The age of uncertainty
An unpredictable new president, Brexit and European elections – are investors too relaxed about the outlook for 2017?

In brief

Recovering, yet exposed
Trump presents a conundrum for emerging market investors

Too hot, too cold or just right?
Mapping the potential roads ahead for global bond markets

Weathering the storm
UK commercial property has been resilient despite Brexit uncertainty

Gearing up for a change
The green revolution is driving towards an electric future
First the EU referendum, then the election of Donald Trump. In 2016, investors were surprised by events that pollsters and other experts said wouldn’t happen, although on both occasions stock markets swiftly recovered before reaching new highs.

Uncertainty and political risk remain key themes for financial markets this year. After his inauguration, President-elect Trump’s policies will become clearer; the UK is expected to trigger article 50 by the end of March; and the eurozone faces important elections in the Netherlands, France and Germany. Italy could also go to the polls if the government appointed following Matteo Renzi’s referendum defeat and subsequent resignation doesn’t last. Any of these events could cause investors to become less relaxed about the outlook for equities.

Our lead article considers how equity valuations may be too high to compensate investors adequately for the risks associated with such a volatile political climate. Financial markets are giving Mr Trump the benefit of the doubt and putting more emphasis on the positive impact of his proposed tax cuts and fiscal stimulus than on any potentially damaging trade policies.

US interest rates were increased in December as expected, but the more hawkish guidance from the Federal Reserve (Fed) was a surprise for investors. Inflation expectations are increasing and bond yields have been rising. We explore the outlook for fixed income markets on page 6. Rate increases in the US and a stronger dollar would also be challenging for emerging market investors as we explain on page 5.

On page 8, we discuss the UK commercial property sector, which has been more resilient than many expected since the referendum result. Lastly, on page 9 we consider the latest developments in the electric vehicle industry and their far-reaching implications.

I hope you enjoy this edition of Investment Insights. Please visit rathbones.com to keep abreast of our latest views on Brexit, the Trump presidency and other key issues that will shape financial markets this year and beyond. Best wishes for a happy and healthy 2017.

Julian Chillingworth
Chief Investment Officer
Equity markets remain buoyant despite political uncertainty

What a year 2016 turned out to be. Stock markets may have risen despite the shock of the EU referendum result and the election of Donald Trump, but will investors be so sanguine this year? Before opening the political can of worms that 2017 could become, however, it might be worth revisiting the theory behind stock market pricing.

Stock markets are simply discounting mechanisms: in essence, investors attempt to project and then discount all future company earnings into today's share price. The rate at which we discount future earnings is the sum of the government bond yield — known as the 'risk-free' rate — and the equity risk premium (ERP). When the risks to future earnings increase — or in other words when tomorrow's world becomes less certain — investors apply a higher ERP. This discounts future earnings at a higher rate, thereby building in an additional cushion against this uncertainty.

Unsurprisingly, there is a strong correlation between the ERP and broader economic uncertainty. As they become less certain about the direction of the business cycle, investors become less certain about future corporate earnings. We have developed tools to quantify 'uncertainty' and calculated this measure for every quarter over the past 30 years. Our analysis shows something unprecedented over this period: political uncertainty has started to drive economic uncertainty. Spikes in the series occur only during periods of global economic — not political — turmoil. Sometimes a large increase in uncertainty precipitates a change of political direction, but political dynamics alone have never caused uncertainty to spike. Until last year.

As we start the new year, there are many sources of political uncertainty — in the UK and US of course, but also in Europe and throughout the emerging economies. We suggest that the risk premia demanded by investors are not commensurate with this uncertainty, which causes us to start the year cautiously. In the US the ERP has fallen back towards its pre-financial crisis levels and we question whether the expected return from equities compensates investors sufficiently for the risks posed by the president-elect. Over the past 12 months, global equities have risen by more than 20% in sterling terms and many portfolio strategies have delivered over and above investors’ required rates of return. To be clear, our base case does not include a recession in 2017, and equity bear markets do not occur without one. So we recommend staying invested, albeit with a cautious approach.

Evaluating the Trump risk
Financial markets appear to be giving Mr Trump the benefit of the doubt by placing more emphasis on the positive impact of his proposed fiscal stimulus measures than on any potentially damaging trade policies. We believe this is a leap of faith.

Even if we assume investors are fully discounting that Mr Trump’s proposed corporate tax cut will go ahead in year one — which could raise S&P 500 Index earnings by $10 to $15 per share — the implied ERP is still at an 18-month low (figure 1). And a tax cut in year one is far from a done deal. Steve Mnuchin, the newly nominated Secretary of the Treasury, has stated that his “number one priority is tax reform”. Reform is different from a cut and likely to take considerably longer to implement than many investors expect. It is complicated, with many competing interests, and Mr Trump and the Republicans in Congress do not necessarily see eye to eye. President Reagan’s tax reform took two years to implement, even though he governed with a much more ideologically unified party and a larger...
The age of uncertainty

congressional majority.

