EB WEALTH

QUARTERLY REPORT
Q1 2018

GLOBAL OVERVIEW

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Worldwide markets started 2018 with great optimism with most equity markets continuing to rise until 23rd January. Markets then fell very quickly, with last year's gains being wiped away within a few days. Over the rest of the quarter, markets were volatile. Japanese, UK and European equity markets were amongst the worst hit with their respective main indices all losing ground. American markets also fell over the quarter but not to the same extent. Brazilian, Russian and Canadian equities were amongst the few markets that posted gains over the quarter, with Brazilian equities being the stand out performer. Government bond yields also rose strongly up over the quarter.

The main events that impacted markets over the quarter were:

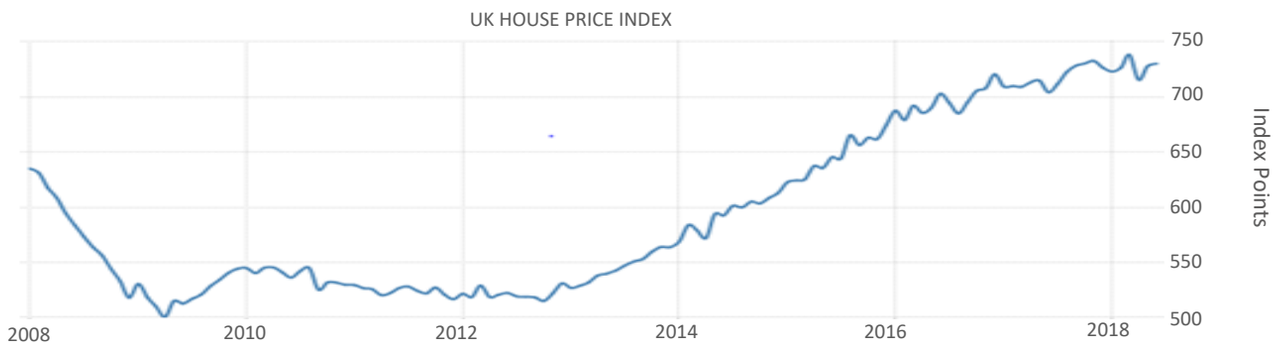
- US interest rate increasing from 1.5% to 1.75% in March 2018 and the Federal Reserve indicating they could rise a further three times this year.
- Donald Trump signing two declarations to implement tariffs on steel and aluminium imports. The tariffs are expected to put a 25% charge on steel and 10% on aluminium.

In 2018, we are expecting multiple interest rate rises in the US, which is likely to cause further volatility in US markets. Closer to home, Brexit negotiations are now firmly in progress and are likely to weigh into UK and European markets over the year. Geopolitical tensions between the US and North Korea still exist and following Trump's latest announcement on tariffs, there is potential for a trade war between China and the US. Overall, there are numerous global issues which could significantly impact on world markets.

Residential Property Investment Analysis

For many years residential property in the UK has been perceived as a safe place to invest; house prices have historically been increasing in value whilst still providing a lucrative rental yield. This has led to a meteoric rise of the wealth and quantity of buy-to-let landlords in the UK. EB Wealth looks at the investment case for residential property going forward.

UK House Prices index 2008-Present



SOURCE: TRADINGECONOMICS.COM : HALIFAX AND BANK OF SCOTLAND

As can be seen in the above graph, UK house prices have risen rapidly over the last five years. However, since the UK voted for Brexit in June 2016, the rate of increase in house prices has significantly fallen with strong indications of a falling market in London. Along with this, various tax changes have been put through by parliament in recent years, which have increased costs and reduced overall returns for buyers of a second property or more, in particular for buy-to-let landlords.

Some of these tax changes can be summarised as follows:

- An additional 3% stamp duty tax is now applicable for second (or more) homes.
- The 10% wear and tear allowance has been eliminated.
- The government phasing in new mortgage interest rate rules, which have reduced the amount of tax relief landlords can deduct for mortgage payments with this relief being completely eliminated in 2020.

