meridian

ASSET MANAGEMENT (C.I.) LIMITED

INVESTMENT MEMORANDUM

This has been a solid quarter for international equity investors, as our table below shows, but a difficult one for fixed interest investors as expectations of rising US inflation and interest rates on the back of fiscal expansion have seemingly swung investors' preferences towards equities and away from fixed interest securities. Following a period of prolonged weakness, exacerbated by Brexit, sterling showed a stronger trend over the quarter as a whole. In the commodity markets, oil rose on prospects for more supply discipline amongst oil producers but gold disappointed its supporters.

The tables below detail relevant movements in markets :

International Equities 31.10.16 - 31.01.17

Total Return Performances (%)				
Country	**Local Currency**	**£**	**US$**	**€**
Australia	+7.7	+4.2	+7.4	+9.0
Finland	+3.0	-1.4	+1.6	+3.0
France	+5.6	+1.1	+4.1	+5.6
Germany	+7.6	+3.0	+6.1	+7.6
Hong Kong, China	+0.2	-2.9	+0.1	+1.5
Italy	+8.4	+3.7	+6.9	+8.4
Japan	+9.4	-0.9	+2.1	+3.6
Netherlands	+4.2	-0.4	+2.7	+4.2
Spain	+3.2	-1.3	+1.7	+3.2
Switzerland	+5.5	+2.6	+5.7	+7.2
UK	+2.7	+2.7	+5.8	+7.3
USA	+7.9	+4.7	+7.9	+9.4
Europe ex UK	+5.7	+1.7	+4.8	+6.3
All World Asia Pacific ex Japan	+3.3	-0.4	+2.7	+4.1
All World Asia Pacific	+5.9	-0.6	+2.4	+3.9
All World Latin America	-1.3	-6.2	-3.4	-2.0
All World All Emerging Markets	+1.6	-2.6	+0.3	+1.8
All World	+6.5	+2.8	+5.9	+7.4

Source FTSE World Indices

FTSE UK Government Securities Index All Stocks (total return) : -1.3%

International Bonds - Benchmark Ten Year Government Bond Yields (%)

Currency	31.10.16	31.01.17
Sterling	1.25	1.42
US Dollar	1.84	2.45
Yen	-0.05	0.09
Germany (Euro)	-0.09	0.44

Sterling's performance during the quarter ending 31.01.17 (%)

Currency	Quarter Ending 31.01.17
US Dollar	+2.8
Canadian Dollar	N/C
Yen	+10.6
Euro	+4.5
Swiss Franc	+2.8
Australian Dollar	+3.3

Other currency movements during the quarter ending 31.01.17 (%)

Currency	Quarter Ending 31.01.17
US Dollar / Canadian Dollar	-2.7
US Dollar / Yen	+7.6
US Dollar / Euro	+1.7
Swiss Franc / Euro	+1.6
Euro / Yen	+5.9

Significant Commodities (US dollar terms) 31.10.16 - 31.01.17 (%)

Currency	Quarter Ending 31.01.17
Oil	+15.0
Gold	-4.7

MARKETS

International equity markets have enjoyed another positive quarter. In local currency terms, the FTSE All World Index has returned +6.5%, in sterling terms +2.8%, in US dollar terms +5.9% and, in euro terms, +7.4%. Looking at local currency returns first, the only particularly significant movements relative to the FTSE All World Index were in the FTSE All World Latin America Index which returned -1.3% and in the FTSE All World All Emerging Markets Index which returned +1.6%. Unusually, compared with recent quarters, sterling strengthened against other major currencies, so returns were lower compared with those of foreign markets in local currency terms. Compared with the local currency returns, there was still outperformance in sterling terms from the FTSE USA Index (+4.7%) and from the FTSE Australia Index (+4.2%). On the other hand, there was underperformance from the FTSE Europe ex UK Index (+1.7%), the FTSE All World Asia Pacific ex Japan Index (-0.4%), the FTSE Japan Index (-0.9%), the FTSE All World Latin America Index (-6.2%) and the FTSE All World All Emerging Markets Index (-2.6%).

