McLaren
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Global Market Strategy – August 2020

China takes advantage of rest of world's virus plight

China was responsible for starting the corona virus pandemic last year, and now they're taking full advantage of the fear and uncertainty being caused across the world as a result of it.

The cold war with China started too early to affect 2nd quarter blow-out earnings from leading tech stocks Apple, Amazon, Facebook and Alphabet but the risk is that Apple earnings in particular will be affected in future quarters if this conflict continues, which seems likely. Apple has worked hard to establish itself in China, and like many similar foreign businesses in China, they are being encouraged, certainly by the US administration, to withdraw bases from China due to a fear of the autocratic nature of the regime and as a demonstration against the action China is taking in Hong Kong, on its border with India, and in the South-China Sea.

This is not to say that Chinese assets are uninvestable. On the contrary, putting the war of words aside, there is plenty of evidence China's economy is turning. China's sovereign bond yield of 3% is attracting foreign money inflows, and their high yield bond yields at 8-10% are attractive to those seeking solace for the returns from bonds in Europe, the UK and US. **Chinese stocks** "wherever you look", according to Nikhil Srinivasan, CIO of PartnerRe, offer attractive valuations, especially Chinese financials, in stark contrast to elsewhere in the world. Holding financials anywhere other than China and Asia is a waste of time and opportunity while lower-for-longer persists. Financials cannot make margin with interest rates at or below zero.

Tech stocks have been propelled forward by the need and wish for people to communicate 'at distance'. The Nasdaq index in the US has outperformed other US indices as investors look through the covid crisis and onto the demand consumers have for home-working accessories, online business and social conferencing, home cinema entertainment, armchair shopping and non-cash payment.

The fact that the US economy contracted during the second quarter more than at any other time since the second world war is supportive for equities because the Federal Reserve will continue to buy government bonds, municipal bonds and, bizarrely now, corporate bonds in order to inject liquidity into the economy in the belief it will be used for stimulative investment. The US now has nearly 17 million people registered for unemployment, approximately 10% of the eligible working population.

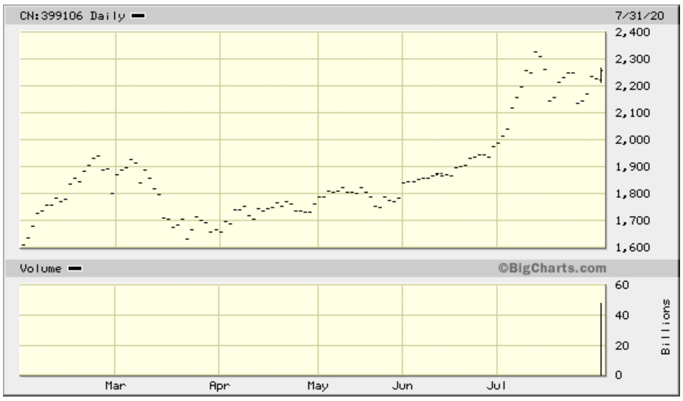
Investors with large portfolio exposure to the US have prospered during the last four months, while those heavily reliant on UK returns have had a miserable time. The UK is caught in no man's land amid Brexit and international trade deal uncertainty, but those with large gains outside tax shelters have an opportunity to take gains and either ISA them, or Pension them or make a top-up payment to an on or offshore bond, depending on circumstances. The annual allowance for capital gains in the UK is £12,300 per individual for the current tax year; realised equity gains over and above this limit are taxed at 10% or 20% depending on whether investors are basic rate or higher or additional rate taxpayers. Bearing in mind the likelihood the UK government could increase rates of CGT and/or remove some of the tax relief available on pension contributions for higher rate taxpayers, it could be worth **taking gains and realising losses** in non-tax-protected portfolios in order to take advantage of ISA and pensions allowances in place now. Ideally, since losses can be carried forward and first act to offset the gains if used in the same tax year, losses should be realised in a tax year prior to the realisation of gains so that the capital gains allowance can be brought into play before needing to tap into the carried forward loss.

Jerome Powell's statement last month that he "wasn't even thinking about thinking" about raising interest rates has caused the US dollar to post its heaviest monthly decline for 10 years (to a sterling level of $1.31 and to a euro level of almost $1.18). With poor economic data and high unemployment, the **US dollar** is expected to weaken further, making US assets less attractive to continue to hold for foreign investors (with the exception of companies in the above-mentioned long term demographic change, in which you just sit and collect the dividend).

