COURTIERS

Over three days and two counties (amid varied weather conditions), clients arrived for the Courtiers 2018 Client Seminars.

Following a warm welcome from Jamie Shepperd, Courtiers Chief Executive Officer, a packed morning of presentations followed.

2018 Market Review – James Timpson

James, a leading Courtiers Analyst (who appeared on the longstanding TV show *Countdown* in 2011), took us through the last 12 months looking at the ups and downs in global markets.

What will 2018 be remembered for?

In what's been a rather volatile year, James first touched on various memorable highlights of 2018:

- **The Trade War between US & China** - a main cause of market volatility.
- **Uncertainty resulting from Brexit.** No fewer than 16 ministers have resigned as a direct result of Brexit negotiations (at the time of James' presentation).
- **A big year for tech giants.** Apple became the first US company to reach a market value of $1 trillion USD with Amazon following suit a few weeks later. Facebook on the other hand hasn't covered itself in glory, with some controversial breaches and suspicion over its handling of personal data.
- **The ongoing decline of the high street**, which saw Toys R Us and Maplin amongst others closing stores up and down the country.

On a more light-hearted note and with a few giggles from the audience, James marked 2018 as a year in which England *didn't* do terribly in the World Cup, with their performance bringing a much needed boost to the UK economy during the summer.

A few more entertaining precursors from James lead to an ultimately memorable event of the year – Theresa May's spectacular dance moves. Will Mrs May be looking for her place on the next Strictly Come Dancing, or will she remain busy navigating the UK through change in 2019? We will see.

Markets

A Tale of Two Wobbles

With a Dickensian twist, James pointed out two wobbles of 2018 – the first in February 2018 as fears over trade wars, higher inflation and interest rates resulted in the biggest market selloff since August 2015.

Markets gradually recovered until October 2018 when a second major selloff took place, for similar reasons. We're yet to see a recovery from this one.

FTSE 100 Index

The FTSE 100 index, measuring the largest stocks in the UK, saw a huge recovery in the spring which lead the index to an all-time high in May of 7877, but it's been downhill from there. Overall as at 28/11/2018, the index had returned -8.9%.

With another rocky week for the FTSE during the course of the seminars, the index dropped a little further and as at 07/12/2018, returns are sitting at -11.8%.

Looking back over the last 10 years, James showed us that the FTSE 100 index had its worst year since 2008 - the year of the global financial crisis.

We still have the rest of the year to go. Since the FTSE 100 index was launched in the 1980s, December's historically provided the highest returns on average, proving positive 82% of the time.

However, as Thursday 6th December 2018 saw the worst day of performance in nearly three years, James made clear it's going to take something of a Christmas miracle for the index to end the year in positive territory.

MSCI Emerging Markets Index

James explained that typically, emerging markets are more volatile than developed markets, meaning the Emerging Markets index tends to be hit harder when there's a major upset, as we can see in the chart below. Over the last three years, 2016 and 2017 were positive. This year the index has gone in completely the opposite direction, down 14.4% as at 28/11/2018.

Source: Bloomberg & Courtiers, 31/12/2015 – 28/11/2018, price return (i.e. does not include income from dividends). Past performance is not a reliable indicator of future returns.

MSCI China index, the largest emerging market, had a particularly troublesome year, a 15.2% drop - a result of the country's ongoing trade wars with the US.

S&P 500 Index

On the other side of the trade war the S&P 500 index, measuring the largest US stocks, was at a 2.6% high on 20 September 2018. Despite similar wobbles in February and October 2018, US Markets still managed to achieve a positive return due to some of the big name tech stocks in the US Market as the following chart shows some huge returns._Amazon, Microsoft and Apple, the three largest companies in the US market, account for around 10% of the entire index. All returned positive.

The one big tech stock scoring negative was Facebook. Back in July 2018, the company broke an unwanted record when it lost $119 billion USD of market value in a single day. James put this into context: if Mark Zuckerberg, the owner of Facebook, gave $15 each to every single person in the world on that day, it would have cost him less money.

Currency – Sterling vs Dollar

The pound started the year strong with a high of $1.43 back in April, but took a tumble in August, as the possibility of a 'no-deal' Brexit weighed more and more on investors' minds.

Overall since the beginning of the year to 28/11/2018, the pound declined -5.1% in value against the dollar.

Many of the fluctuations in the pound have been due to the ongoing Brexit developments. So what lies ahead for the pound and indeed Theresa May, will there be *Great Expectations* with a smooth transition? Or if it doesn't go so well, are there *Hard Times* ahead?

Playing the Markets Right

Following last year's introduction of "Play Your Markets Right", which originated as a tribute to the late Bruce Forsyth, James presented us with more numbers to guess, with a reminder in the process of Caroline Shaw's warning against Bitcoin in the 2017 Client Seminar. A -70.5% drop in Bitcoin's value caused a gasp, while Donald Trump's approval rating scored 'higher' than Bitcoin's decline, down just -1%.

Investment Strategy Update - Jacob Reynolds

Courtiers Quantitative Analyst and Data Scientist, Jacob (aka Jake) Reynolds, took the audience through the Courtiers investment strategy with a specific look at using "put & call options" for "protective calls".

Following a (very) potted history of options, Jake explained how Courtiers uses options in its investment strategy, to help protect clients' wealth against downturns in the market (known as protective options).

Simplifying the technicalities of options using real world examples, Jake made sure those without a deeper knowledge of investing could understand how options can help smooth out the effects of market volatility on portfolios in a downturn.

Portfolios in Action

Jake demonstrated how the use of options has allowed Courtiers to protect clients' wealth held in its multi asset funds over the course of the year.

Focused on the Courtiers Total Return Cautious Risk Fund, as markets rallied into October, protective options gave Courtiers more equity exposure in the rally. Courtiers was able to outperform in the upmarket and as the October wobble hit, was able to continue to outperform as the market tumbled, despite having higher equity levels going into the downfall.

It was the same story with the Courtiers Total Return Balanced Risk Fund. Courtiers outperformed slightly as the peer group had similar equity levels going into the downfall, but in the downfall the effects of performance become clear as options were exercised.

With the Courtiers Total Return Growth Fund, which caters for higher risk with a lot more equity exposure, as the downfall hit Courtiers was able to hold onto the outperformance it gained thanks to the options in place.

Options are simply options

Jake closed by explaining to clients that as they drill down into their portfolios via their Courtiers online accounts, if they see assets called Puts or Calls, know they're doing the same thing…protecting their capital within the fund.

Alongside traditional stock holdings, by including options within its investment strategy, Courtiers can continue to ride the waves of markets wobbles in volatile times, with a view to smoothening them in the process.

COURTIERS

Fund Performance and Infrastructure Investments - Caroline Shaw

Caroline, Head of Fund & Asset Management, summarised Courtiers fund performance over the year before focusing on infrastructure investments in the Courtiers portfolio, with a specific focus on China.

Looking first at ethical portfolios, Caroline said returns from an ethical portfolio are very different to an index return, largely due to the fact huge sectors aren't available in ethical. For example, you wouldn't see oil in an ethical portfolio so if the oil companies are doing well, you won't see that reflected in an ethical portfolio.

Fund Performance

Courtiers Ethical Portfolios

In a difficult year, The Courtiers Ethical Bond Portfolio was off just shy of -3%. Reasonable performance in an environment where bonds haven't done well. The Courtiers Ethical Equity Portfolio was just off -0.7% as at November 2018, which Caroline described as a pleasing result over a year where global equities have had a pretty bad time.

Launched on 27/11/2015, these funds now have a three-year track record. The UK Equity Income fund, which, like the FTSE 100 index can only invest in UK Equities, returned -3.7%.

Comparing all the UK Equity funds in the country offering investment opportunity, you'd see Courtiers UK Equity Income fund sitting in the top 25%, which Caroline again concluded was a pleasing result.

The Global ex-UK Equity Income fund showed greater performance with a return of -1.0%, largely due to the fact it can invest globally and U.S. Exposure has helped this portfolio this year.

The Investment Grade Bond fund, investing in bonds issued by governments globally, returned positive at 2.0%. While gilts have gone a little off this year, this fund's done really well – again in the top 25% of its peer group.

Courtiers Multi Asset Funds

The **Courtiers Total Return Cautious Risk Fund** (lowest risk), eeked out a 0.3% return, largely due to a wide range of asset classes within the fund alongside the protective options in place to protect against market downfalls.

The Courtiers Total Return Balanced Risk Fund with a little more risk returned a slightly more positive return of 0.4%.

The Courtiers Total Return Growth Fund returned -0.4%. Pretty good in year where we've seen global markets take a real beating. Investing in a wide range of asset classes, these funds performed well against the FTSE. All three funds sit in the top 25% of funds available in the market.