Additionally, after many years of historically low and falling interest rates, the Bank of England seem likely to increase interest rates in the coming years, which will result in mortgage rates increasing, having a negative effect on a vast number of buy-to-let landlords.

Given the above headwinds to the UK property market, we at EB Wealth feel that the short and medium-term prospects for the buy-to-let property market look bleak – in particular in London where yields are relatively low. However, due to the lack of property supply, property is still likely to provide a good long-term return despite all the shorter term distractions.

At EB Wealth we review all asset classes on a quarterly basis and invest worldwide into strategically diversified portfolios for different risk profiles based on our investment views at the time. Whilst property is a very important asset class, we believe it should only be used as part of a portfolio rather than as the main way to create and retain wealth.

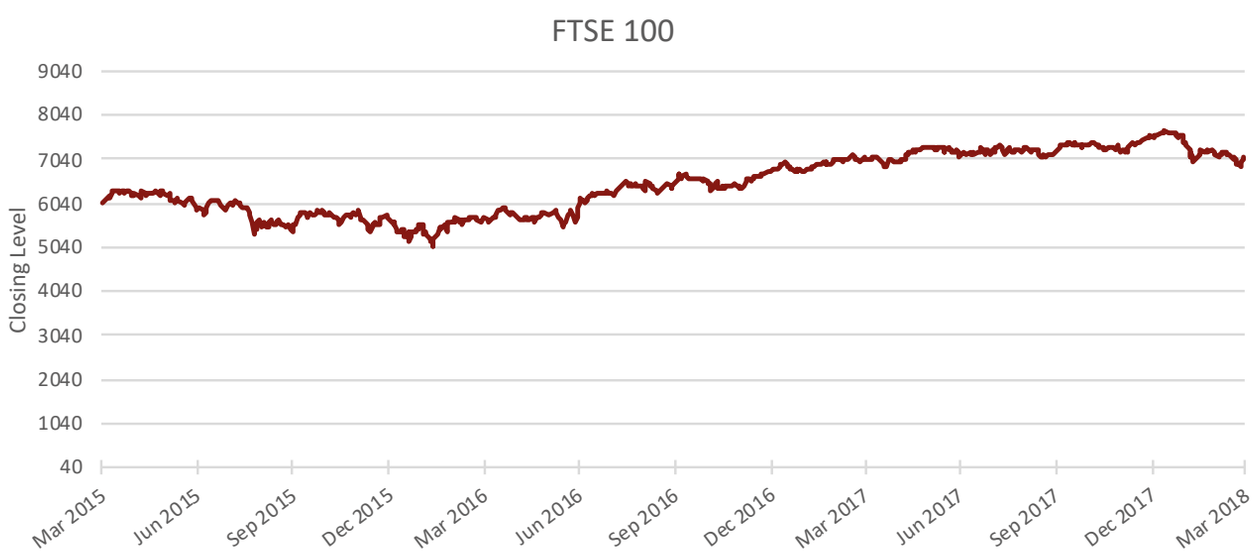
MARKET COMMENTARY

1. UK

Macroeconomic Highlights 01/01/18 to 31/03/18		
	Latest Reading	**Compared to Previous Quarter**
GDP growth	0.4%	Increased from 0.3%
Inflation	2.7%	Fell from 2.9%
Wage growth including bonuses	2.7%	Increased 2.3%
Unemployment rate	4.3%	Remained at 4.3%
Interest rates	0.5%	Remained at 0.5%

UK equity markets fell over the quarter, with the FTSE 100 down 8.2% and the FTSE All-Share falling 7.8%. Initially, UK markets reached a record high riding on the back of Trump's corporate tax cuts. However, UK markets then fell on fears that the Federal Reserve would increase interest rates at a faster rate than anticipated following promising macroeconomic data, which led to equities becoming less favourable. The Bank of England indicated that they are considering raising interest rates this year, which led to the £ increasing in value against the US$ and euro.

In anticipation of a correction, the EB Wealth portfolios were heavily underweight on UK equities throughout 2017. Following the fall, we increased our allocation to UK equities in our February portfolios but believe that markets are likely to remain volatile this quarter and thus have kept a slightly underweight allocation.