On the other hand, international bond markets experienced a poor quarter. Taking ten year government bond yields as a benchmark, UK government bonds saw a 17 basis point rise in their gross redemption yield to 1.42%, of 61 basis points in the US Treasury bond to 2.45%, of 14 basis points in the Japanese Government Bond to 0.09% and of 35 basis points in the German Bund to 0.44%.

As touched upon above, there was a turnround in the foreign exchange markets as far as sterling was concerned. Against the yen, it rose by 10.6%, against the euro by 4.5%, against the Australian dollar by 3.3%, against the US dollar and Swiss Franc by 2.8%, whilst it was unchanged against a strong Canadian dollar.

In commodity markets, oil, as measured by Brent crude, rose by 15%, as OPEC tried to install some supply discipline into markets, but gold performed disappointingly, down 4.7%.

ECONOMICS

After the extraordinary events of 2016, investors are naturally apprehensive about what 2017 has in store. They might take comfort from the fact that stock markets took Brexit and Donald Trump's victory in their stride despite many people not having expected either of these outcomes. One of the many lessons to be learnt from 2016 is that markets can be very resilient in the face of unexpected news. There are always reasons for investors to worry but these reasons should not lead to extreme investment decisions such as selling all of one's holdings or taking highly risky and concentrated bets based on some apocalyptic view of events. Things rarely turn out as badly as worst case scenarios suggest and it hardly ever pays to take extreme positions in portfolios. One only has to consider the performance of some hedge funds in 2016, which have been published in the financial press recently, to realise how dangerous such policies can be. Whilst sophisticated investors might realise the characteristics of the funds in which they invest, examples quoted of reductions of nearly half in the net asset value in a good year for mainstream investors, like 2016, highlight the value of prudent conventional policies for mainstream investors. Of course, extreme investment policies can lead to excellent returns if the calls are right, as well as bad results if they are wrong, but very high levels of volatility affect risk adjusted returns and, so, one should approach 2017, a year which has plenty of question marks around it, wary about taking an investment position which is predicated on some sort of economic or political disaster occurring. One can always find plenty of reasons not to be invested at all because of multiple concerns about the economic or political situation but to take such a position risks very poor financial returns for long term investors.

Before we look at the prospects for 2017, let us take a look at the latest projections, just published, from the IMF in its January 2017 World Economic Outlook update. On the face of it, the projections are unremarkable in that they do not hint, in most cases, at any extraordinary turn of events in 2017. It has made no change in its projections, made last October, for world growth in 2017 and 2018 of 3.4%, and 3.6% respectively. Within that projection, there has been a slight increase in forecast growth for Advanced Economies, raised by 0.1% for 2017 to 1.9% and by 0.2% to 2.0% in 2018. Within the Advanced Economies group, the USA has seen a modest increase of 0.1% in forecast growth for 2017 to 2.3% and a much larger one of 0.4% to 2.5% in 2018. There is little change in the IMF's forecast for the eurozone, a small increase of 0.1% for 2017 to 1.6% and an unchanged forecast of the same figure for 2018. The most significant changes for the eurozone come in its projections for Italy, the eurozone's third largest economy, where the forecasts have been cut by 0.2% and 0.3% respectively for 2017 and 2018 to 0.7% and 0.8%, a concern for an economy with a large debt overhang and for which much faster economic growth would be the best way to tackle the problem. In relative terms, Spain still continues to be the star of the show as far as the eurozone is concerned. The IMF has raised its forecast growth rate by 0.1% this year and 0.2% next year to 2.3% and 2.1% respectively. The German projections have been raised very slightly for 2017 and 2018 by 0.1% for each year to 1.5% in each case but there has been no change for France for either year at 1.3% and 1.6% respectively. The IMF's forecasts for the UK have changed quite significantly from last October. It has raised its forecast substantially for 2017 by 0.4% to 1.5% but cut it back for 2018 by 0.3% to 1.4%. For Japan, there has been a slight uplift in its projection for 2017 from 0.6% to 0.8% but it has left next year's forecast unchanged at 0.5%. For Canada, there is no change in this year's forecast of 1.9% and a slight uplift of 0.1% to 2.0% for 2018. There is very little change in its projections for Emerging Markets and Developing Economies. There is a shading down of the forecast for 2017, by 0.1% to 4.5%, whilst next year's figure remains unchanged at 4.8%. Within this category, the IMF has raised its forecast for China in 2017 to 6.5% from 6.2% but left its forecast unchanged at 6.0% for 2018. India's projection has been downgraded by 0.4% this year to 7.2% but remains unchanged at 7.7% for 2018. Forecasts for Russia are unchanged at 1.1% and 1.2% respectively, whilst the projections for Brazil have been downgraded by 0.3% to 0.2% this year and left unchanged at 1.5% for 2018.