Infrastructure

Infrastructure, with a mix of transport, healthcare, education and justice sectors, delivered 15% in the portfolios this year, proving a great defence against volatility in the market.

Touching on windfarms, which were in the portfolios this time last year but no longer are, Caroline explained that a lot of the decisions the Investment Team makes involves saying 'no', and the windfarm investment was a good example of saying no at the right time.

China

The first thing Caroline made clear is Courtiers isn't invested in any Chinese-listed companies – good news as it was down 15% this year.

China is the world's second largest economy so it can't be ignored, but this fact is by virtue of having a huge population – China's GDP per capita is around $8,000 USD. 1/7th that of the US. So it's still a developing country.

Digging into China

Caroline went into great detail about Xi Jinping's Belt and Road Initiative, a network of trade routes reflective of the old Silk Road (an ancient network of trade routes established around 130BC).

The Belt and Road initiative is a huge project intended to extend China's trade routes across the world, covering railways, ports, roads, infrastructure, digital infrastructure and pipelines. It's estimated by The World Bank to involve 65 countries equating to 30% of world GDP, 62% of world population and 75% of world energy reserves. Big ideas and big plans.

Who's funding the Belt and Road Initiative?

Several organisations.

The Asian Infrastructure Investment Bank has pledged around $100 billion in capitalisation so far. This bank has existed since 2016 and largely due to the Belt & Road initiative. It has 86 founder members, of which the UK is one. The US has no input. China has the majority shareholding with 31% so calls the shots.

The Silk Road Fund, capitalised by China with $40 billion. This is an investment fund and is in it to make money.

The **China Development Bank** - The world's largest development financial institution. This has pledged $250 billion to the Belt and Road Initiative projects and while Caroline would have liked to explain the terms of the loans, all she could confirm is that the bank doesn't disclose them.

The **Export Import Bank of China** – around since 1994. Again, really no transparency on the loans but it's estimated that their loan book for foreign projects is bigger than the loan book for the World Bank and the G7 combined – clearly a big player in the market.

Risk

When lending to a developing country there's always a risk. The Center for Global Development published a map highlighting countries with debt vulnerability and out of the 23 countries showing debt stress, eight of these had China's as a dominant creditor. Exactly what is China up to?

Transparency is key

With investments, having confidence in what is happening on the other side, Caroline explained, is a key driver in any decision to invest. It seems safe to say following Caroline's presentation that China is incredibly opaque from an investment perspective.

With some great insight into China's Belt and Road initiative, its ambitious 'string of pearls' and the country's increasing dominance over the financial positioning of an increasing number of countries strategically placed to serve the Belt and Road Initiative, Caroline made it clear. It might be wise to keep a close eye on China, but investing money? A risky game as it stands.

Bridges

It's no secret Caroline likes bridges, which is helpful when they're in Courtiers client portfolios.

Caroline closed her presentation with a picture of the Chief Mistawasis Bridge in Saskatoon, Canada. This is in client portfolios and Caroline explained, "while-ever it's open, we get paid", reiterating the fact that infrastructure has returned 15% this year to 28/11/2018.

An incredibly informative presentation from Caroline.

Wars, Trade and Brexit – commentary from Gary Reynolds

A Notorious 10th Anniversary

Tempus fugit – time flies! It is 10 years since the collapse of Lehman Brothers marked the epicentre of the global financial crisis. In fact, the crisis had been simmering for over 18 months since March 2007 when HSBC wrote-off $11 billion in the value of its US subsidiary American Home Mortgage Investment. Later that year, Northern Rock would fail as its management team, woefully short of banking experience, discovered that if you borrow lots of short-term money and lend it long-term, you are exposed to an up-tick in short-term interest rates, leaving you with massive losses that eventually bankrupt your business.

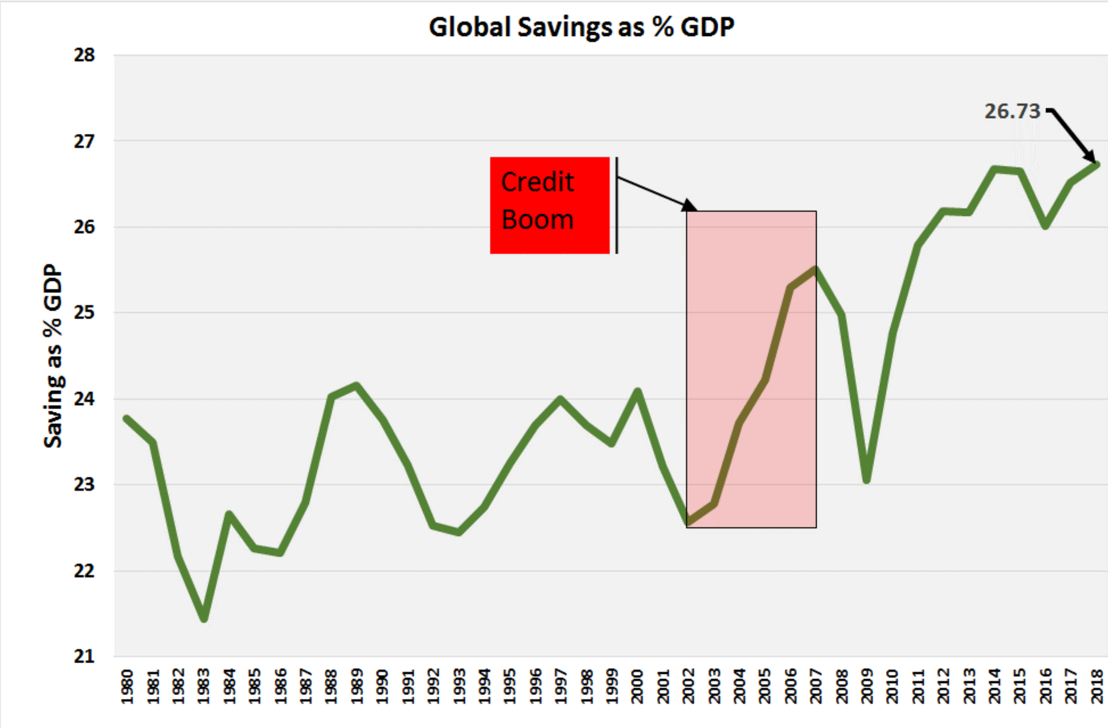
HSBC's and Northern Rock's problems turned out to be mere precursors to the commotions of autumn 2008, which tore into the very fabric of the global financial systems.

It transpired that the world, and in particular the western Anglo Saxon economies, were awash with borrowers, some of whom were the largest of large banks that were unable to service their debts. Warren Buffet says that *"you only find out who's swimming naked when the tide goes out"*. When the tide went out in September 2008, the beach was littered with nudity!

As I have said many times over the last 10 years, the cause of the crisis was not too much borrowing, it was too much lending. The success of the Asian Tiger economies, and China, in exporting significantly more than they imported, had created a savings bubble such as the world had never seen. Markets clear – i.e., they match sellers with buyers at an appropriate price, and in the early 2000s the markets had cleared a mountain of savings that China and the Asian Tiger economies, and latterly the north central European economies, had built up through running persistently large current account surpluses.

These problems have not gone away, as the charts below show:-

Chart 1 – Global Savings as % of GDP



Source: International Monetary Fund (IMF)