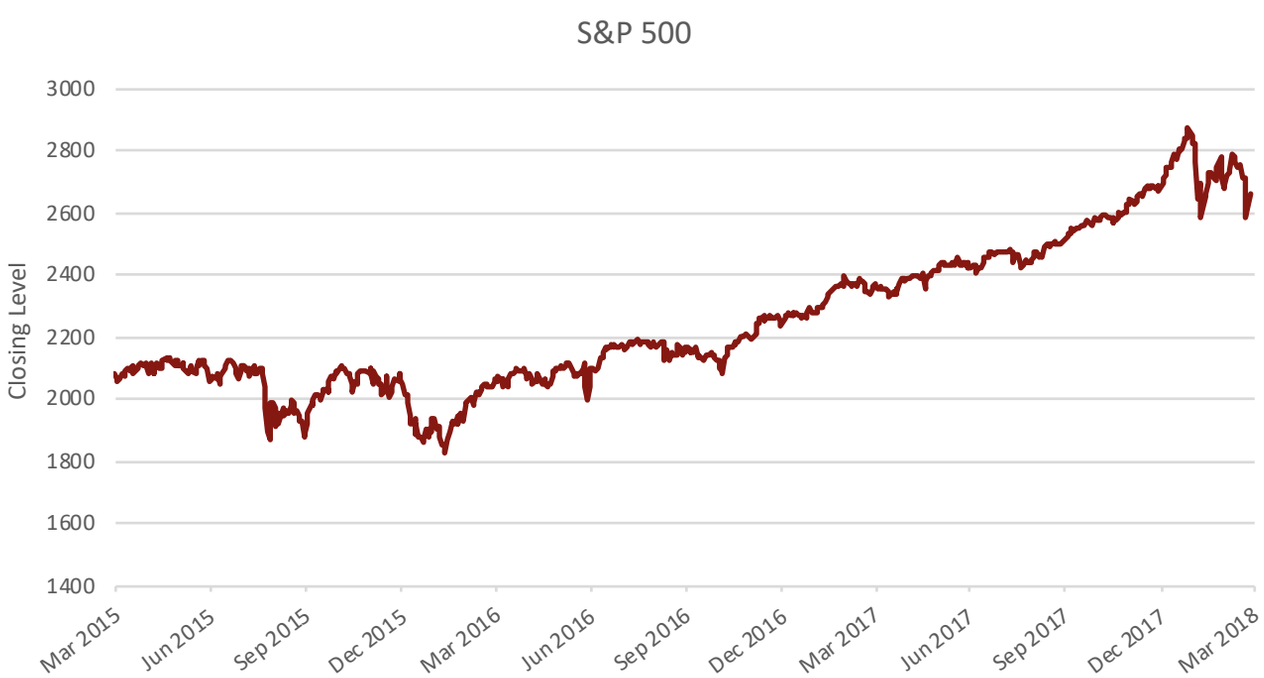


2. US

Macroeconomic Highlights 01/01/18 to 31/03/18		
	Latest Reading	**Compared to Previous Quarter**
GDP growth	2.0%	Fell from 2.7%
Inflation	1.1%	Increased from 1.4%
Wage growth	1.7%	Increased from 1.6%
Unemployment rate	8.6%	Remained at 8.7%

US equities fell over the quarter, with the S&P 500 down 1.2%, the Dow Jones down 2.5% and the NASDAQ down 2.3%. In January, markets reached all-time highs in anticipation of strong company earnings resulting from Trump's corporate tax cuts. However, at the end of January, US markets plunged, with strong macroeconomic data giving rise to expectations that the Federal Reserve will raise interest rates faster than expected. For the rest of the quarter, US markets were volatile, largely due to Trump's announcement on steel and aluminium tariffs.

With several interest rate rises seeming a realistic probability in 2018, we increased our US exposure in early February but remain underweight in the region overall as we expect volatility to remain high.