Not surprisingly, the IMF indicates that there is a wide dispersion of possible outcomes because of current uncertainties. The course of US economic policy under President Trump is unclear and the IMF says that its forecasts are based on the assumption of a changing policy mix in the USA. Whilst the IMF emphasises the possibility of upward risks to its forecasts, it also lays out some factors which could pose downside risks. Protectionism is one factor, a tightening of global financial conditions that could link with balance sheet weaknesses in parts of the euro area and in some emerging market economies, increased geopolitical tensions and a more severe slowdown in China.

Before we look at some of the potentially negative issues for markets this year, it is important to note that economic activity appears to be picking up and that there is some positive economic momentum moving into 2017. If we take one indicator, the highly regarded purchasing managers indices, we see a string of quite positive readings. The latest composite PMI for the UK stands at 55.5 with any reading over 50 suggesting economic growth. In the USA, the PMI for manufacturing stands at 56.0 and that for services at 56.6. In the eurozone, the latest composite PMI stands at 54.4. In Japan, the composite PMI stands at 52.3 and, in China, the PMI for manufacturing stands at 51.3 and for non manufacturing at 54.6. Some countries' readings are stronger than others but all point to economic expansion, so this is not a bad start to the year and provides some underpinning for international equity price levels. At a time when the media usually seems to accentuate the negative aspects of economic news, the less newsworthy but, arguably, more important positive economic data normally gets relegated to the back pages. It is important to note that the IMF also points to upside risks to its forecasts and this puts the outlook properly into context.

However, because the downside risks are more prominent in terms of visibility, even if not necessarily in terms of importance, we should spend more time considering them, starting with the USA.

The USA is, of course, only days into Donald Trump's presidency so we can only outline potential positive and negative features of what we know about his plans. At the outset, it is important to lay out the checks and balances in the US constitution. Because Donald Trump is so controversial, the majority of coverage naturally involves him. However, he does not have untrammelled power and Congress can impose severe restraints on a President's actions and powers. It is true that the Republicans control the House of Representatives and the Senate, which is usually an enormous advantage when it comes to enacting policies if the President is of the same party. We have said before in previous reviews that the best situation is often a divided executive and legislative branch of government because, if the US economy is progressing satisfactorily, as is the case now, it could be that harmful government measures, whether instigated by Congress or the President, could derail it. These measures might be blocked as a result of the checks and balances. It might be thought, therefore, that with the Republicans controlling the White House and both houses of Congress, not to mention most state governorships and legislatures, President Trump has a free hand to enact whatever he likes. However, this is far from the case. It is quite clear that President Trump is not a conventional Republican and it is very difficult to identify him with a particular political party. For example, his personal and corporate tax cutting agenda fit very much with the Republican Party's traditional beliefs but, on the other hand, his protectionism does not. As was seen in the bitter battle for the Republican nomination for the Presidential Election, he had many enemies within the Republican Party and policy differences were often substantial. The same divergence of views can be seen in his probable relationship with Congress. In the financial and economic area, two issues, and there are bound to be many more, come to mind. One is unfunded tax cuts and increased federal expenditure, which President Trump has promised on infrastructure, and the other is the protectionist measures he has advocated. Many in Congress are balanced budget supporters and will not support wider federal budget deficits which are implied in his plans and many will certainly not support protectionism. Despite the Republicans being in complete charge of the different arms of government, there is almost certain to be a lot of intense opposition to his economic plans, as outlined in his election campaign, and we might see the executive and legislative arm of government at loggerheads despite, nominally at least, being in control of the same party. This will also be relevant to other plans of his, for example, his wish for closer ties with Russia, which will be opposed by many Republicans. Although many of his pronouncements, if they pass into policy or law, have the ability to affect financial markets, directly or indirectly, we will concentrate on three of his economic policies which he outlined in his election campaign, those on tax and trade.