Chart 2 – Current Account Balances $

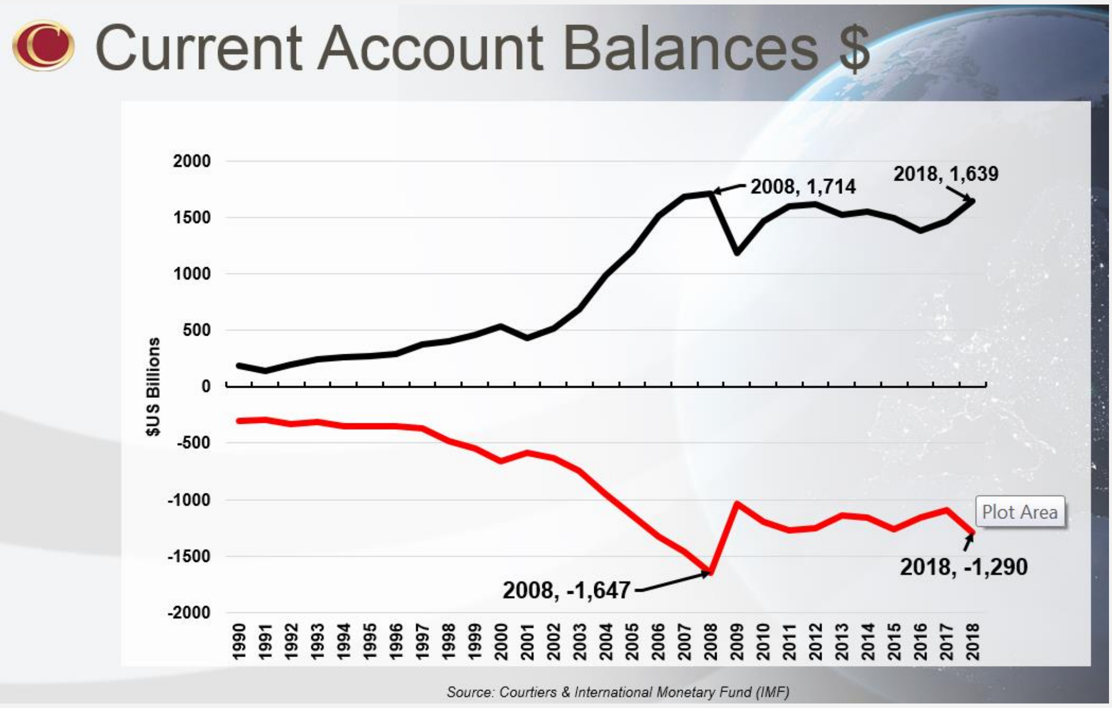


Chart 3 - Current Account Balances $USD

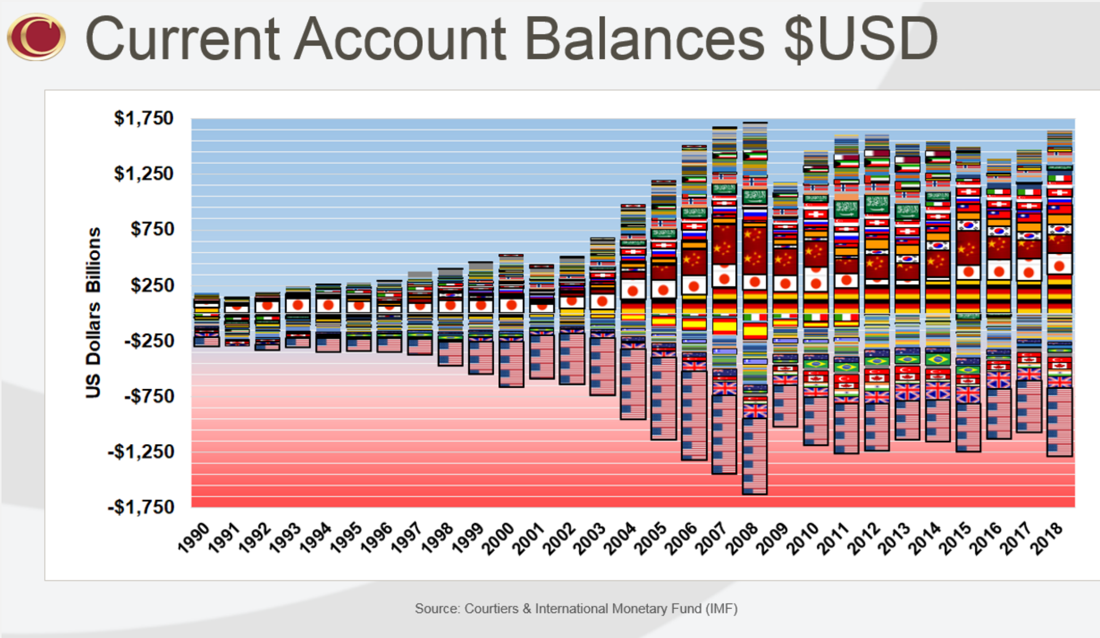
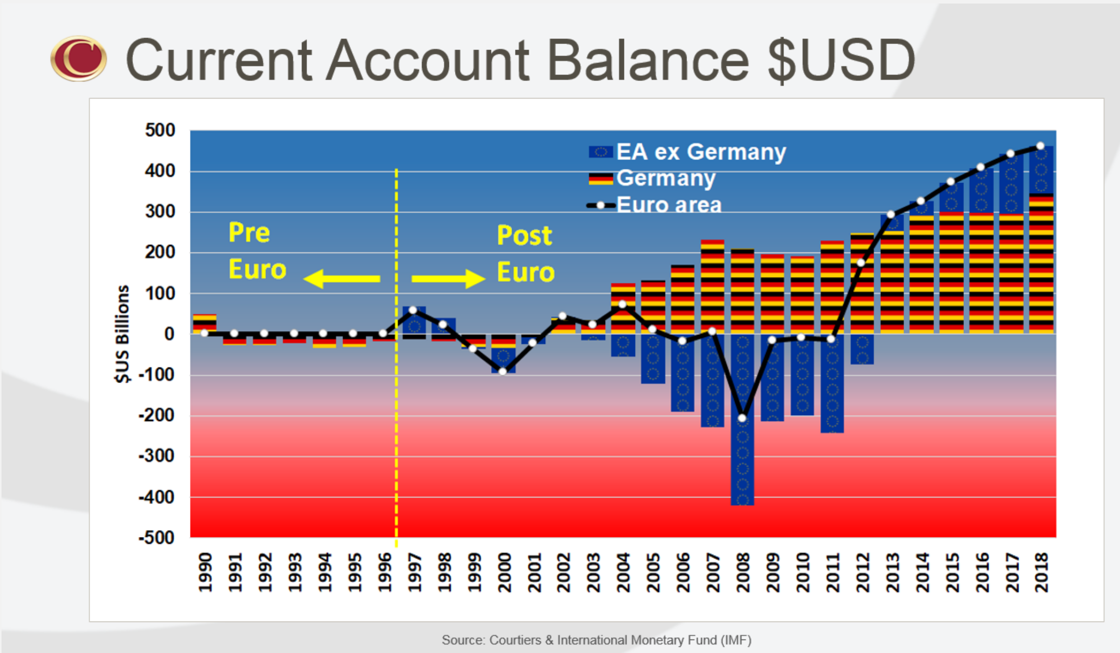


Chart 4 - Current Account Balances $USD



So, are we heading for a repeat of 2008?

The answer is emphatically "no"! The conditions today, especially with regard the financial strength of global banks, are very different to 2008.

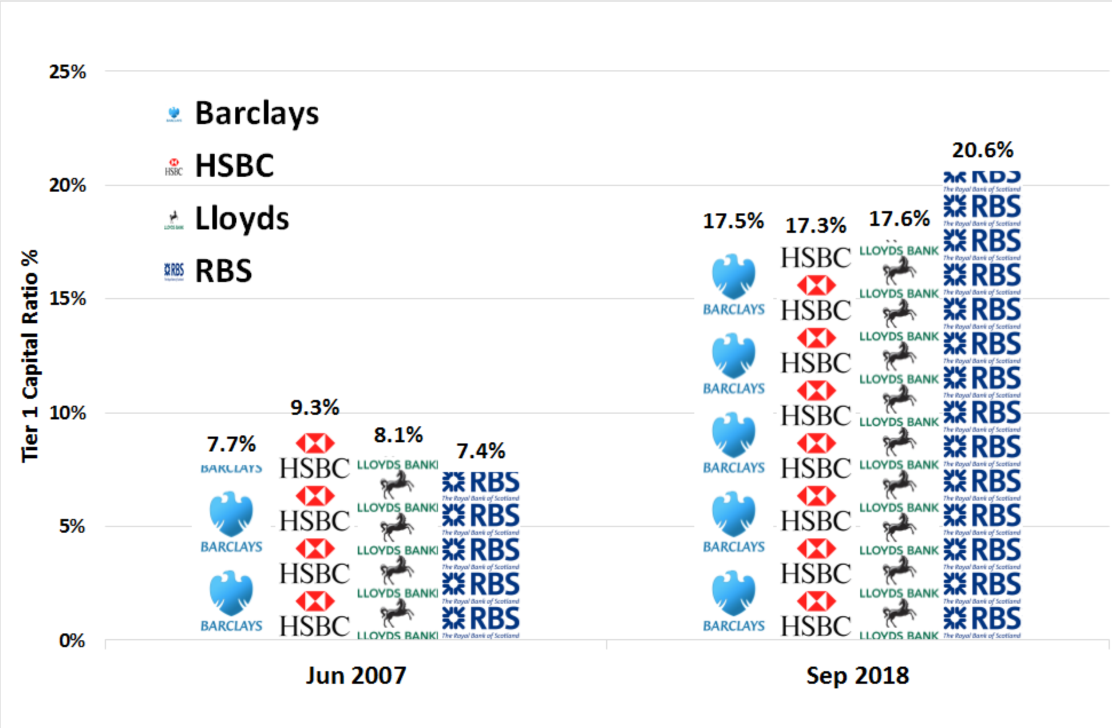
This does not mean to say that there is not a "bubble" or two within global capital markets. But contrary to what many people think, bubbles are much more difficult to spot before they burst. Once they have popped, everybody sees them, but in the lead-up to that "pop" many investors will be happily paying high prices for their favourite assets because they think they will make money. If this were not the case then bubbles could not inflate in the first place.

