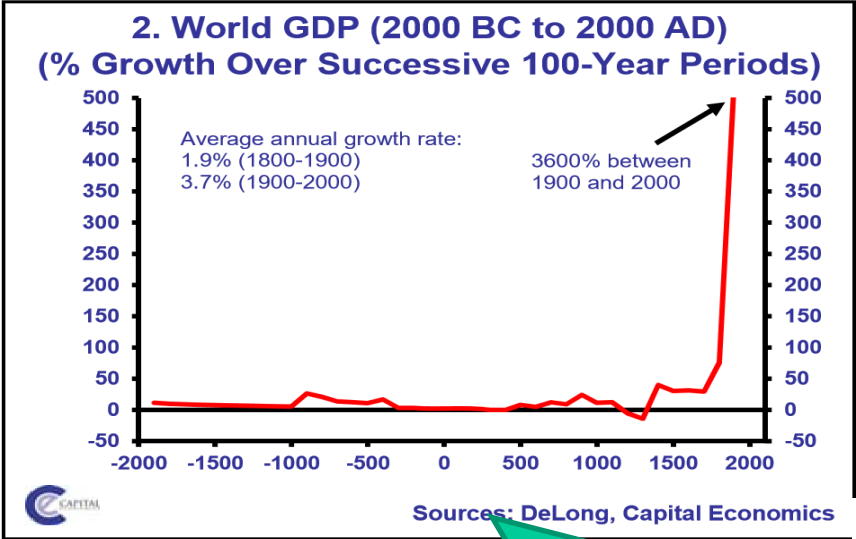
European Assets Trust NV (UK) (EAT LN EQUITY) 1045.00 10.0

2016-10-07



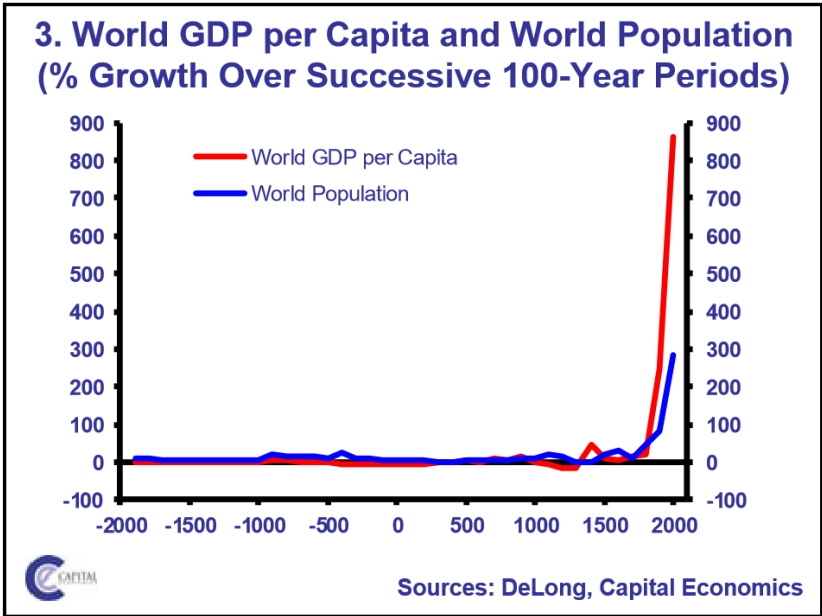
What's Interesting Today

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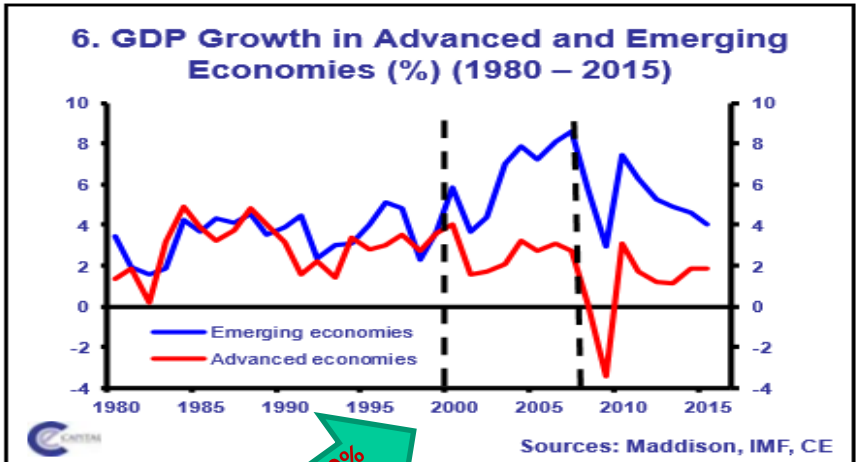
- ### 4. Robert Gordon's Three Industrial Revolutions
- 1750 - 1830: Mechanised cotton spinning, steam engines and railroads.
 - 1870 - 1900: Advances in electricity, internal combustion engine and telephone.
 - 1960 - late 1990s: Computer and internet revolution.

**4th industrial revolution? Energy/
healthcare/finance/household? Dr
David Brown.....**



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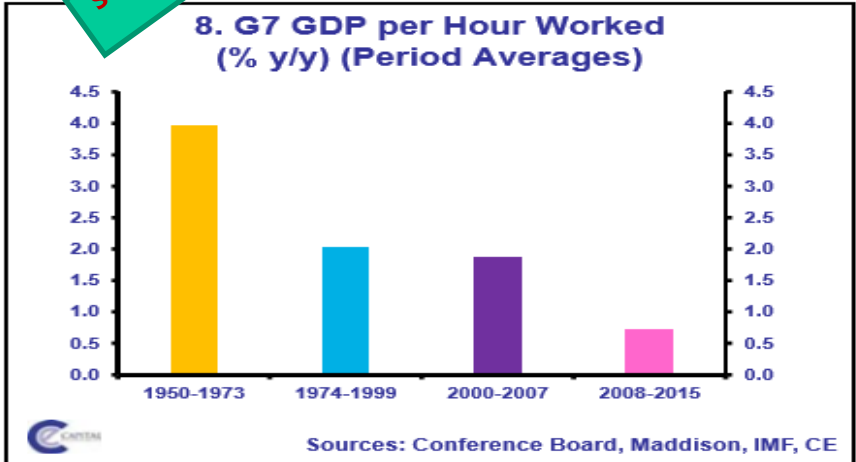
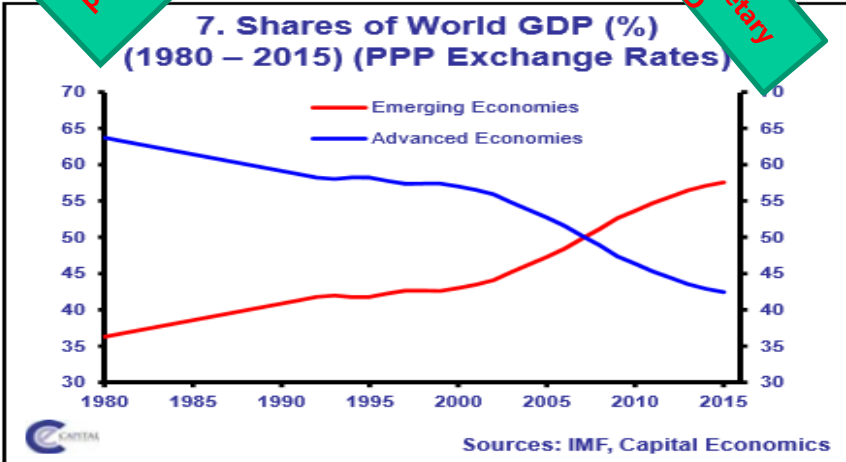
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It all goes right: GDP, pop, tech, USA, trade barriers etc