3. Europe

Macroeconomic Highlights 01/01/18 to 31/03/18		
	Latest Reading	**Compared to Previous Quarter**
GDP growth	2.9%	Fell from 2.5%
Inflation	2.2%	Increased from 1.7%
Wage growth	2.6%	Increased from 2.5%
Unemployment rate	4.1%	Remained at 4.1%
Interest rates	1.75%	Increased from 1.5%

European equities followed US and UK equities down this quarter with the Paris CAC down 2.7%, the German DAX down 6.4% and FTSEurofirst 300 down 5.1% over the quarter. The European markets had started the year on a strong note; stocks advanced amid a robust growth backdrop and accelerating economy. However, European equity markets retreated in February and March due to rising inflation, interest rate concerns and global trade worries. With President Trump vowing to impose tariffs on foreign steel and aluminium, this led to a sell-off in global equity markets. China retaliated by unveiling tariffs on US$3 billion worth of imports from the US. Amid this escalating trade rhetoric, European investors were somewhat relieved when the White House declared a temporary exemption for the European Union and other nations on the steel and aluminium levies.

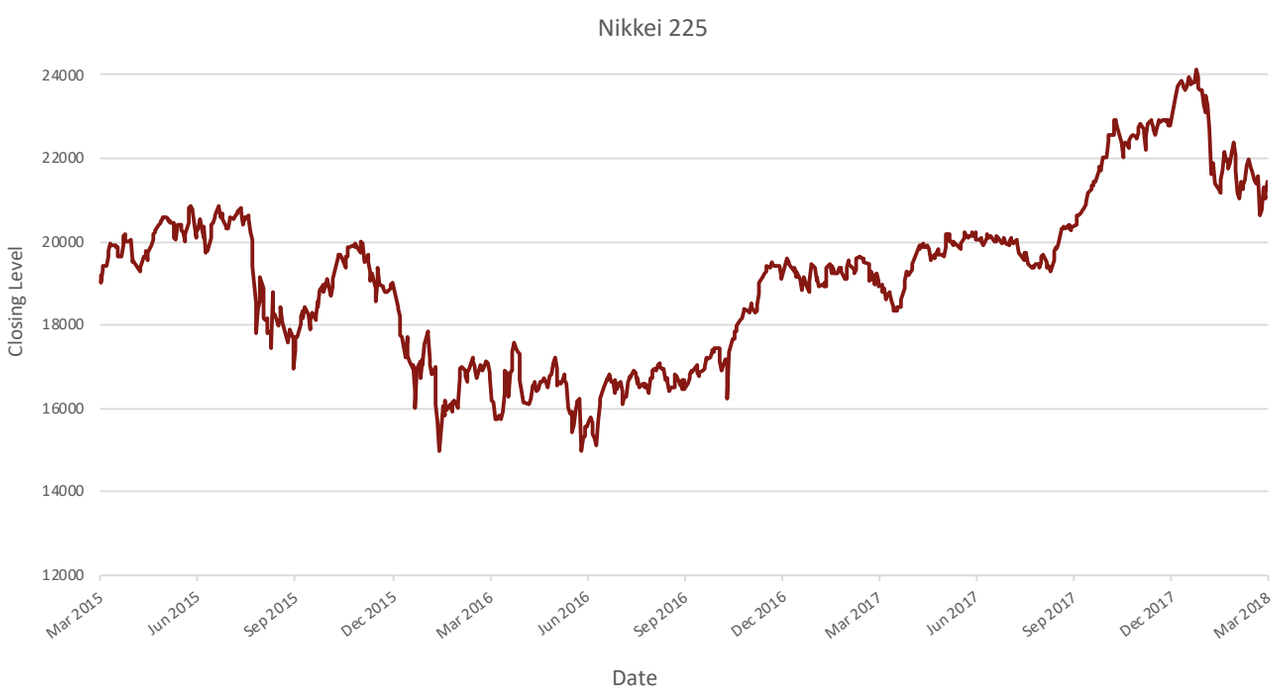
Eurozone economic growth forecasts are still positive for the region. EB Wealth note that European equities have underperformed other regions over the last year and consequently increased exposure to the region in February after the sell-off. We also upgraded our position from neutral to overweight and believe that Europe could outperform other regions this year.