Central banks and governments have not been twiddling their thumbs for the last decade, on the contrary, they have been very active in trying to ensure that the global credit crisis is not repeated.

Aside from a raft of new and detailed regulations, the authorities have forced banks to dramatically increase their core capital relative to their loans. This provides the buffer which a bank falls back on in a crisis.

The charts below show the change in major UK banks' core capital ratios since 2007.

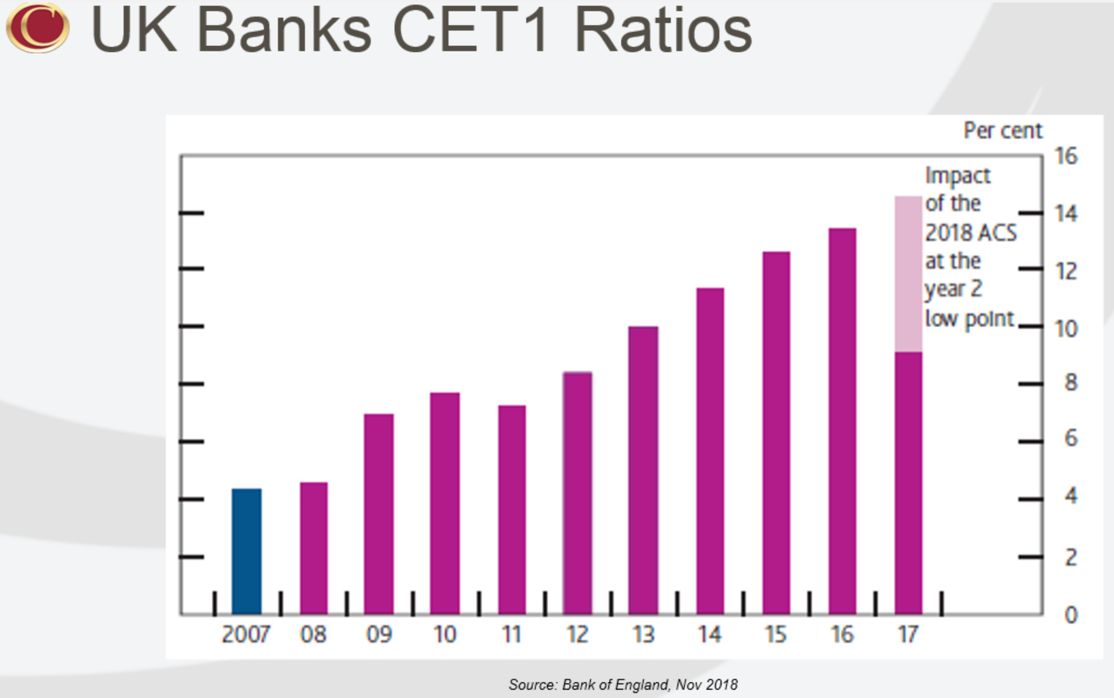
Chart 5 – Major UK Banks Tier 1 Capital Ratios %[1]



Source: Bloomberg

[1] **Tier 1 capital ratio** compares the core equity capital of a banking entity to its risk-weighted assets. The ratio is used by bank regulators to assign a capital adequacy ranking. A high ratio indicates that a bank can absorb a reasonable amount of losses without risk of failure.

Chart 6 – UK Banks CET1[2] Ratios



Bank capital has increased significantly over the last decade and this, together with a raft of rules designed to make senior executives and managers responsible for the actions of their banks has put the global banking industry back on a firm footing.

But one consequence of these tighter regulations has been a reduction in bank lending. This has made it more difficult for businesses to obtain the capital they need for expansion from their local bankers, and it has made it much more difficult for would-be home-buyers to get mortgages. First time buyers have been the hardest hit of all.

Companies have overcome this shortage of bank credit by going directly to the market, in other words, they cut out the banks and access capital directly from the individuals or institutions who own it.

Lots of investors have been very happy to make loans directly to corporations, in the form of bonds, especially when the interest rates on deposits and government debt have been cut to paltry levels. This practice has shifted the risk from banks to the owners of portfolios which means that, in the event of another major collapse in asset prices, the banks should weather the storm quite well, but wealthy investors are likely to be left licking their wounds. We will not, however, see the same level of contagion in markets as happened in 2008.

<u>The Last 20 Years</u>

[2] **CET1 (Common Equity Tier 1)** is a component of Tier 1 capital that consists mostly of common stock held by a bank or other financial institution. It is a capital measure that was introduced in 2014 as a precautionary means to protect the economy from a financial crisis.

Aside from the 2008 global financial crisis, the last 20 years has had plenty of other occurrences to trouble investors:

- The Russian debt crisis
- The fall of hedge fund Long-Term Capital Management
- The bursting of the technology bubble
- The rise of populism
- An eruption of tensions in the middle east
- The resurgence of trade wars

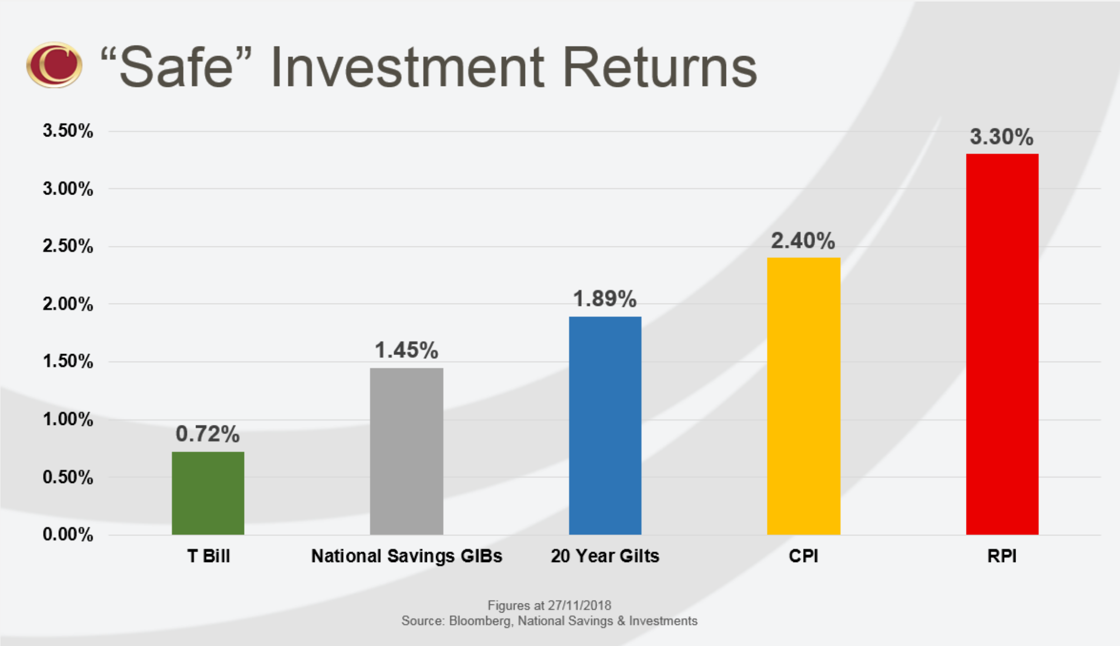
For the UK, we also had the fall of the Cameron government after losing its European Union (EU) referendum in June 2016. And if managing the Brexit process were not bad enough, very many investors and business people in Britain are wondering whatever happened to the "new" in "New Labour", especially as the official opposition to the UK government appears to be promoting a concoction of communist and Trotskyist policies as a panacea for our economic woes.

Interestingly, it is among the very young that Corbyn seems to have garnered support. And who can blame them? Lots of youngsters are leaving university with debts of between £40-£60,000, limited prospects and virtually no chance of getting on the property ladder. They can be forgiven for aligning themselves with Corbyn on the basis of having nothing to lose, but if grandma, grandpa, mum and dad want to avoid having 10% of the stake in the businesses they own "nationalised", with dire consequences for share values, then they will be well advised to inform their children and grandchildren that the last time we toyed with these policies the country ended up going cap in hand to the IMF. Still, I have sympathy for the financial plight of our young people.

<u>Current Conditions</u>

Those investors seeking a safe home for their money have a real dilemma – there is no safe home that provides a decent return, and by that I mean a return that will at least out-strip inflation and so maintain the purchasing power of capital.