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

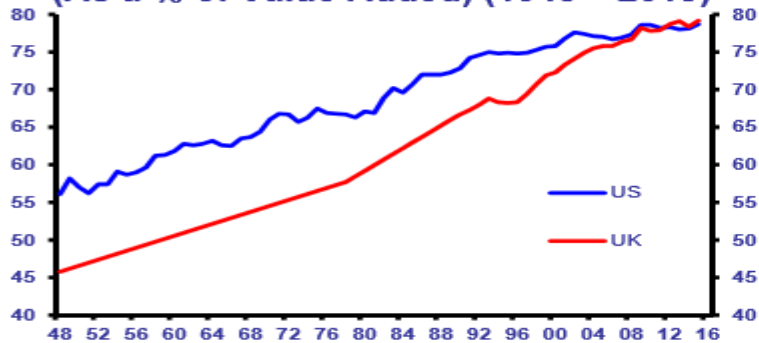
Steady (60% x 4%) + (40% x 2%) = 3.2%



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11. Share of the Service Sector in GDP (As a % of Value Added) (1948 – 2015)



Sources: BEA, ONS, World Bank, CE

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?

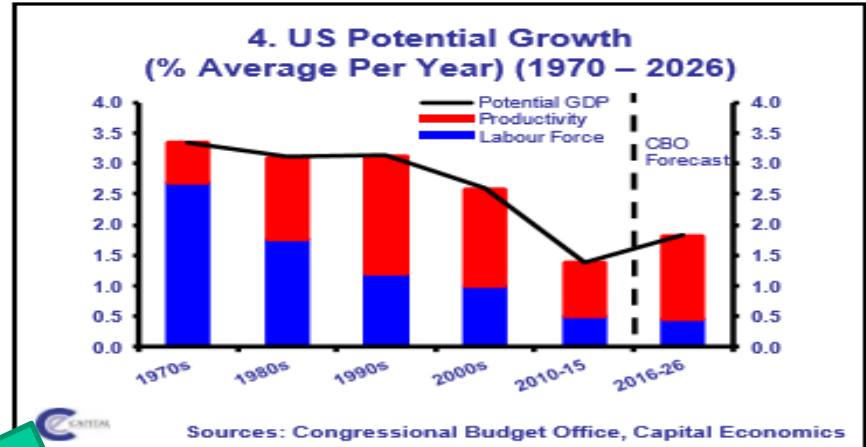
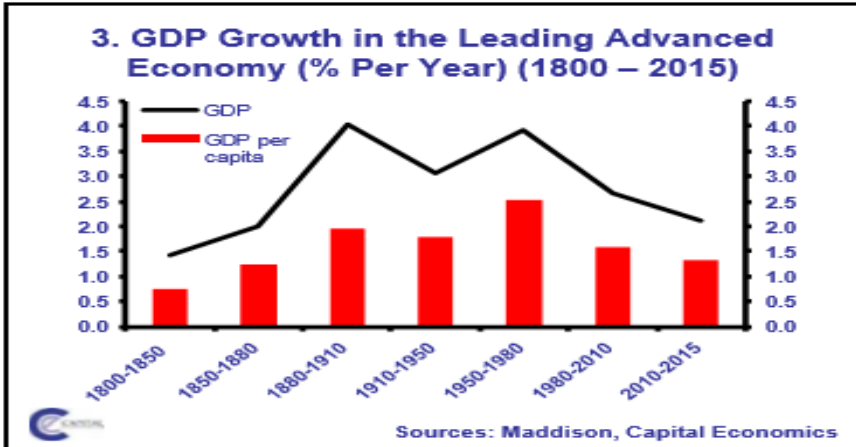
- Sir Charles Bean estimated that for the UK between 2005 and 2014, it could be 0.3% to 0.6% of GDP growth per annum.
- On this basis, mismeasurement could explain about three-quarters of the slowdown in GDP per capita in the UK since 1980-1999.
- But can we believe these estimates?
- Is it GDP that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

15. Conclusion

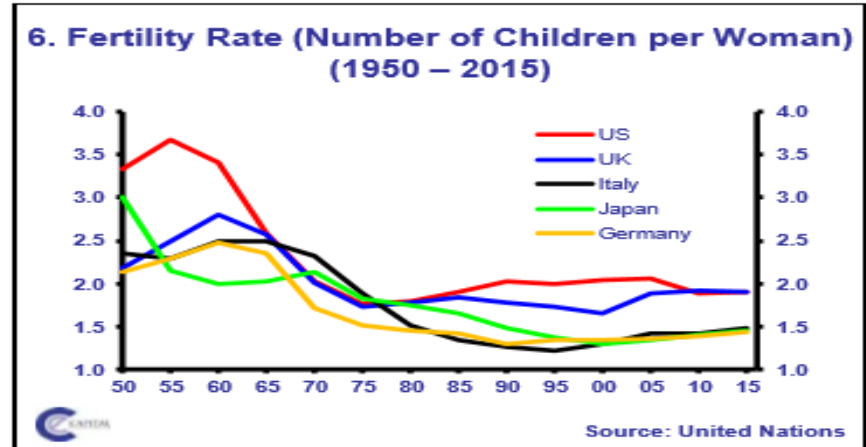
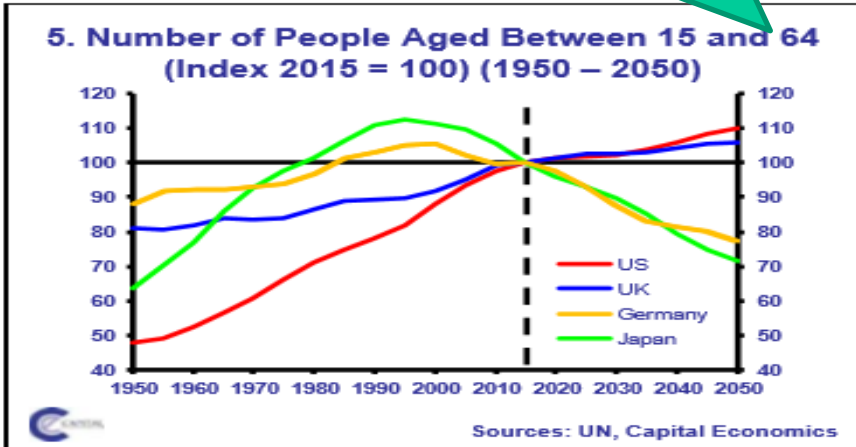
- **The Golden Age was exceptional and won't be repeated.**
- **Rapid growth in the EMs in the early 2000s offset a sharp slowdown in the advanced economies.**
- **Half this slowdown was due to slower growth of the working-age population, half to slower prod. growth.**
- **Could world GDP growth bounce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