In the aftermath of Donald Trump's election victory last November, US equities performed strongly as investors concentrated on the aspects of his policy announcements which they liked and ignored those which they did not. Tax cuts are what investors like and his pronouncements on personal and corporate tax cuts were well received. Ignoring, for a moment, the effects of unfunded tax cuts on the federal deficit, personal tax cuts would leave more room for consumption and could be expected to be positive for economic growth. Corporate tax cuts would have a number of positive implications. The headline US corporate tax rate of 35% is very high by international standards and renders the US uncompetitive. One example is the number of tax inversions in recent years as US companies have sought to move to countries with lower corporate tax rates by buying other companies in a lower tax jurisdiction. The US tax regime also penalises companies with significant amounts of cash trapped overseas, as to repatriate it to the USA would incur a large tax bill. There have been suggestions that President Trump favours a lower tax rate for cash repatriation which would encourage the process in the hope that it would be invested in the USA. Other things being equal, a cut in the tax rate would raise earnings per share, helping to validate the recent rise in US equities. One way or another, cuts to personal and corporate tax rates should help to stimulate further economic growth in the USA. There is a second theme, put forward by Donald Trump, which should have no difficulty in uniting Republicans, and that is deregulation. In recent years, in the USA, as elsewhere, the number of rules and regulations has increased dramatically through the actions of governments and regulators seeking to micromanage all sorts of things. Some regulations are obviously necessary but unnecessary ones impose a dead weight on an economy which is costly. Deregulation, if done properly and carefully targeted, is a cost free way of stimulating economic growth at the margin and it is refreshing to see a politician who is prepared to act on one of the most unwelcome trends in the world economy these days. There are problems of unfunded tax cuts even though, in the short term, they may lead to higher economic growth in the USA. Federal borrowing would increase, almost certainly inflation would accelerate and interest rates would increase faster than they would otherwise have done. This would be likely to raise the value of the US dollar in international currency markets which would be a headwind to business. Nevertheless, tax and deregulation could be two areas to benefit from the new era in Washington.