Chart 7 – Safe Investment Returns and Inflation



It seems potty to me for any long-term investor to put money into an investment that is likely to buy less in 10 years than it does now. That defeats the whole point of investing in the first place. And yet that is exactly what is happening with lots of supposedly "safe" products.

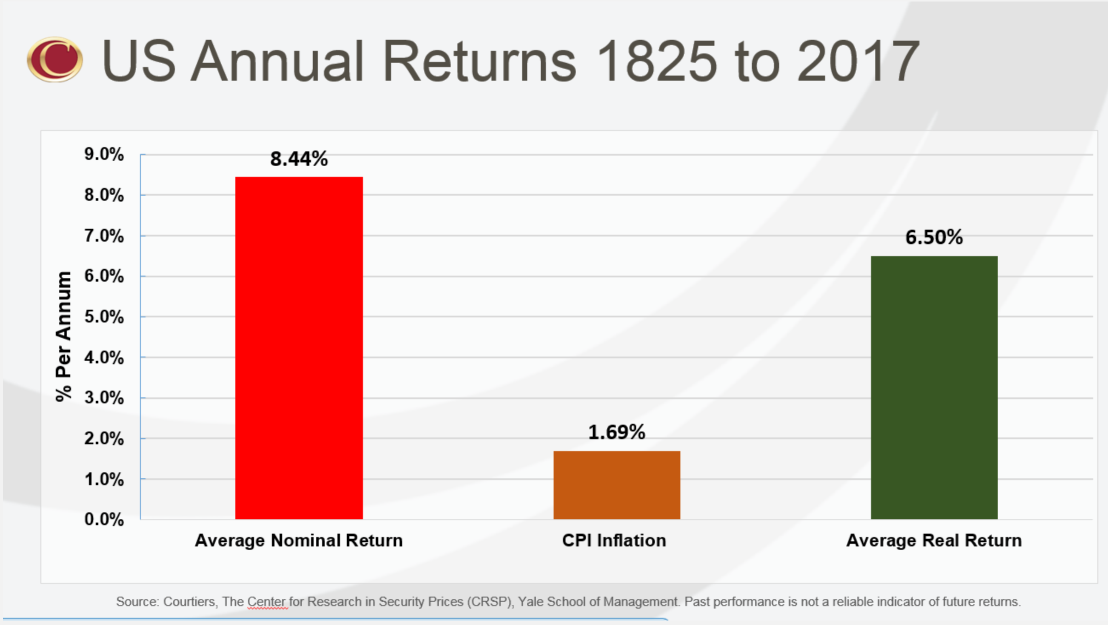
Are equities the only alternative?

Equities

Equities are a "real asset". These confer ownership on the holder where the return is contingent on the rent or profit from that asset, and the appreciation of its value over the longer-term. The two main "real assets" are property and shares (equities), but here I will concentrate on shares as they are the main alternative to making loans, such as depositing with a bank or lending money to a company in the form of a bond, or lending money to the British government in the form of gilts.

This year, the Courtiers Investment Team have been working on a project to extend our historic data on returns from equities back to the start of the 19th century. We managed to complete this for US shares where we can now examine the annual returns from 1825 to 2017 inclusive, a period of 193 years. Over this period the returns were as follows:-

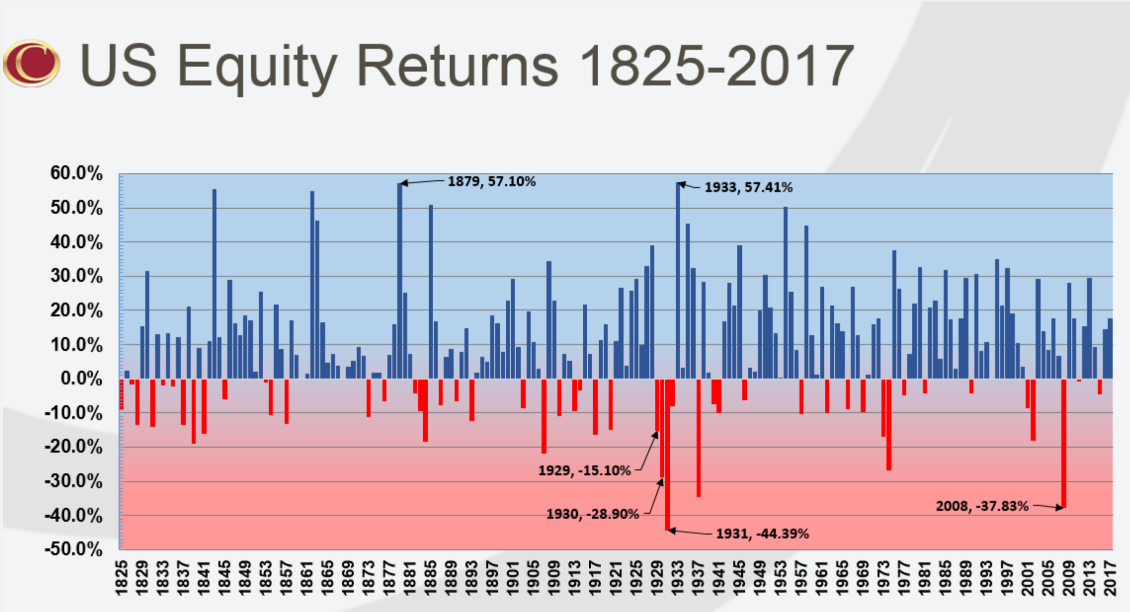
Chart 8 - US Annual Returns From Equities 1825-2017



Whilst US equities have delivered a descent return averaging 8.44% pa, which is considerably in excess of the average rate of inflation of 1.69% pa, it has not been plain sailing.

The following chart shows the actual return in each of the last 193 years, with the worst period being 1929 to 1931 where US shares delivered net returns of -15.1%, -28.9% and -44.39% respectively. If you had held US equities through those three years, which included the 1929 Wall Street Crash then, by the end of 1931, the value of your portfolio had declined by two-thirds. These three years combined make the losses of -37.83%, which US shareholders suffered in 2008, look like a walk in the park.

Chart 9 – US Equity Returns and Volatility 1825-2017

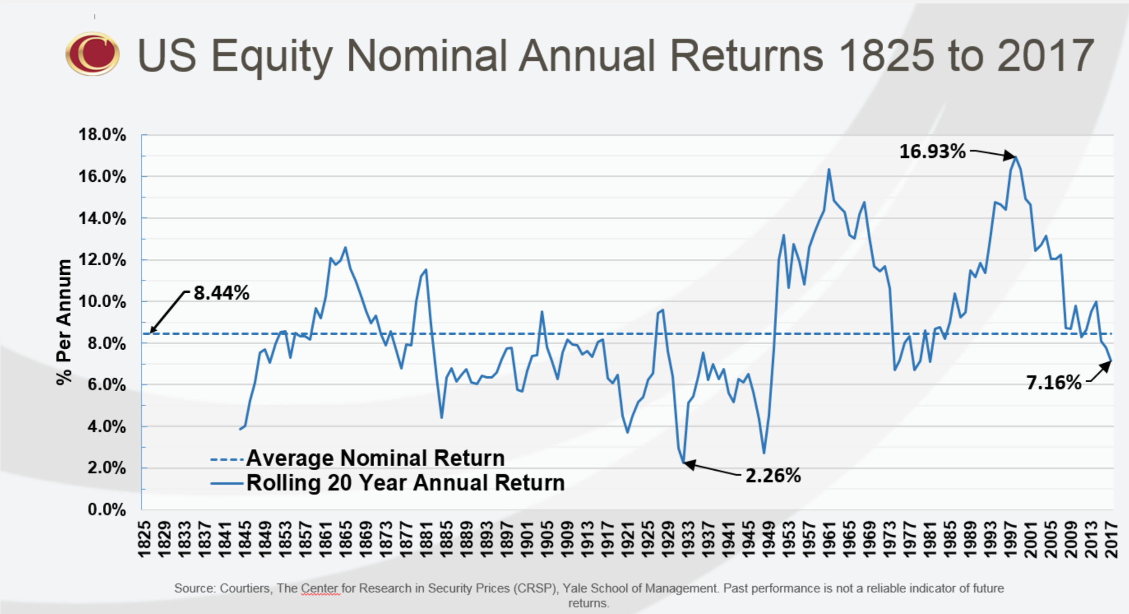


Source: Courtiers, The Center for Research in Security Prices, Yale School of Management. Past performance is not a reliable indicator of future returns.