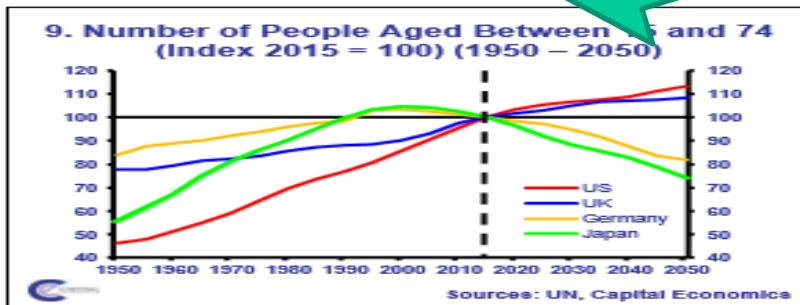


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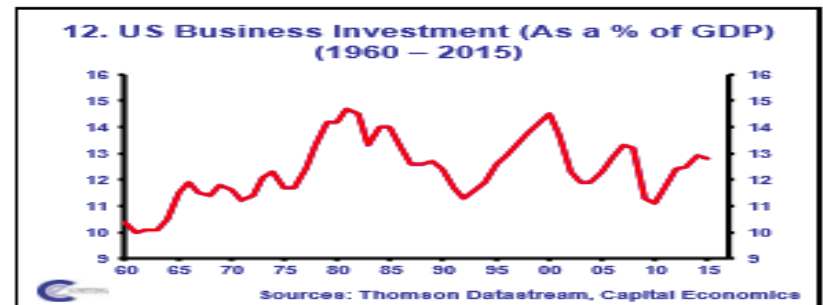
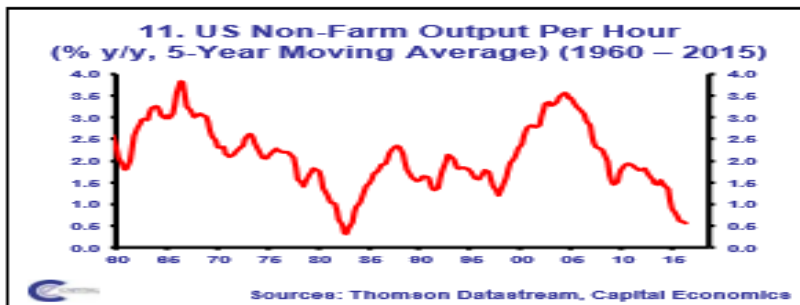
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US, UK good, Germany, Japan bad



- 10. Change needed to add 0.5 percentage points to growth in labour supply each year for 10 years**
- Increase average number of children per family by 0.5, from 1.5 to 2.0.
 - Raise female participation rates by 15 percentage points, from 65% to 80%.
 - Raise average retirement age by 5 years, from 65 to 70.
 - Net immigration of 2.5m people in country of working age population 50m (total pop. 80m).



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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

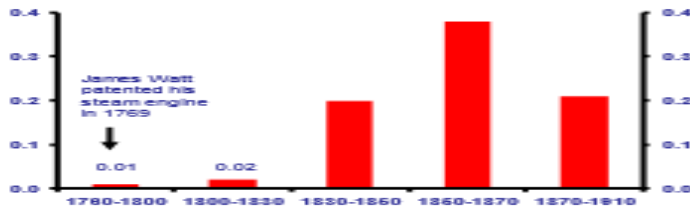
14. The impact of robotics

- 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?

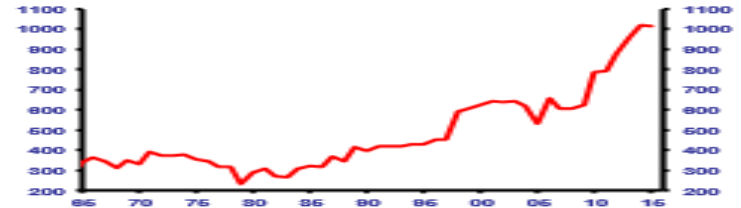
15. Contribution of Steam to British Labour Productivity Growth (% per year) (1760 – 1910)



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

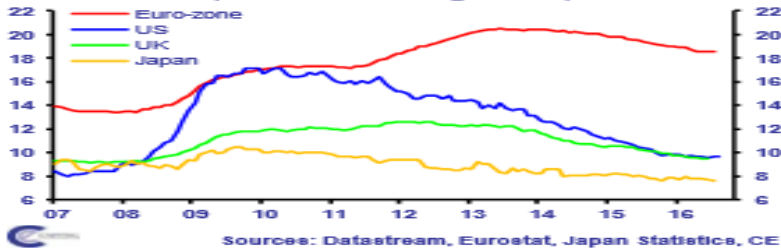
- Has demand been weak?
- Is this still a hangover from the crisis?
- Structural reasons for demand being sluggish.
- Will there be a rebound in demand?

2. Has demand actually been weak?

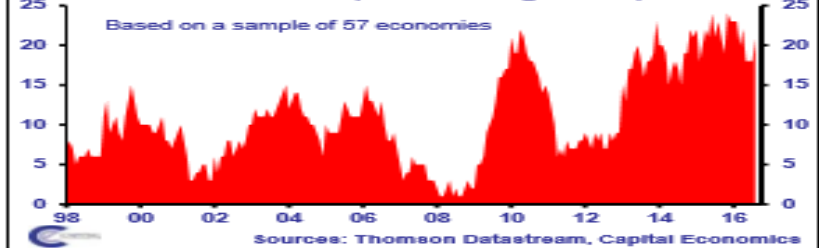
- Low unemployment rates.
- Increases in household spending.
- Record equity prices.



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



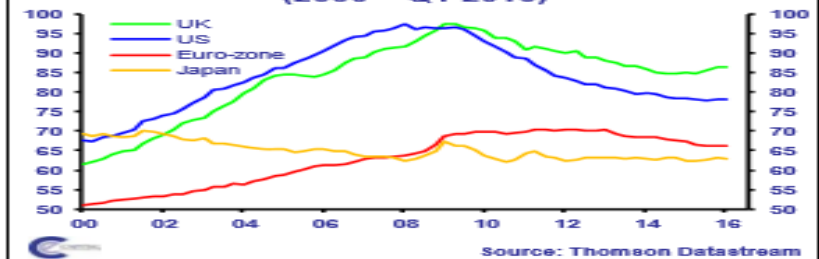
4. Number of Economies with Core Inflation Below 1% (1998 – Aug. 2016)



5. Is this just a hangover from the crisis?

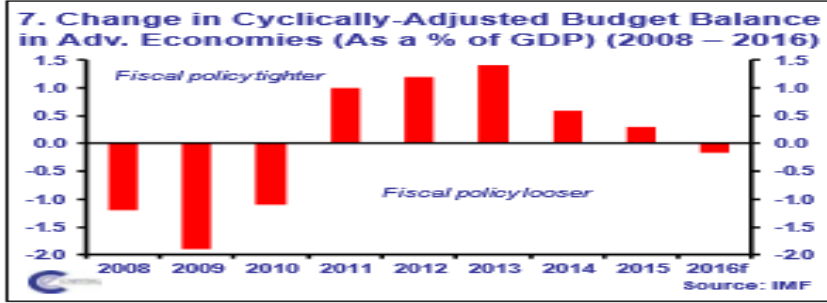
- Households paying down debt.
- Governments implementing austerity.
- Banks rebuilding capital buffers.