Whilst the tax and deregulation plans of President Trump may be good news for investors, his protectionist policies, again indirectly outlined in his inauguration address and followed up by an executive order withdrawing from the Trans-Pacific Partnership and preparing to renegotiate NAFTA, are definitely dangerous. The economics of protectionism are awful and it was ironic that it took President Xi Jinping to extol the virtues of free trade at Davos. It is worth going through the ideas which President Trump has put forward, accepting, of course, that the reality may be different. The theory of comparative advantage, originally described by David Ricardo in the early 19th century, suggests that economic welfare is maximised when one country can produce goods and services at a lower opportunity cost than another and, as short hand, we can say that the best outcome is to buy goods and services from countries that can provide them relatively more cheaply than another. As we bring this up to modern day economics, it is important to say, in the conditions outlined by David Ricardo above, that the market should not be distorted by subsidies, so that, if a country is able to produce something more cheaply than others, its price is not artificially low because it is subsidised. Assuming that is not the case (and a lot of the criticism of China is that it is, with some items like steel being dumped), if tariffs are put on imported goods in order that they may be produced in the USA competitively, then, whilst some US jobs may be saved or created, consumers will be less well off because, if they have to buy the goods or services at an artificially high price, they will have less to spend elsewhere and, so, other businesses will be damaged and jobs lost. It is extraordinarily simplistic to ignore second order effects of protectionism. The idea, which is being floated around as this is written, is a border adjustment tax, which is effectively a tax on imports whilst exports are not taxed. US consumers have benefited from cheap imports and competition between US retailers. Were a border adjustment tax to be introduced and import prices increased, many consumers would be worse off. Retaliation would be bound to follow. A salutary lesson for protectionists should be the effect of the Smoot-Hawley Tariff Act of 1930 which raised tariffs substantially and was initially introduced to help the US farming industry. Those tariffs spread and represented about as bad a policy as could be imagined in the Great Depression. International trade contracted severely and this misconceived act is always cited as a reason why protectionism is so dangerous. It is one of the unfortunate side effects of the financial crisis and the resulting economic one that anti globalisation feeling has increased. President Trump has exacerbated this problem. He is in the White House because, although he lost the popular vote, he won the rust belt states of Pennsylvania, Michigan and Wisconsin on his protectionist appeal. These states have seen losers from globalisation but protectionism threatens to cause many more people to lose out elsewhere in the USA. If an international trade war ensued as a result of protectionism emanating in the USA, the result could be an economic recession or even depression. It is true that the USA is a relatively closed economy (with trade accounting for 28% of GDP according to the World Bank, half the level of the UK) relying on trade much less than many other countries, but it would still be considerably worse off economically if it goes along this path. This is what we see as the greatest economic risk arising from President Trump's pre and post election statements. We will have to hope that wiser counsels prevail. In this respect, China's leverage, as the second largest holder of US government debt, is significant. As this is written, the strength of the US stock market suggests that investors believe that more pragmatic policies will prevail.

Another risk is potential economic trouble in China. The country's overall debt levels in relation to GDP are high. It is estimated that the quantum of non financial debt, comprising the corporate, household and government sectors, is somewhere around 270% of GDP, and the biggest component of this debt is the corporate sector. There are some concerning signs of a loss of confidence within China because, although the country runs a current account surplus of around 2.3% of GDP, its foreign exchange reserves have been falling on a regular basis. In December 2016, they stood at US$3.011 trillion which was the sixth straight month of decline to leave the country's foreign exchange reserves at their lowest level since February 2011. As well as some capital outflows, the central bank has been selling foreign currency to support the renminbi, which fell by 6.6% against the US dollar in 2016. If a country is running a large current account surplus, one would not normally expect it to have to support its currency. There are signs of significant capital flight. It makes the situation with the USA more difficult because some politicians there already consider China to be a currency manipulator. The authorities have been trying to stem the outflow with various restrictive measures, a sign of some concern on their part. So far, on official figures, the Chinese economy has continued to grow at a steady rate but there must be some concern about the rate at which the foreign exchange reserves, whilst still very substantial, are declining. So, China is another political issue for investors in 2017, apart from effects on its economy resulting from actions of the new US Administration.

This ties in with an issue for emerging markets generally arising from potential US protectionist measures. Whilst damaging them directly because of lower exports, it is likely that the US dollar would rise in these circumstances, which would be difficult for those companies and countries with US dollar denominated debt. There could be vulnerabilities here.