Of course, equity investors tend not to invest for just one year. Most investors hold assets over a much longer period and that helps to smooth the ups and downs (although it doesn't stop portfolios fluctuating in the interim).

The following chart looks at average annual returns over rolling 20 year periods.

Chart 10 – US Equity Nominal Rolling 20 Year Returns 1825 to 2017

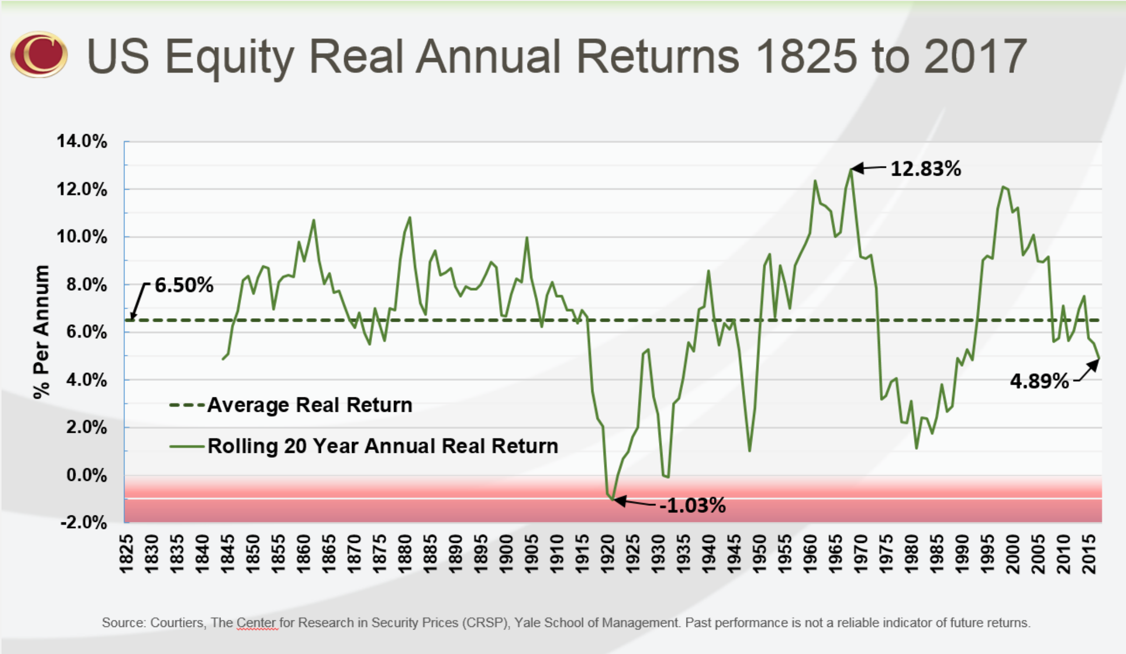


The worst return was 2.26% pa which was for the 20 years ending just after the 1929 Wall Street Crash. The best 20 year return was 16.93% pa, which ended just before the tech bubble burst in 2000.

I mentioned earlier that the real objective of any investor should be to preserve and grow the purchasing power of their capital, so what we are really concerned with over the long-term is how assets perform in relation to inflation.

The next chart shows US equity real rolling 20 year returns i.e., they are adjusted for inflation.

Chart 11 – Rolling 20 Year US Equity Real Annual Returns 1825-2017



The worst 20 year period for real returns was a real loss of -1.03% pa in the period that included the high inflation in the Great War (World War I). The best 20 year period was a real return of 12.83% pa in the 20 years ending 1968, which included the low inflation years of the 50s and 60s.

We can't track back UK equity returns to 1825, but we have gone back to 1900, and over the last 118 years UK shares, like their American counterparts, delivered good returns.

Chart 12 – UK Equity Returns 1900 to 2017

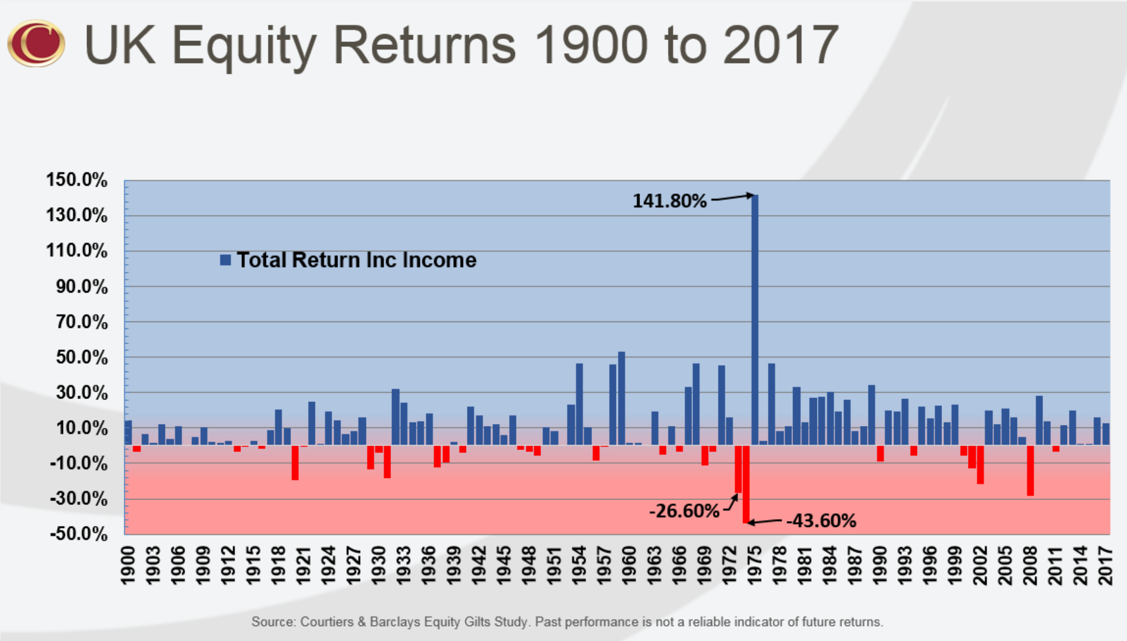
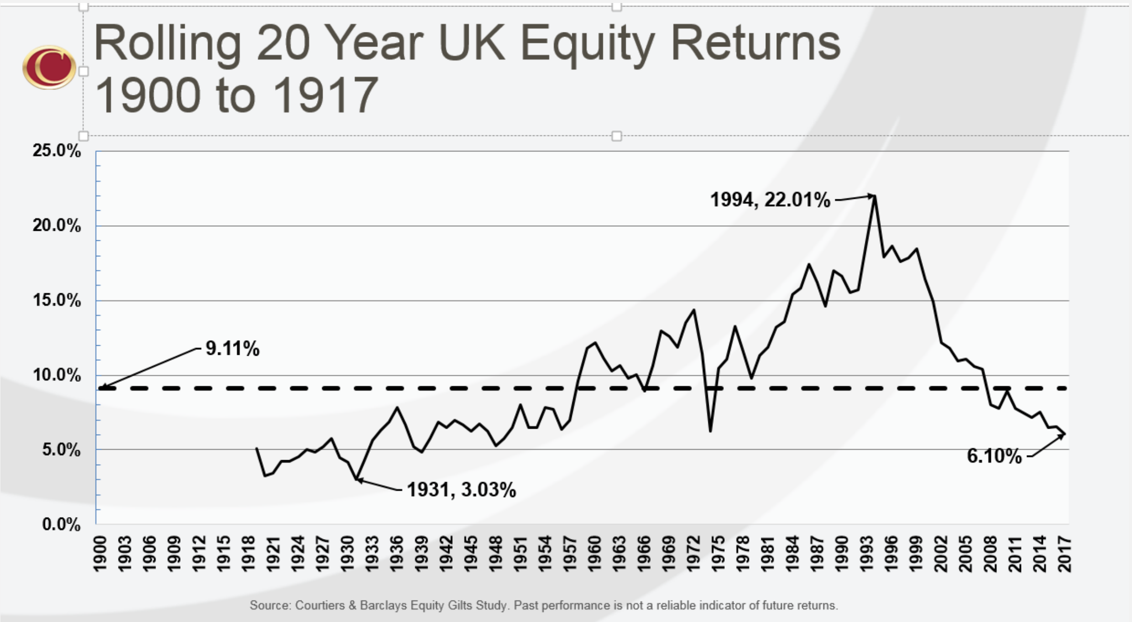