4. Japan

Macroeconomic Highlights 01/01/18 to 31/03/18		
	Latest Reading	**Compared to Previous Quarter**
GDP growth	0.5%	Increased from the 0.2% contraction
Inflation	0.9%	Remained at 0.9%
Unemployment rate	2.4%	Fell from 2.7%

Japanese equities dropped in the first quarter with the Nikkei 225 falling just under 6%. Like most, Japan's equity market made a positive start to 2018, ending the January higher for the 5th consecutive month, lifted by expectations that global economic growth will fuel an improvement in corporate earnings. However, the market pulled back towards the end of January after the yen strengthened against the US dollar on concerns surrounding the protectionist trade policies touted by President Trump; speculation that the Bank of Japan may start to normalise monetary policy; and the US Treasury Secretary's remarks welcoming a weaker dollar. Concern about the impact of a stronger yen against the US dollar is one of the factors behind the recent stock market correction.

Although Japanese markets have fallen this quarter, they have still performed well over the last year. With the Federal Reserve planning to increase interest rates several times this year, this is likely to further devalue the yen against the US dollar, which will further boost revenues for the many large exporters in Japan. Therefore, we continue with our overweight position in 2018 but will be keeping a close eye on political tensions and monetary policy in Japan.



5. Emerging Markets

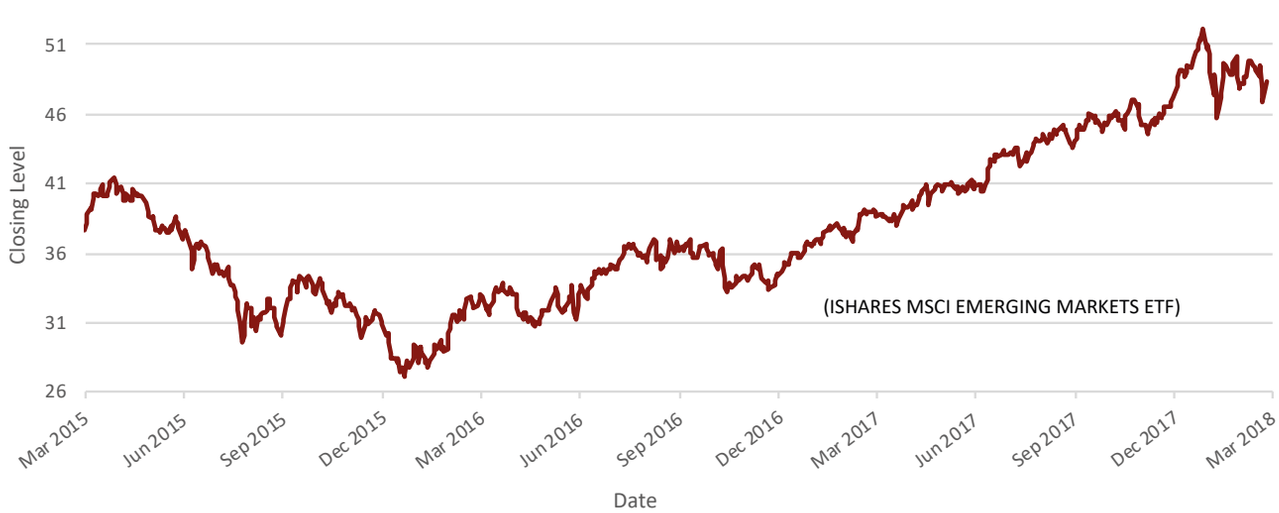
Emerging markets continued to rise in January 2018 but dropped in February and March in most regions. Latin America was the best performing region with Brazil leading the way. Russian equities also performed robustly while 'Emerging Asia' (led by India, South Korea and China) were the weakest performing regions. Equity losses in Europe, Middle East and Africa were less marked.