An exit from US dollar assets will lead to disposable capital available for deployment elsewhere, notably Europe and China and Japan, which are under-owned and undervalued, especially **Europe** and China. Both Europe and China are dealing with the pandemic better than elsewhere, and Chinese stocks and Chinese bonds represent are particularly appealing. China government bonds yield 3%, and high yield China bonds yield 8-10%, and with this higher yield comes good prospects for Chinese financials. Despite the furore over Hong Kong, China has attracted large inflows of foreign capital since March, and the Shanghai Composite has responded accordingly, up 22% in six months.

Shanghai Composite Index, 6 months to July 31st 2020 (Source: BIgCharts.com)

The tech heavy Shenzhen index has likewise performed strongly, up 41% in six months.



Shenzhen Composite Index, 6 months to July 31st 2020 (Source: BIgCharts.com)

European equities have historically performed well when Chinese stocks are on a wave higher.

Partly as a result of a weakening dollar and partly due to global geopolitical and economic factors, gold and silver performed strongly in July. **Gold** is now at record levels, moving serenely on July 27th through the previous high of $1921 in September 2011 to $1980 per troy ounce. **Silver** has much further to run before it gets to its record of $49.45 from January 1980. (It reached $49.31 on 25th April 2011.). Goldman Sachs has lifted its price target from $2,000 to $2,300 in the near term, suggesting prices are supported by low opportunity cost (investors barely give up anything by holding gold in preference to bonds), unstable geopolitics, high world government indebtedness and a drift away from holding inflated US stocks in the absence of a cure to the pandemic.

Gold Comex Futures, December 2020 (Source: CNBC)

Silver hit a 6 year high of $24.63 on the last day of July. It is up 11% since March. Bill Baruch of Blue Line Futures speaking on CNBC last week believes $26.50 is current resistance but the price needs to stay above $21 to get there before moving on to $30 near term.

Silver Futures, ten years (Source: BigCharts.com)

Many families planning for generational wealth and the legitimate avoidance of UK inheritance tax take out a **Loan Trust** wrapped around an **onshore** or **offshore life assurance 'bond'.** This is typically arranged by those in retirement looking to draw a 20-year tax deferred 'income' via repayment of the loan while all growth accrues in trust outside the estate. What is not appreciated by many is that the loan repayment can be waived if the settlor (or widow/widower beneficiary) feels they will not require access to it.

The 'loan' is an asset of the estate. Just like any other asset, whether property or shares, paintings or antiques, it can be left in an individual's will to a specific beneficiary or trust. It makes sense for a client creating a loan trust to update their Will at the same time to ensure that the loan does not have to be called in by the executors. This in turn means the bond does not need to be surrendered, and so a potential income tax bill can be avoided.

Options for dealing with the loan:

- **Leave to a surviving spouse**. This would be an exempt transfer for IHT and the widow(er) would have the same options for dealing with the loan as the deceased had during their lifetime.
- **Waive the loan to the trust** i.e. make a gift of the loan to the trust. This would be a chargeable transfer as the spouse exemption will not apply, even if the widow(er) is a potential beneficiary of the trust but the trust would be free from debt and the whole fund held for the trust beneficiaries, leaving trustees free to assign the policy, or segments of the policy, to those beneficiaries as and when appropriate.
- **Contingency option**. A combination of the above two options. The loan could be passed to the surviving spouse if they survive the settlor but otherwise waived in favour of the trust.
- **Gift loan to someone else,** such as an adult child. Again, this would be a chargeable transfer on the settlor's death.

These steps need to handled carefully so professional advice should be sought in advance.

Favoured investment plays:

Nil risk:	
Cautious risk:	Cash
Balanced risk:	**Managed / Multi-asset funds**
Market risk:	**Multi-asset funds,** UK equity
Adventurous risk:	**Asia, Europe, Japan,** US equity,
Speculative risk:	**Technology, Healthcare, Precious metals**

Disclosure:

Nicholas Chappell has the following personal investment exposure: Technology (all US) 22%, China 7%, Asia 13%, Global Equity 42%, Pharmaceutical 1%, European equity 4%, US smaller companies 1%, Emerging Market equity 8%, New Energy 1%, Silver 1%

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