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

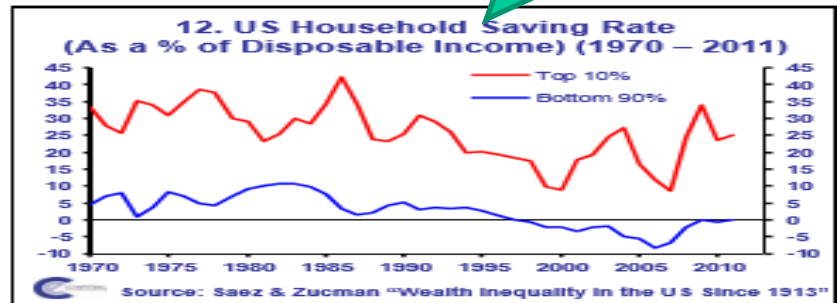
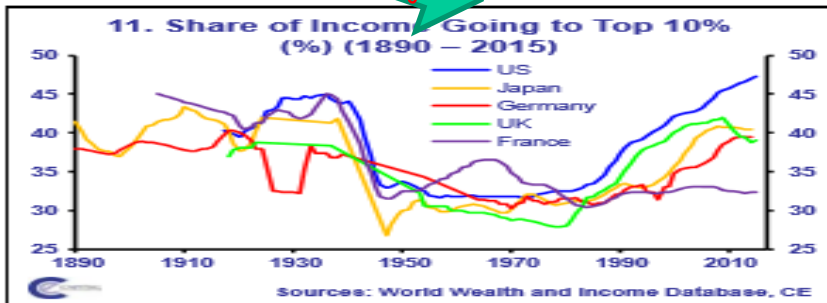
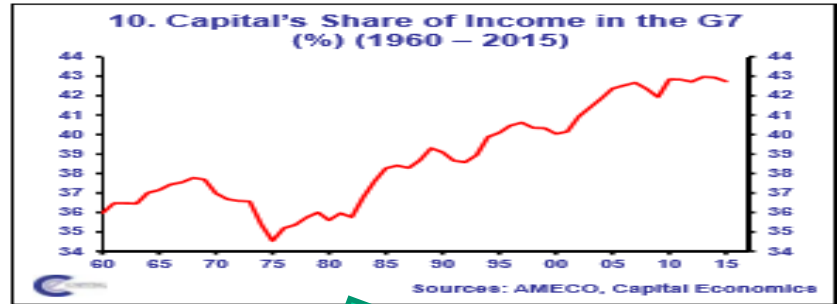
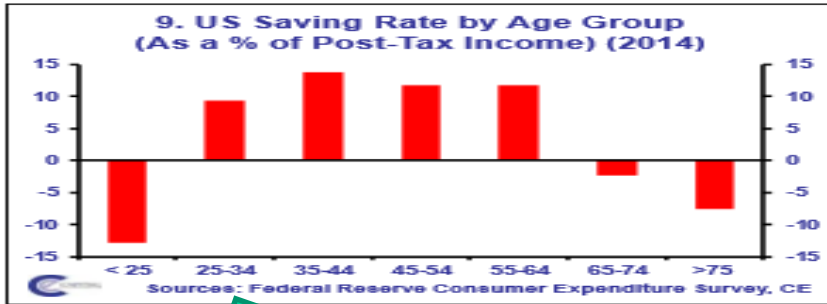


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- 8. Structural reasons for demand being sluggish**
- Baby boomers have reached peak saving age.
 - Greater share of income going to top 10% of earners, who save more.
 - Several factors have prevented investment from taking off again.

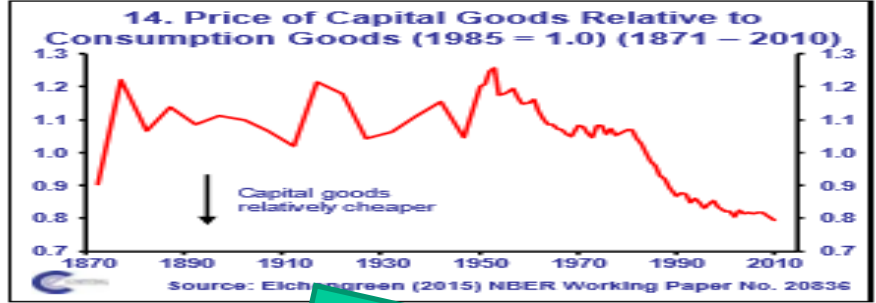


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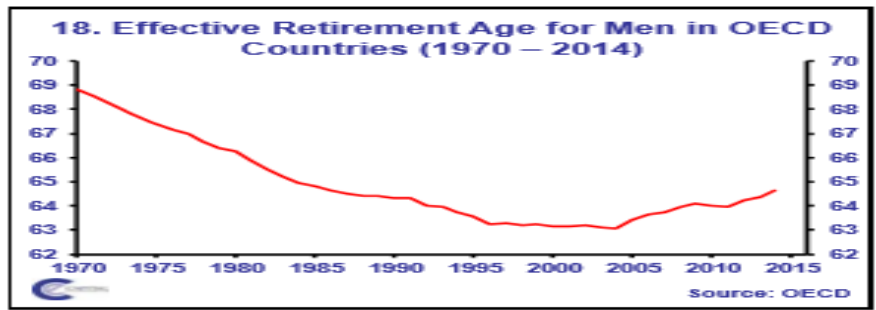
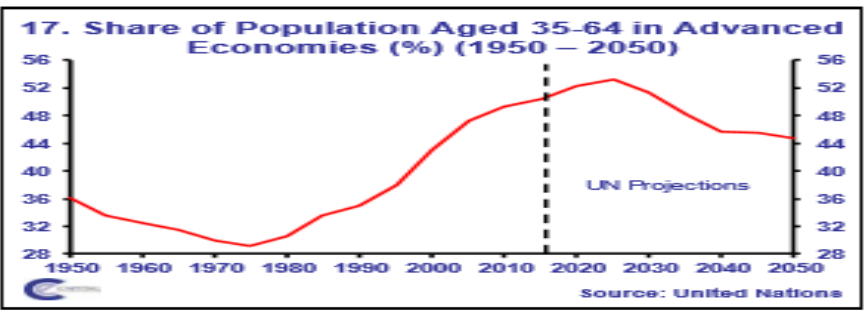
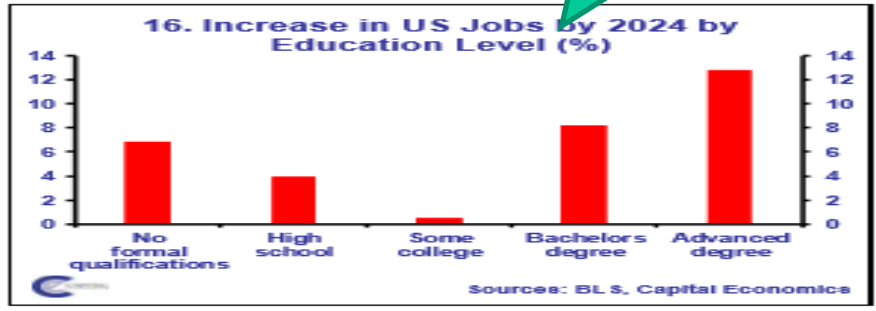
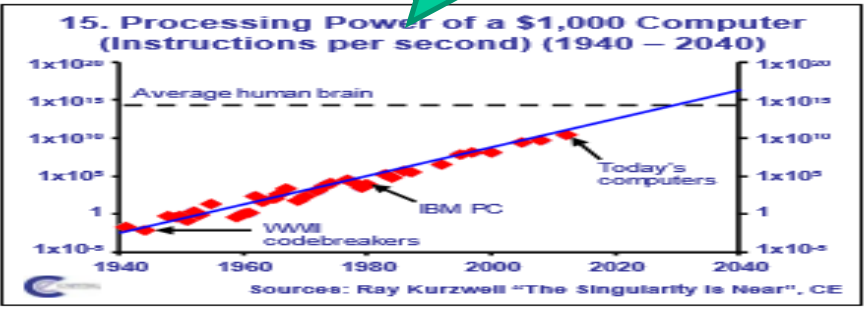
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- 13. Reasons why investment is subdued**
- Low potential growth.
 - Animal spirits dampened by the crisis.
 - Short-termism.
 - Falling cost of capital goods.