Chart 13 – Rolling 20 Year UK Equity Returns 1900-2017

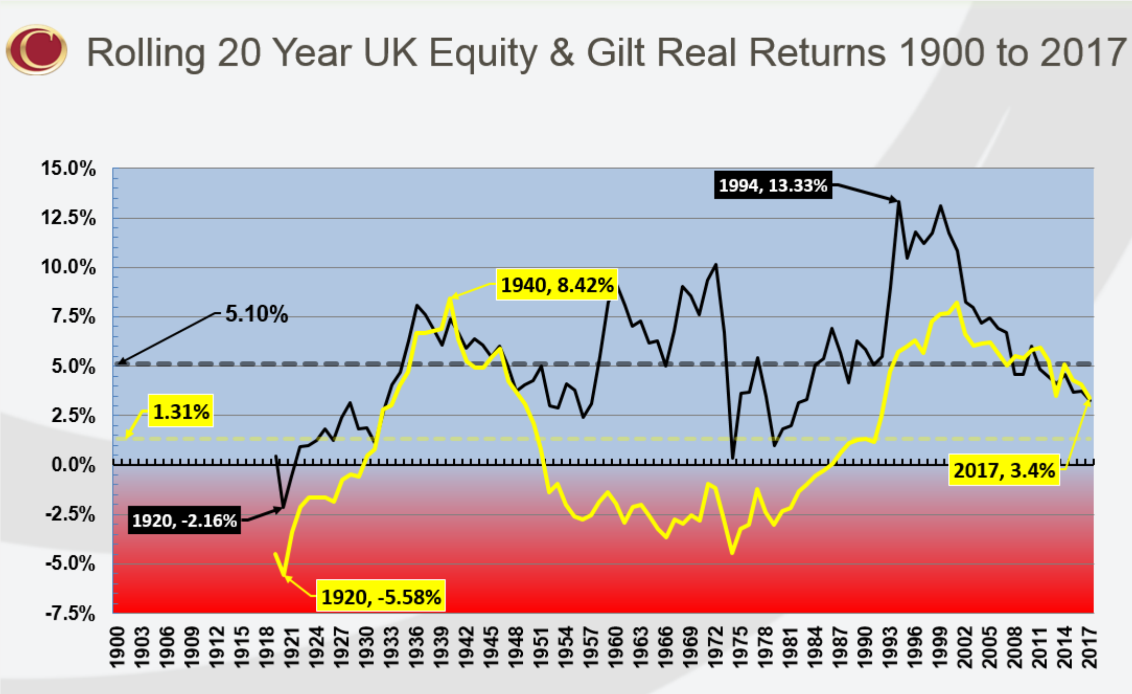


As in the US, UK markets, year by year, can prove quite volatile, although the worst period for the UK was in the 1970s when rapid increases in global oil prices tipped the UK economy, already struggling with inefficient nationalised industries and horrendous loss of working days through mass labour disputes, into a period of very high inflation (inflation peaked in 1975 at 24.9%).

Contrary to popular belief, UK government bonds (gilts) are not necessarily "safer", over the long-term, compared to equities.

The following chart shows the "real" (inflation-adjusted) returns from UK equities and gilts over rolling 20 year periods from 1900 to 2017.

Chart 14 – UK Equity and Gilt Rolling 20 Year Real Returns 1900 to 2017

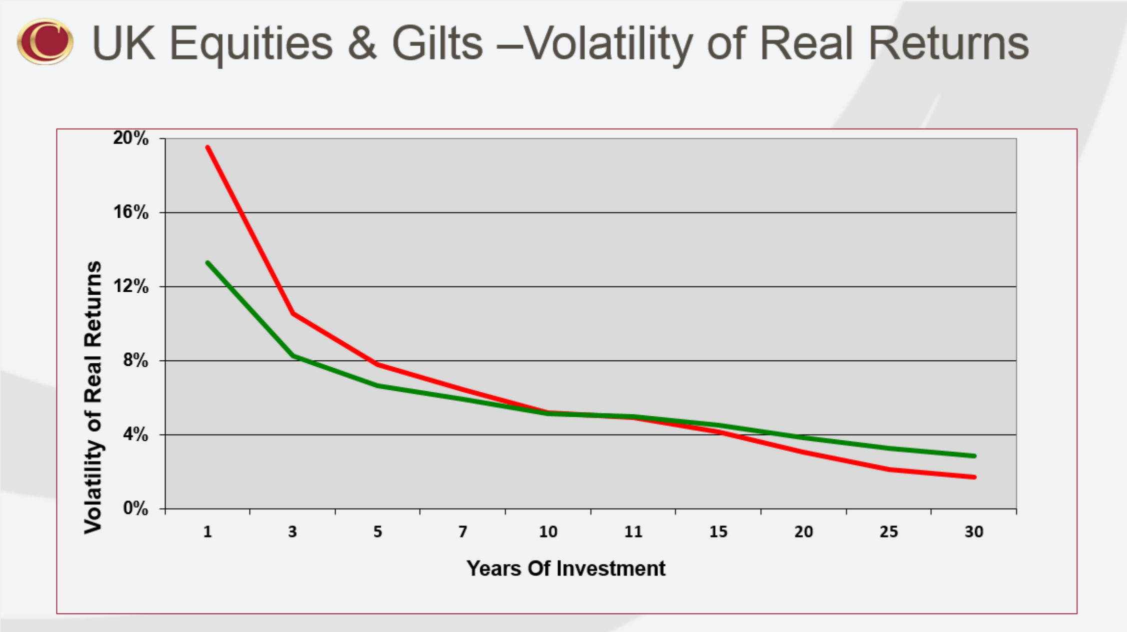


Source: Courtiers & Barclays Equity Gilts Study. Past performance is not a reliable indicator of future returns.

UK equities out-perform in nearly every 20 year period. The worst portfolio returns are from gilts, which delivered an inflation-adjusted loss of -5.58% pa in the 20 years ending 1920. The best returns are from equities which delivered an inflation-adjusted return of 13.33% pa in the 20 years ending 1994.

If we dig into these "real" inflation adjusted returns, we can analyse the average return against the volatility.

Chart 15 – Equities and Gilts – Volatility of Real Returns



Source: Courtiers & Barclays Equity Gilts Study. Past performance is not a reliable indicator of future returns.

This chart shows that if you can hold your equity portfolios for 11 years then the "real" (inflation-adjusted) returns from equities will be less volatile than those from gilts. In other words, not only will an equity portfolio on average give you a better return than gilts over 11 years, it will also deliver it with less risk.

Where are the Risks?

Equity investors have to stomach short-term volatility in return for, generally, long-term performance that is preferable to holding other types of assets.

Over the last 193 years, US shareholders have lost money on average one in every four years with an average loss of -11.63% (the worst loss was -44.39% in 1931).

Losing money one in every four years can be gut-wrenchingly unnerving, but for the long-term holder of US shares the rewards have been obvious because there has never been a 20 year period in the last 193 years when nominal returns have been negative. The figures for the UK are remarkably similar to those for the US. Over the last 118 years, holders of UK shares record losses on average one in every four years, at an average loss of -9.6%.

Just like in the US, over the last 118 years, there is no 20 year period that recorded losses for UK shareholders. The worst period was the 20 years ending 1931 when the average return was 3.03% pa, and the best was the 20 years ending in 1994 with a mouth-watering annual return of 22.01% pa.

So what storms could upset the equity holder's boat over the next few years? One is never quite sure what is coming over the horizon, but in plain view are trade wars and, nearer to home, Brexit.

Trade Wars

Men and women have traded with each other for thousands of years. The benefits are obvious, if everyone spends their time producing what they make most efficiently, and buy from others what they are not so good at producing, then everyone is better off. In fact, as the economist David Ricardo proved in his theory of "Comparative Advantage", it doesn't matter if you are not "best" at producing any particular thing, as long as you concentrate on producing what you are least worst at!

In 1776, Adam Smith[3] in "Wealth of Nations" said that "*the tailor does not attempt to make his own shoes, but buys them from the shoemaker. The shoemaker does not attempt to make his own clothes, but employs a tailor. The farmer attempts to make neither the one nor the other, but employs those different artificers. All of them find it for their interest to employ their whole industry in a way in which they have some advantage over their neighbours, and to purchase with a part of its produce, or what is the same thing, with the price of a part of it, whatever else they have occasion for.*" Smith sums up: *"it is the maxim of every prudent master of a family never to attempt to make at home what it will cost him more to make than to buy"*.

What applies to the family also applies to the nation. Smith again "*…by means of glasses, hot beds and hot walls, very good grapes can be raised in Scotland, and very good wine too can be made of them at about 30 times the expense for which at least equally good can be bought from foreign countries. Would it be a reasonable law to prohibit the importation of all foreign wines merely to encourage the making of claret and burgundy in Scotland?"*

Smith was vehemently against tariffs with the exception of two cases:-

1. When some specific industry is necessary for the defence of a country and, therefore, warrants protecting. Smith gave the example of Britain's ships, whose right to UK carriage was defended under the Act of Navigation.