Brazil's main index rose over 11% this quarter. This resulted from a faster-than-expected economic recovery. Rising commodity prices also provided a positive backdrop for Brazil's equity market. The International Monetary Fund increased its growth outlook for Brazil in 2018 to 1.9%, as businesses and consumers responded to record low interest rates. Uncertainties over the Government's delayed pension reform plans prompted ratings agency Standard & Poor's to cut Brazil's credit rating (sovereign debt) from BB to to BB-. Russia's main index was also up over 8% as the country's recovery from recession gained further impetus. According to data from the country's Federal Statistics Service, the Russian economy grew by 1.5% in 2017 following two years of recession.

Equity losses in Latin America were broad-based with Mexico being the weakest performer in the region. Economic growth unexpectedly slowed in Mexico last quarter as consumers faced higher interest rates. While trade jitters undermined China's equity market, the region's weakest performers were Indonesia, Philippines and India. Performance elsewhere in emerging Asia was not as bad with Taiwan and Malaysia's main indexes not falling as much as others. South Korea was helped by news of potential talks that may lead to the denuclearisation of North Korea. Kim Jong-un, the leader of North Korea, met with the Chinese President in Beijing on 27 March 2018, and may even meet up with US President Trump.

After a very strong year in 2017, emerging market equity markets have been hit with a range of political and trade tensions so far this year. Trump's trade tariffs have raised concerns of a trade war so we will be closely watching the trade negotiations. Despite the uncertainty, we have maintained our overweight allocation to this sector.

MSCI EMERGING MARKETS



6. Fixed Interest

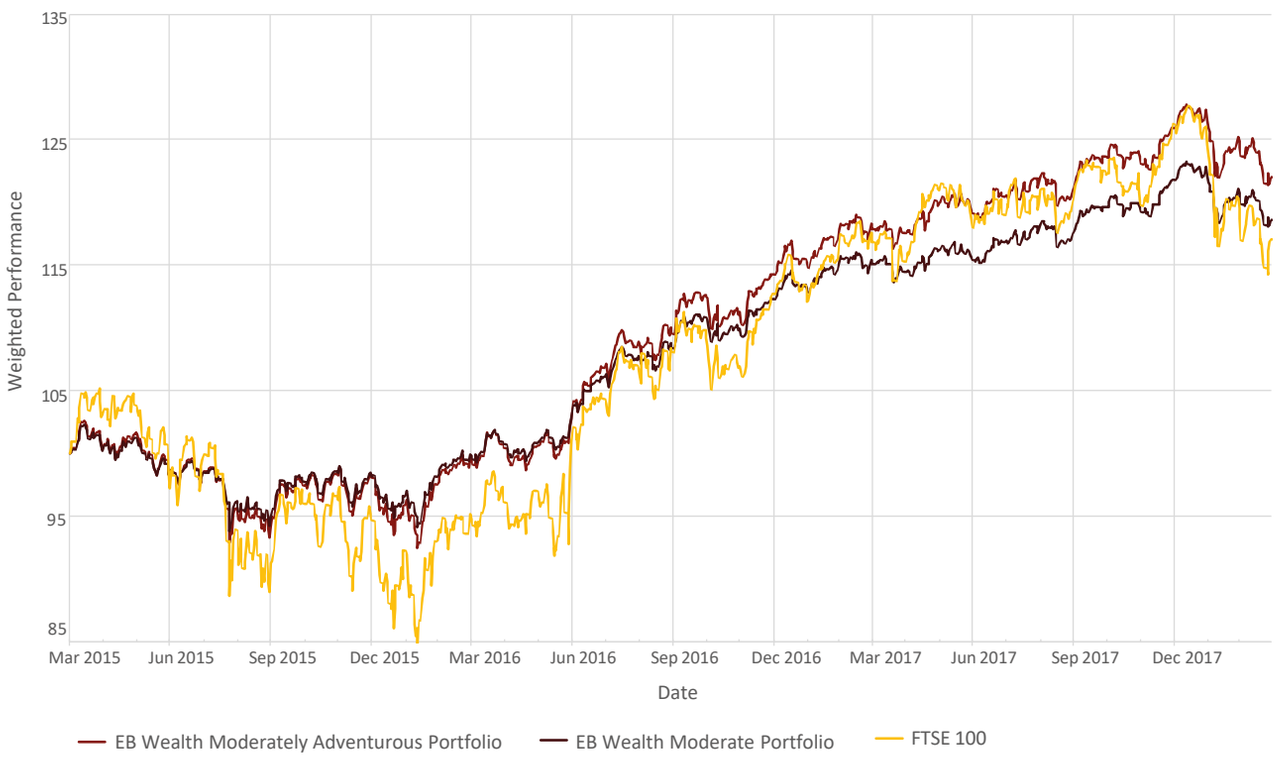
2018 saw the US Treasury market lead government bond prices lower. The falls detracted from returns for less interest rate sensitive parts of the corporate bond market. High yield corporate bonds, which have a lower interest rate sensitivity, outperformed investment grade corporates and delivered a positive return.