Human brain goes out of business in 2030?



Get that degree!



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13. Reasons why investment is subdued

- Low potential growth.
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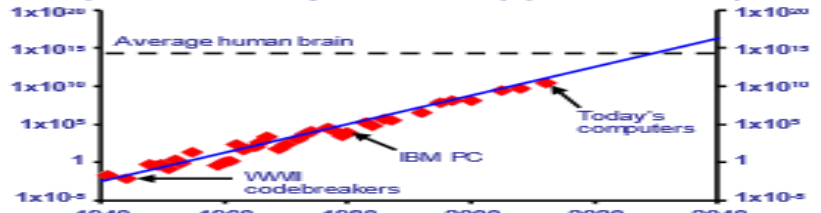


14. Price of Capital Goods Relative to Consumption Goods (1985 = 1.0) (1871 – 2010)



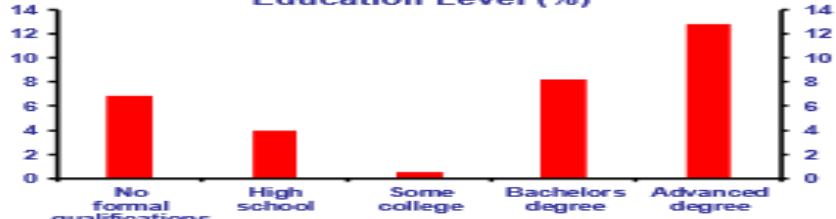
Source: Eichengreen (2015) NBER Working Paper No. 20836

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



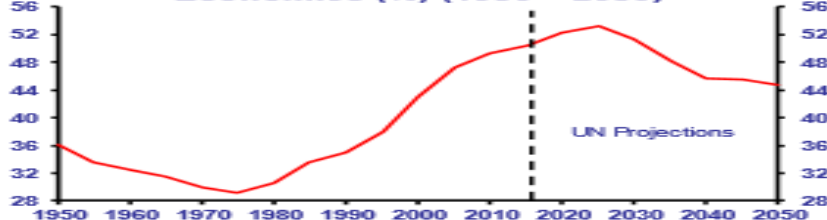
Sources: Ray Kurzweil "The Singularity Is Near", CE

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



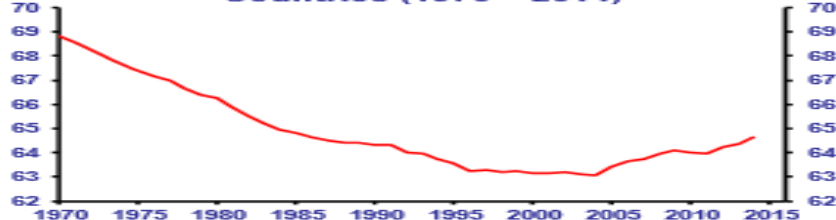
Sources: BLS, Capital Economics

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



Source: United Nations

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

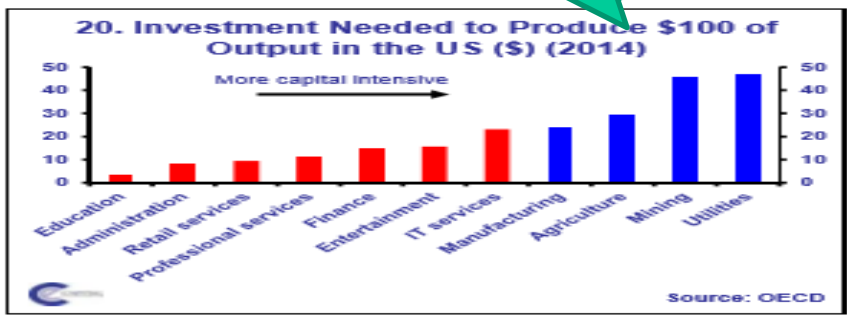
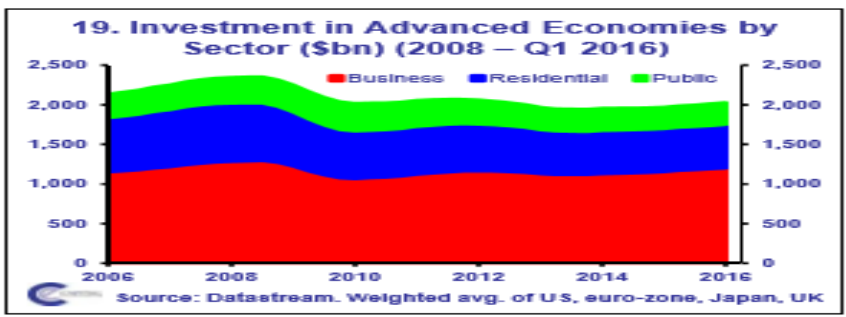


Source: OECD

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Jobs created services not sunset indus

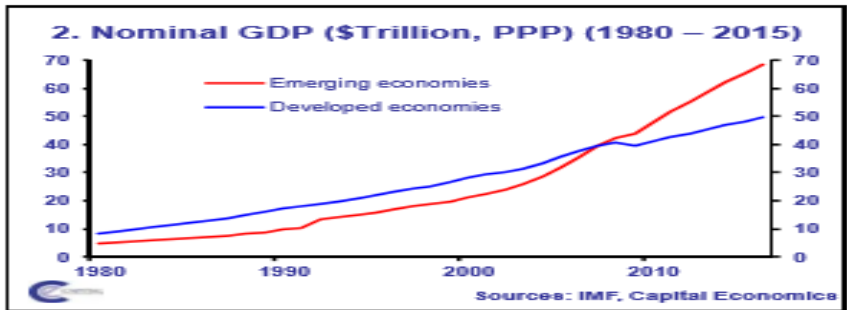


- 21. Conclusions**
- GDP and employment growth are likely to remain below potential.
 - Inflation in most economies will stay low.
 - Central banks will keep interest rates low and continue to pursue unconventional policies.
 - New wave of fiscal stimulus?

Are prospects better in the emerging world?

EM > DM

- 1. Agenda**
- The recent performance of EMs.
 - Is slower growth cyclical or structural?
 - The demographic outlook.
 - Productivity growth in the emerging world.
 - Conclusions.