The eurozone remains a constant source of concern, notwithstanding some better economic news recently. If the IMF's projection is correct for growth of 1.6% this year, that will be slightly less than the 1.7% predicted to have been the outcome for 2016 and 2.0% actual in 2015. These rates of growth are too low to make a dent in debt levels in countries where there is a problem and, yet, the eurozone is going to be exposed to a series of political events in 2017 which are unpredictable. These surround elections in France, the Netherlands, Germany and, perhaps, Italy. Whilst unexpected results like Brexit and the election of Donald Trump are considered unlikely, they are not impossible. In all of these countries there is rising criticism of the EU and the eurozone and, were one of these parties to be elected, the effect on the EU and eurozone would be very serious at best and terminal at worst. It is not going to happen in Germany but a strong showing by the AfD (Alternative für Deutschland) could change the mood in that country and it seems likely that the party is going to demonstrate a strong performance in the elections. Specific issues could arise from the problems of the Italian banking system where there are estimated to be €360 billion of problematic loans on Italian banks' balance sheets. These have yet to be dealt with and pose a very difficult problem for the Italian government and the ECB. Italy is one of the most indebted of the eurozone economies and, as the third largest member of the eurozone, problems there could rebound badly on the eurozone. All the while, the ECB is providing substantial quantitative easing and, yet, growth remains very modest, which suggests that monetary policy has lost nearly all of its power to influence economic outcomes any further. All of this is tied up with the problems which a dysfunctional monetary union causes and, far from converging, economies are diverging. Just one example is Germany's current account surplus at around 8.8% of GDP. Had Germany still retained the Deutschmark, it would have had a higher value than now and countries such as Italy and France, which have lost competitiveness, would have had lower currency values. As it is, there is no adjustment mechanism. So, the eurozone could become a bigger problem any time as the inherent contradictions in the common currency come into full focus.

Tied up with the EU and the eurozone is Brexit. Probably, the main immediate reaction, sterling's currency adjustment, has happened and, whilst there is little reason to see sterling recovering much ground, it is unlikely to show a similar severity of fall as it has done since 23rd June. The UK's broad plan has been set out by the Prime Minister, thus giving as much clarity as any negotiations can without showing her hand. With the Supreme Court decision to require the UK government to seek parliamentary approval for triggering Article 50, it remains to be seen how those parliamentarians in the House of Commons and the House of Lords who oppose Brexit will react and whether any obstructionist tactics will be successful. From an economic and stock market point of view, the danger of a delay in triggering Article 50 after the end of March could be to increase uncertainty and weaken economic activity which, up to now, has held up well. But, whilst it may seem counter intuitive to say it, the UK is probably less of a potential concern than the ones just mentioned, of which US protectionism, if it materialises, is likely to be the greatest threat.

Finally, there are the ever present political threats, whether it be terrorism, the Middle East and North Korea, to mention some obvious problems. These are all unpredictable, but investors cannot sensibly proceed on the basis that they should not invest in case anything happens. If that were the case, investors would not buy securities and that, obviously, has not been a sensible course of action given the long term uptrend in share prices.