Government bond yields surged over the quarter with the US 10-year Treasury reaching 2.73%, 10-year UK Gilts rising to 1.36% and German bunds rising to just over 0.5%. Contributing to the rise in bond yields was the improving economic backdrop. The International Monetary Fund upgraded its forecasts for economic growth to 3.9% for 2018. By end of January, the yield on the US 10-year Treasury had risen to 2.71%. A number of market participants noted that, the 10-year Treasury might have broken out of its long-term downward trend. Contributing to the rise was a less accommodative message from the European Central Bank at its January meeting than many had expected. Among the factors contributing to the volatility and subsequent demand for government bonds was the US Government's imposition of tariffs on select Chinese imports, a reshuffle of US Government personnel, a sell-off in leading technology companies and survey data that suggested global economic growth might be weakening.

In view of equity market volatility, corporate bonds held up relatively well. Index data from Intercontinental Exchange Bank of America Merrill Lynch shows European high yield currency markets lost only 0.2% while euro investment grade bonds lost 0.1%. Sterling investment grade corporate bonds were positive returning 0.5%. The premium sterling investment grade companies need to pay to borrow has now moved to its widest level since May 2017. Meanwhile, contingent capital (CoCo) bonds, the most junior debt issued by banks lost 1.0%.

Government bond prices fell across the board this quarter especially in developed Europe, UK and the US with many 10-year bond yields registering double digit increases. We believe governments bonds will remain volatile while US interest rates continue to rise. In February we added an additional gilt fund to our moderately cautious portfolio and increased our allocation to inflation linked gilts for our more cautious clients. Overall, we are maintaining our current underweight position in gilts and bonds.

EB Wealth Portfolio Performance



The above graph shows the performance of our Self Invested Personal Pension (SIPP) portfolios, including a 25% weighting into a basket of structured products which were recommended to clients over the same period.

Due to the close-ended nature of structured products, not all clients can be invested into the same products and will therefore not have received the same returns. The graph above shows the average returns our clients would have received were they to have invested in our moderate or moderately adventurous portfolio, including the average returns they would have received from the structured product element of their portfolio.

OUR TACTICAL ALLOCATION

Sector	Forecast	Action	Morningstar Moderately Adventurous Allocation %	Tactical Overlay %	Final Allocation %
US	Unfavourable	Underweight	11	-2	9
UK Large Cap	Unfavourable	Underweight	22	-3	19
UK Mid Cap	Unfavourable	Underweight	8	-1	7
UK Small Cap	Unfavourable	Underweight	5	-1	4
Europe	Favourable	Overweight	13	+2	15
Japan	Favourable	Overweight	7	+2	9
Asia	Fair	Neutral	4	0	4
Emerging Markets	Favourable	Overweight	9	+2	11
Property	Unfavourable	Underweight	5	-1	4
Commodities	Fair	Neutral	5	0	5
Global Fixed Income	Unfavourable	Underweight	2	-1	1
UK Gilts	Unfavourable	Underweight	2	-1	1
UK Corporate Bonds	Unfavourable	Underweight	2	-1	1
UK Inflation-In-dexed	Favourable	Overweight	2	+1	3
Cash	Favourable	Overweight	3	+4	7

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