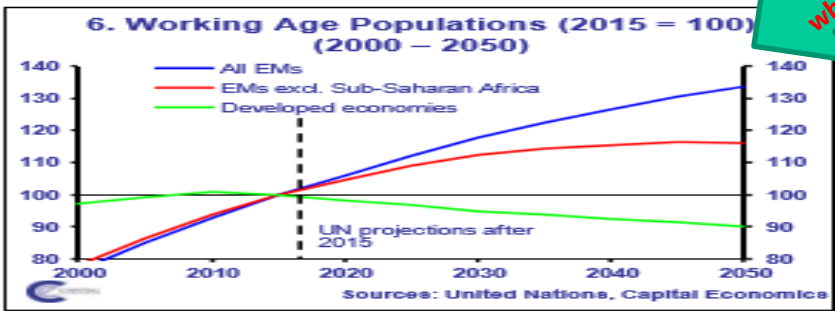
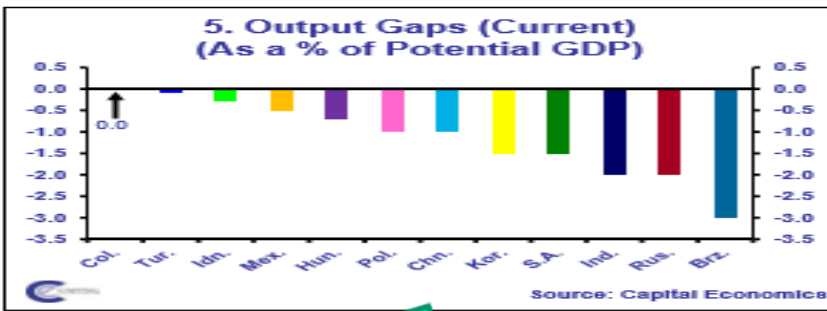


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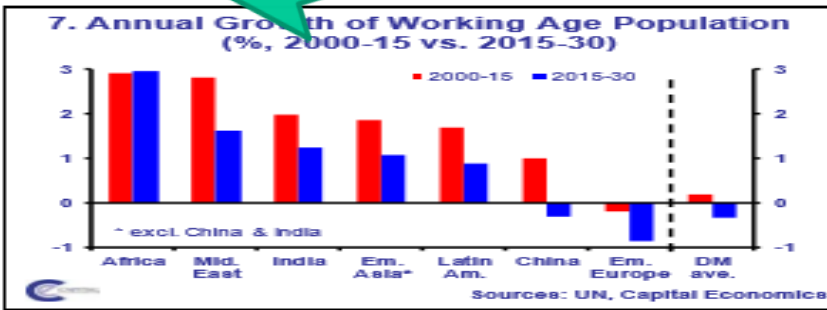
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- ### 4. Cyclical headwinds to EM growth
- Deleveraging after unsustainable credit booms.
 - Weak demand for EM exporters.
 - Lower export prices for commodity producers ...
 - ... but many EMs should have benefitted too.



Africa where it's at

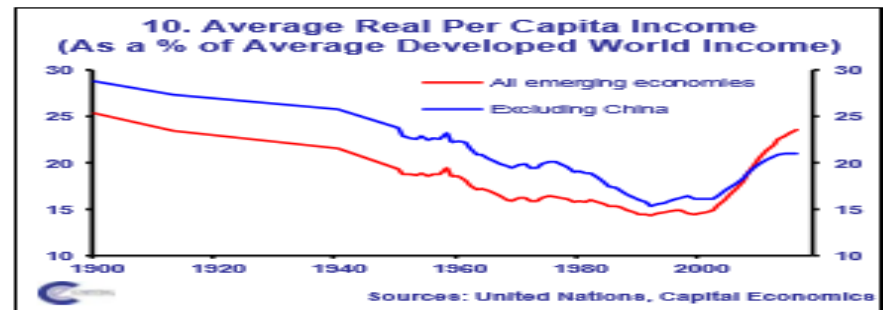
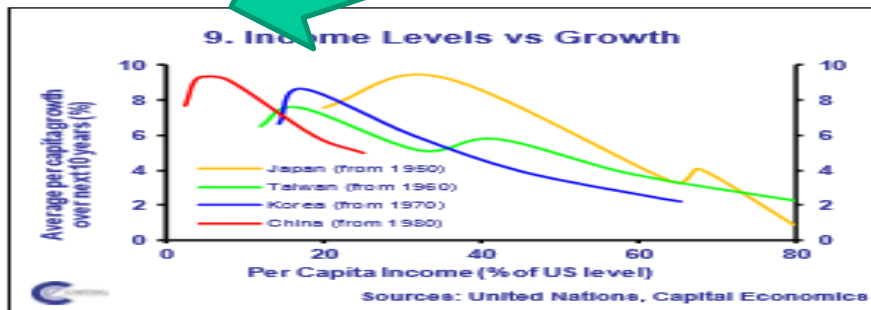


Africa where it's at

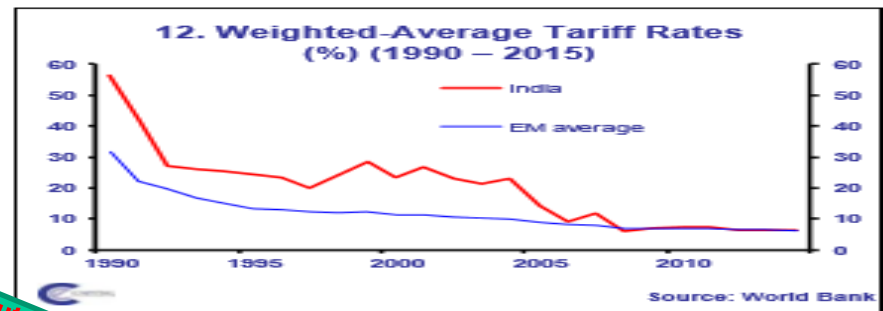
- ### 8. Drivers of medium-term growth
- Increasing number of workers.
 - Working age population for EM world still rising.
 - But workforce growth is set to slow nearly everywhere.
 - Increasing output per worker.

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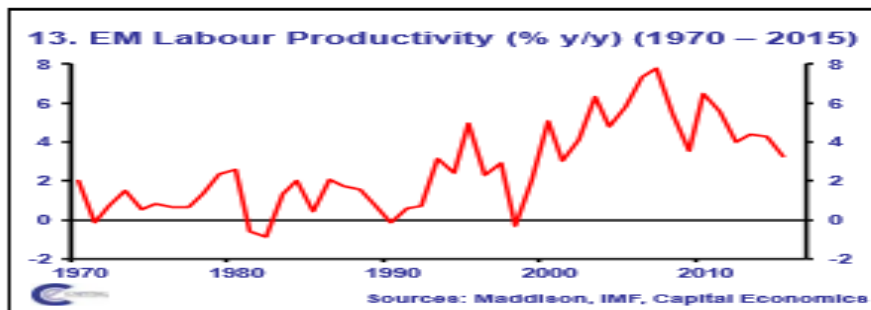
As you develop, growth down, per cap inc up



- ### 11. Drivers of rapid EM productivity growth in the 2000s
- Boom in China, generating positive spillovers for other EMs.
 - Integration of EMs into global economy:
 - Creation of market economies in former Soviet bloc.
 - Cuts to tariffs, openness to FDI.
 - IT revolution.