At the start of 2016, some commentators were concerned about the possibility of the world entering a deflationary era. The price of oil was near its low point and large doses of quantitative easing had failed to shift the dial. Although we considered it unlikely that the world economy would experience general deflation and feel even more confident now about saying that, the consequences of deflation are so severe that they inevitably attract a lot of attention. After all, in the past, most people were more concerned about inflation. Falls in prices are potentially dangerous if they occur over a prolonged period. They discourage consumption, thereby weakening an economy and quite possibly leading to a recession or depression at worst. They raise the real value of liabilities, thus threatening businesses and individuals and raising the prospect of an increased level of bad debts at banks. In such a situation, unemployment will rise. There will be no incentive for individuals or businesses to buy goods and services which they do not need. Now, a year later, there is very little talk of deflation. To go back to the IMF's World Economic Outlook, it is now forecasting inflation in advanced economies to be 1.7% this year and 1.9% in 2018. Although this is a low level of inflation historically, central banks' official interest rates are generally well below this and, with a bit of a lift expected in world growth this year, central bank interest rates would normally be considered well below their optimum level and negative interest rates to be almost unthinkable. With central banks' balance sheets in the USA, eurozone, UK and Japan having expanded dramatically, the dangers of inflation being caused by this period of very loose monetary policy are rising. Some say that this type of monetary policy does not pose a threat to inflation but, if all the money sitting on banks' balance sheets starts to circulate more quickly, causing increased activity and bottlenecks to appear in an economy, inflation could well become a problem as the prices of labour and raw materials are bid up. In the first instance, we would expect central banks in the USA and UK to start returning interest rates on a path towards their normal levels but the eurozone and Japan will be well behind this more. They will also want to shrink the size of their central banks' balance sheets by selling down their stock of assets they have acquired back to the private sector. There is an increasing belief that monetary policy has run its course in terms of effectiveness and that further actions to ease monetary policy will have ever decreasing economic effects. So, the tone of economic policy is tending to emphasise more fiscal activity. That seems to be the course that President Trump advocates and there is some loosening of fiscal policy in the UK and eurozone, either in terms of pushing back the target date for a balanced budget in the UK or some loosening of the constraints of the Stability and Growth Pact in Europe. The problem is that loosening fiscal policy, initially at least, will worsen governments' finances.

The background of rising inflation, although well below historical levels, and a probable further deterioration in public finances, is not a good background for the fixed interest securities detailed in our table at the beginning of this review. Bonds have endured a poor quarter, with Donald Trump's victory wrong footing investors as his plans for fiscal expansion were not factored into the market. Besides its effect on the federal deficit, inflation expectations have increased as well as that for economic growth, with none of these outcomes being good for bonds. In our view, bond yields are far too low for the risks involved. Investors, who purchased bonds in the summer, have seen some significant losses. In August, there were nearly US$13.5 trillion of negative yielding bonds in issue and that figure has now come down dramatically. Whilst one appreciates that there is a large captive market for bonds, and some investors have no choice but to buy and hold them, the investment outcome is almost certain to be bad. Notwithstanding recent falls in bond prices, we reiterate our view that the fixed interest market is deeply unattractive. The risks are increased federal deficits in the USA, rises in US interest rates, higher inflation and, ultimately, a start to the process of reversing quantitative easing, not to mention any credit issues which arise. Just looking at the gross redemption yields on ten year government bonds outlined in the beginning of this review should make one cautious and these yields are much higher than they were. One would have to ask oneself if one bought any of these bonds now and held them to redemption whether one could possibly be happy with such low returns. The investment world would have to be a very risky place if those returns were considered acceptable. Where shares have the advantage is that, unusually, they often yield more than bonds, measured against ten year government bond yields, although this is not now the case in the USA. Although we ultimately expect interest rates to rise, but not in lockstep throughout the world, shares are still likely to be buoyed by cheap and plentiful money. This is not the best reason for strength in asset prices but does reflect current day reality. In time, a tightening of monetary policy, not only through increased interest rates but also a reversal of quantitative easing, is likely to pose a challenge to shares and this process will have to be handled carefully if it is not to prove disruptive, such is the scale of quantitative easing. Although the big elephant in the room is President Trump's trade policies, the macroeconomic background is reasonably favourable for equities at the moment, with some acceleration in the rate of economic growth anticipated in 2017 and 2018. The major unknown is how far President Trump's protectionist utterings will be converted into action.

In summary, assuming that an all out trade war does not start, equities remain our preferred asset class. Last year was exceptional and we must be realistic in our expectations for this year's returns. There has been a solid start to 2017 but we must expect setbacks in share prices from time to time reflecting the uncertain political background not only in the USA but also in Europe. Economic growth expectations should underpin share prices at a time when fixed interest securities remain, in our view, very vulnerable. For sterling investors, a wide geographical spread of investments should continue to provide the benefits of diversification which were so apparent in 2016.