2. The second similar case is where a tax is applied to domestic goods, so applying the same equivalent tax to foreign goods ensures that the domestic industry is not disadvantaged, through domestic taxes.

Smith acknowledged that one country may retaliate against tariffs and restrictions applied to its exports by imposing tit-for-tat tariffs on imports coming from that country. This was not an uncommon practice in the 17th and 18th centuries, though it often led to war!

Smith went on to say that "*there may be good policy in retaliations of this kind, where there is a probability that they will procure the repeal of the high duties or prohibitions complained of. The recovery of a great foreign market will generally more than compensate the transitory inconveniency of paying dearer during a short time for some sorts of goods*".

These comments are often used by those championing the case for retaliatory tariffs, but that is only because they choose to ignore Smith's subsequent references. With regard the effectiveness of retaliatory tariffs, Smith says "*to judge whether such retaliations are likely to produce such an effect does not, perhaps, belong so much to the science of a legislator, whose*

[3] All quotes from Adam Smith are taken from Book 4, Chapter 2, of "The Wealth of Nations".

deliberations ought to be governed by general principles which are always the same, as to the skill of that insidious and crafty animal, vulgarly called a statesman or politician. And Smith goes on to say *"when there is no probability that any such repeal can be procured, it seems a bad method of compensating the injury done to certain classes of our people to do another injury ourselves, not only to those classes but to almost all the other classes of them"*.

Winston Churchill shared Adam Smith's passion for free trade and spent the early part of the 20th century defending it. *"We say that every Englishman shall have the right to buy whatever he wants, wherever he chooses, at his own good pleasure, without restriction or discouragement from the state", said Churchill*[4].

And when Gerald Balfour, brother of then Prime Minister Arthur Balfour, said that he was prepared to fight for free trade by imposing tariffs on foreign goods, Churchill's response was "*I wonder what would happen to free trade, if it had been left alone in a dark lane with such a champion as that!*[5]"

In the last four decades, free trade has lifted hundreds of millions of people out of poverty. It has enabled third world countries to prosper by concentrating on the production of items, and commodities, which can be used in the supply chain that provides us with high quality goods and services at affordable prices.

Companies have benefited from free trade and it encourages the best businesses to thrive.

Tariff wars are not new. They have, over the centuries, been frequently employed by politicians trying to garner votes by appearing to protect domestic industries. However, in the end those same protective policies provide unchallenged profits to domestic businesses, and always at a cost to the consumer.

Brexit

If anybody wants to get a better understanding of the procedures for Brexit, including the Withdrawal Agreement and Political Declaration then I encourage you to read David Nicholsby's excellent article of 6th November 2018[6].

I suspect there will be many more twists and turns before we arrive at the date of leaving the EU on 29th March 2019.

I voted "remain" because I thought that the process for leaving the EU would be messy and a distraction to the business of the UK.

Further, I thought a decision to leave the EU would disrupt capital markets, which it has done. But most of all, I personally had little trust in the leaders of the Brexit campaign to deliver a favourable outcome.

[4] From a speech by Churchill at Birmingham Town Hall, 11th November 1903.

[5] From a speech by Churchill on Retaliation and Dumping, Midland Hall, Manchester, 19th June 1904.

6 **"Brexit – 5 Months. 3 Scenarios. 1 Investment Approach"**, 14th November 2018, David Nicholsby. Link: https://www.courtiers.co.uk/news/brexit-5-months-3-scenarios-1-investment-approach.

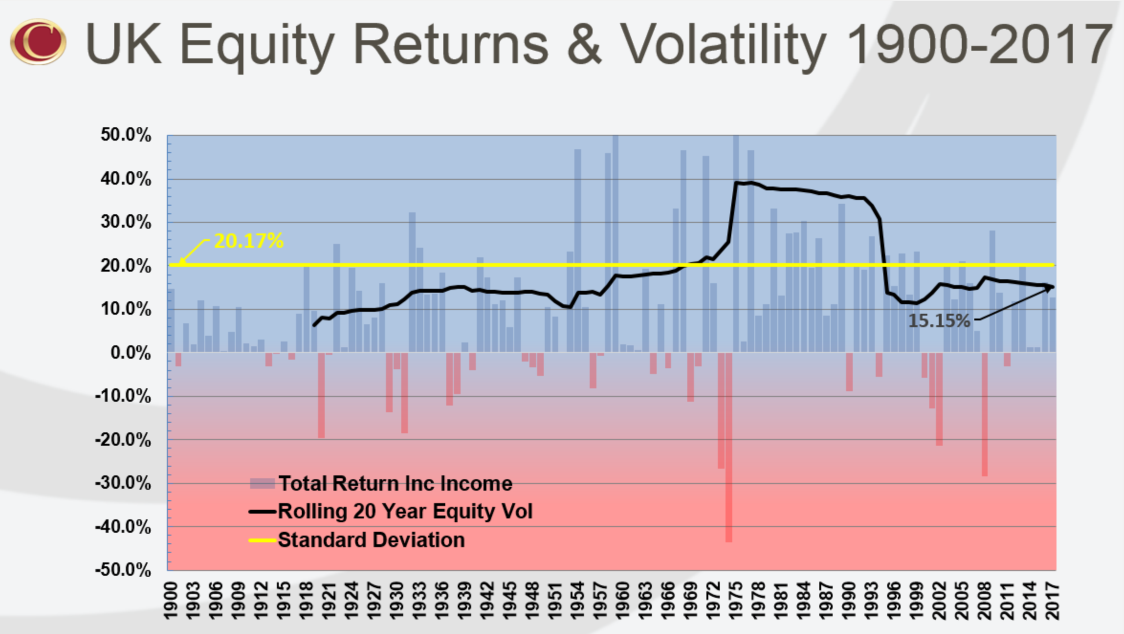
The country's decision to leave the EU was, however, democratically taken and we must get on with it. My preference is that we simply leave, withdraw all tariffs on imports, even if they are not reciprocated, and commence a new era of trading relationships with the rest of the world. This, incidentally, is the position adopted by economist Patrick Minford who argued for leaving the EU on the basis that it did not support free trade and imposed tariffs on imports from all non-EU countries. Patrick Minford reckoned that adopting this policy would give a boost to the UK economy of around 3%[7], a figure which was latched onto by most Brexiteers, though they failed dismally to explain how that figure was arrived at.

I do not know what the final outcome of our leaving the EU will be, although I suspect there will be some deal that enables the UK to trade fairly freely with the rest of the EU. But in the run up to 29th March, there will be many twists and turns, and every one of them will have an impact on UK domestic markets, especially the value of the pound.

Conclusion

As usual in my address at this time of the year, I will conclude with some predictions, but before I do so, let's just take another look at a chart showing the rolling 20 year volatility of UK equity returns.

Chart 16 – UK Equity Returns & Volatility 1900 to 2017



Source: Courtiers & Barclays Equity Gilts Study. Past performance is not a reliable indicator of future returns.

Despite all the traumas of the last 20 years in both the UK and US, the volatility of equity returns over this period was less than the average volatility of 193 years of returns in the US and 118 years of returns in the UK. There is a very simple conclusion that you can take from this, and that is that the last 20 years were normal and no more exceptional than the years before them. Credit crises, bubbles, political storms, and bankruptcy of big businesses are a feature of the world in

[7] Balance of Competencies Review: Setting Business Free Into The Global Economy. Published by the Hampden Trust, 2013.

which we live. If you expect them, you can better prepare to withstand them. The two most important ways for long-term investors to make sure they can get through market traumas, and still benefit from the superior long-term returns that equities have tended to deliver, is by:-

i) never investing in the market what you will need, or may need, to spend in the short-term, and in this regard we normally say for 3 years;

ii) making sure you are well diversified.

Few people realised that Northern Rock was built on sand, and still fewer expected the Royal Bank of Scotland (RBS) to be taken into intensive care in the form of government ownership to protect both the economy, and RBS depositors. Never become over-exposed to any one business, type of investment, or sector, no matter how secure they may appear to be.

Predictions for 2019

Finally, and with much trepidation, here are my forecasts for next year:-

- Brexit will go to the wire
- Global Gross Domestic Product growth will slow

To next year

Without a doubt, Courtiers has another busy year ahead and we'll continue to keep clients updated with regular commentary around tax, regulation, investment strategies and fund performance.

If there's any aspect of this year's seminars or this summary that you'd like to discuss in more detail, please speak to your adviser or contact us.

Finally, a big thank you to all our clients for entrusting Courtiers to manage wealth throughout an eventful 2018. We look forward to seeing you next year and until then, Seasons Greetings and Happy New Year!