...but China NOT the problem media states

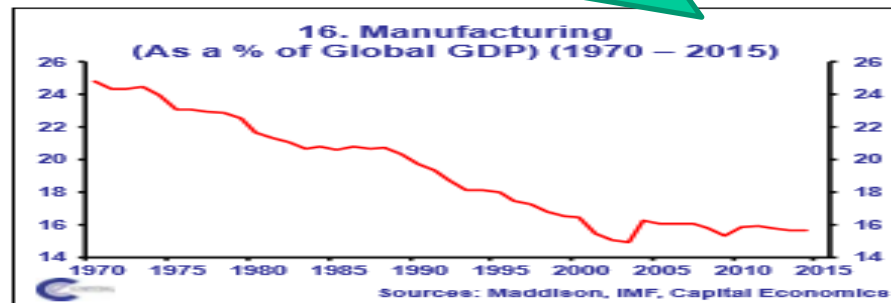


- ### 14. Winners & Losers
- There will be individual successes: encouraging reforms in Mexico, Argentina and Indonesia.
 - But other major EMs facing new headwinds:
 - Low investment rates starting to bite in Turkey, Brazil, Russia and South Africa.
 - Misallocation of resources in China threatens to drag potential growth much lower.

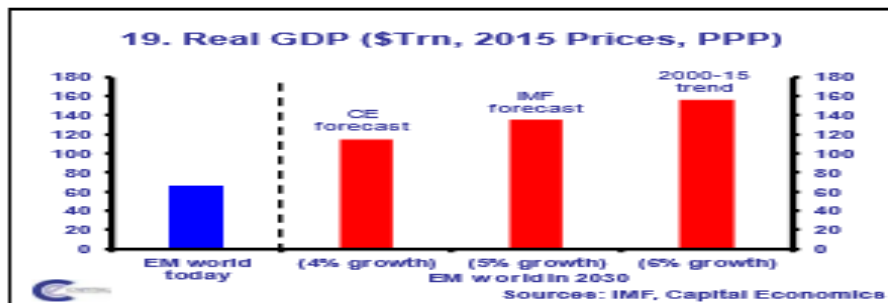
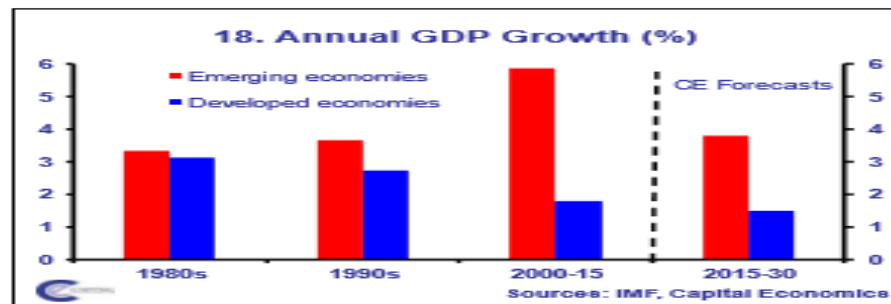
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EM 4% not recent 6%



- ### 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.



- ### 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?



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.

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.

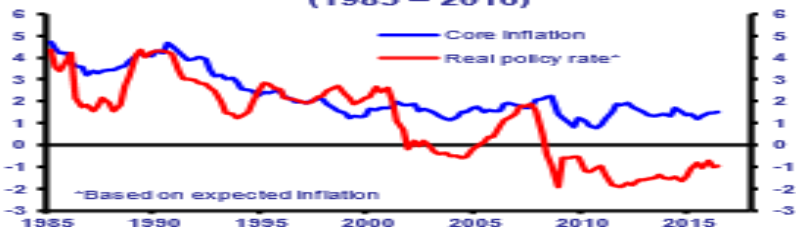
3. Global Savings/Investment as a Share of GDP & G7 Real Policy Rate (%) (1985 – 2015)



Sources: IMF, Thomson Datastream, IFO, CE

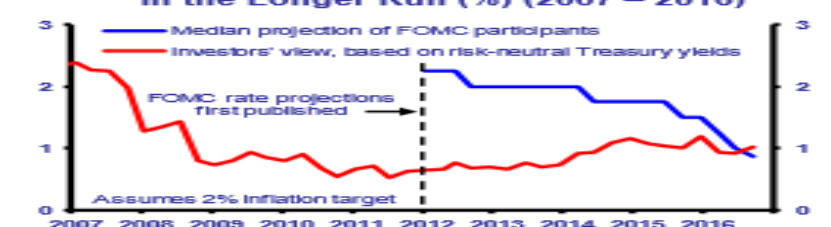
Low and staying low

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



Sources: Thomson Datastream, IFO, CE

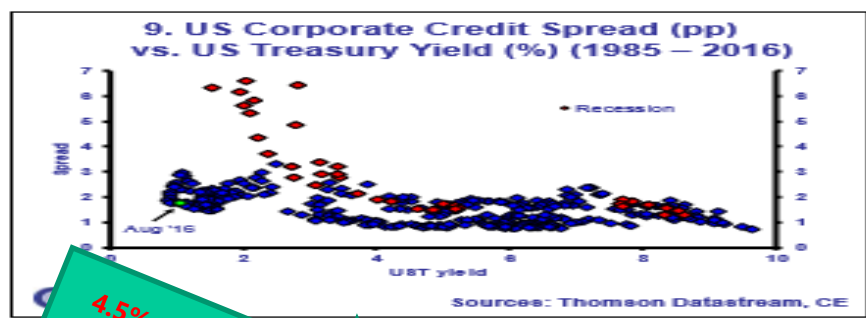
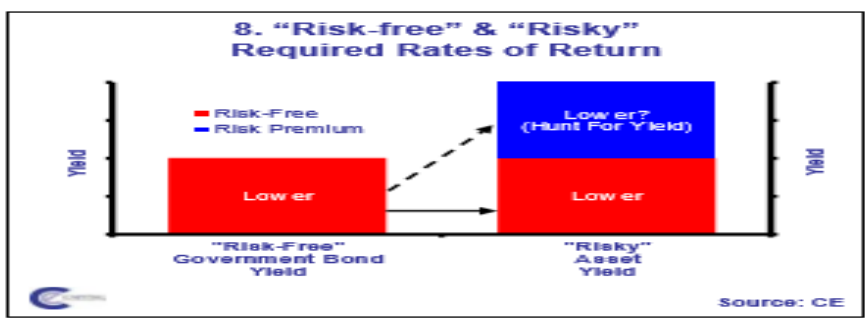
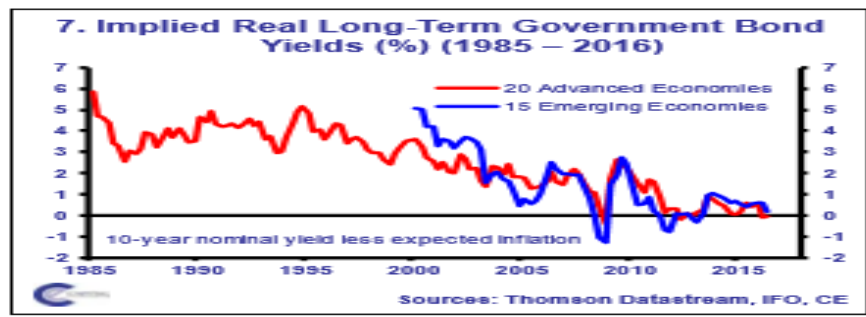
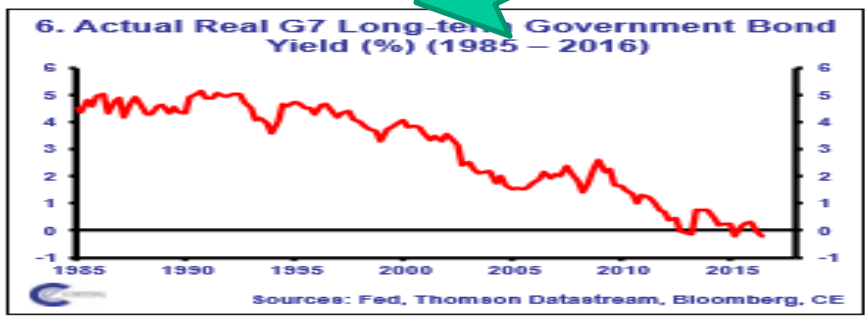
5. Assumptions about the Real/Fed Funds Rate in the Longer Run (%) (2007 – 2016)



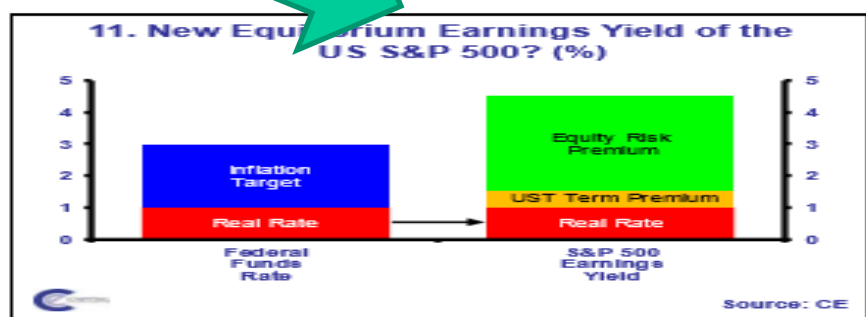
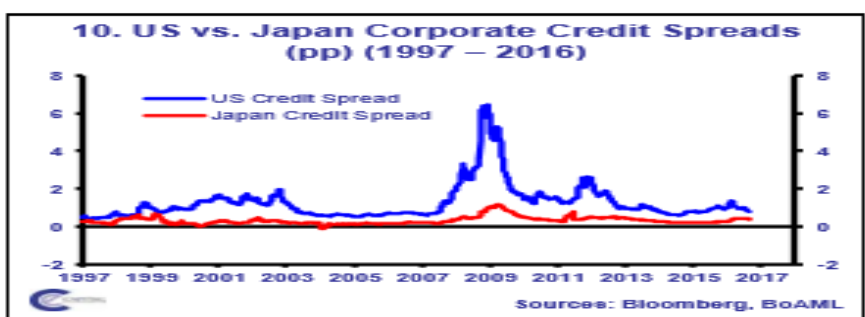
Sources: Fed, CE

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But who makes money here at 0%?

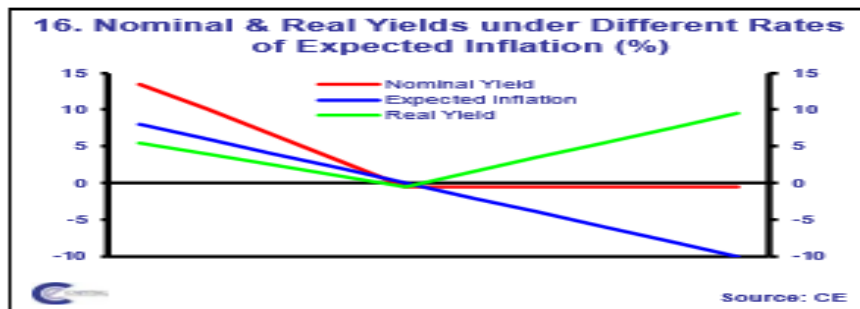
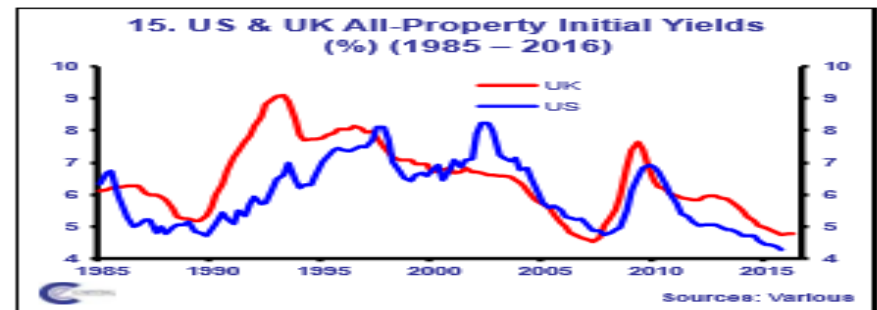
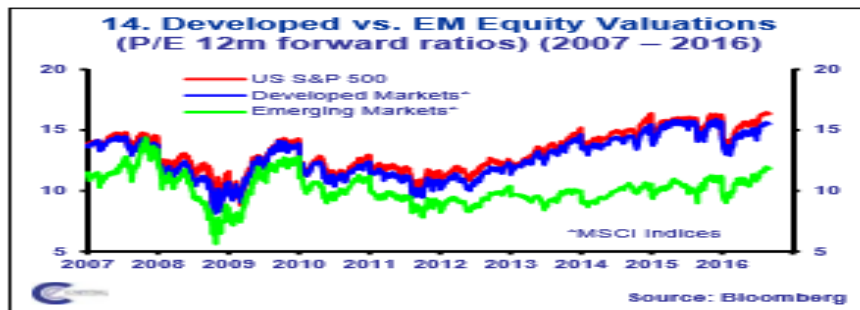
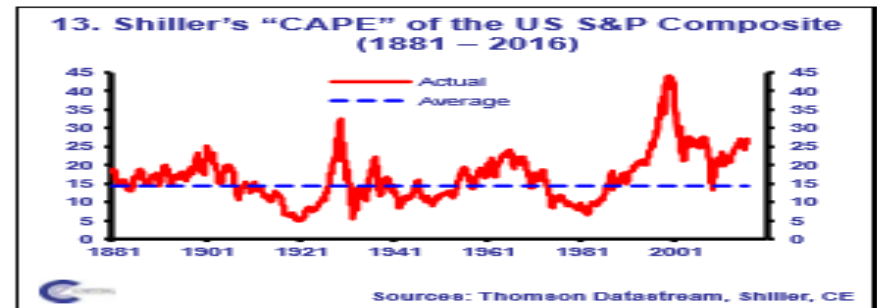
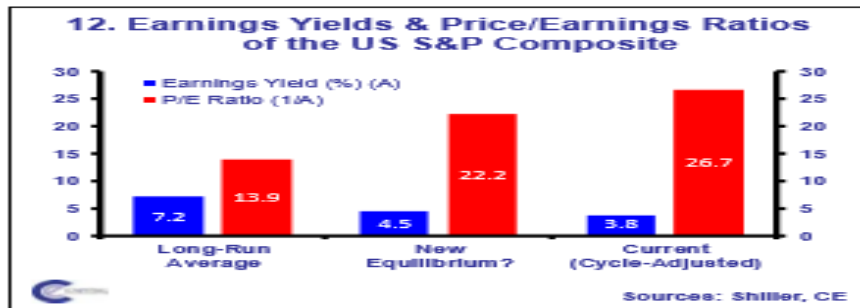


4.5% EY => PER 22x



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- 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.

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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