Flash investor surveys conducted recently by investment banks tell us that most investors expect Mr Trump to do something on tax or infrastructure in his first 100 days in office. Yet very few believe he will start to follow through with the protectionist, anti-globalisation rhetoric that dominated his campaign. In short, investors are separating Mr Trump’s fiscal plan from his trade plan. This may turn out to be right, but the point is no one knows and the market’s optimism seems rather gung-ho, especially after a review of his team’s policy documents. The plans released during the campaign made clear that he intends to pay for his huge fiscal stimulus – which would otherwise add trillions to the national debt – with protectionist trade policies, which he thinks (wrongly, in our opinion) will double the rate of growth in the US economy. Mr Trump needs to pay for his huge fiscal stimulus somehow or he is very unlikely to secure the approval of the large number of extremely fiscally conservative Republicans in the House.

Mr Trump’s Contract with the American Voter places protectionism at the forefront of what he hopes to achieve in his first 100 days in the White House. His nominee for Secretary of Commerce and the ‘landing team’ for staffing the US Trade Representative office have strong links to the steel and coal industries and have lobbied vociferously for Congress to file antidumping duties against China (not necessarily without good reason). Worryingly, the House Republicans’ own tax reform agenda includes a ‘border adjustability tax’ – essentially a tax on imports and a tax credit on exports, which is protectionism by another name.

The threat posed by protectionism and a possible beggar-thy-neighbour global tariff war is about the medium and long term. It’s about what it does to input costs, and, moreover, productivity, which ultimately drives corporate profits. Even if Mr Trump presses ahead overtly with protectionism, an economic or corporate profit recession is still unlikely in 2017. Yet investors are likely to start to discount that threat to medium- and long-term profits.

No one yet knows exactly which policies Mr Trump will pursue or be able to achieve during his first year in office. Nevertheless, the S&P 500 has so far responded positively rather than discounting underlying earnings a little more harshly in response to the uncertainty, as we might have expected. Oxford Economics suggests financial markets are pricing in a fiscal stimulus equivalent to 1% of GDP for every year of Mr Trump’s term. If he disappoints the markets, a correction would be likely.

Batten down the hatches in Europe

Back across the Atlantic, investors will be bombarded with politics in 2017. Eurozone politics are fractious as it is, the Italian banking crisis rolls on and inflation expectations remain worryingly weak. The pro-eurozone Italian prime minister, Matteo Renzi, resigned in December, and the far-right, anti-eurozone Marine Le Pen is likely to win the first round of the French presidential election in April. While we do not believe that either of these developments pose an existential threat to the eurozone, they create uncertainty and many investors may start to increase their discount rates.

Meanwhile, equity valuations in the eurozone are not cheap compared with their long-term average or historical ratio against other regional equity markets. Notably, the returns on equity are unlikely to improve without a recovery in the eurozone. The potential for them to send the economic cycle into a tailspin this year is limited and investors should remain invested. However, this doesn’t mean that stock prices won’t fall if events make the policy outlook more uncertain.

Productivity isn’t everything...

American protectionism, political loggerheads in Europe and Brexit concern us because of their potential to impede productivity and so the potential rate at which company earnings could grow over the long run. The potential for them to send the economic cycle into a tailspin this year is limited and investors should remain invested. However, this doesn’t mean that stock prices won’t fall if events make the policy outlook more uncertain.

Figure 2: What if...

This chart shows how changes to the ERP could affect the S&P 500 Index.

% 5 0 -5 -10 -15 -20 -25 -30

ERP falls back to 2014 average

ERP falls back to 2014 average; yield curve shifts up 0.5%

ERP rises to 2011 average

ERP rises to 2011 average and terminal growth revised down

Source: Datastream and Rathbones.
Trump presents a conundrum for emerging market investors

While financial markets in the developed world responded positively to the election of Donald Trump, the reaction in emerging markets (EMs) was mostly negative. The majority of equity markets have recovered most of their initial losses, but performance has lagged developed markets considerably. Currencies have suffered too, and in particular the Mexican peso and Malaysian ringgit.

There are three interconnected channels through which the Trump presidency could harm emerging economies:

— American protectionism and a paradigmatic shift away from globalisation;
— changes to the pattern of global capital flows; and
— the effect a strong US dollar could have on EM funding costs and commodity prices.

We have ranked 19 emerging economies in order of vulnerability to these channels (figure 3). To do so, we assess their export exposure to the US and the importance of manufactured goods to their economies, which are more likely to be subject to high tariffs under a protectionist scenario. We look at how volatile cross-border capital flows have been, which makes an economy’s financial markets more susceptible to a shock, as well as the size of each government’s foreign exchange reserves, which can be deployed as a shock absorber by policymakers when faced with a sudden outflow of international capital. Finally, we look at foreign funding requirements and the proportion of foreign currency denominated debt due to be repaid over the next year. High scores here leave an economy very susceptible as US interest rates or the US dollar rise.

The overall scoring explains more than 70% of the variation in the behaviour of these economies’ exchange rates since the US election (if we exclude Brazil, which is still reeling from its deepest recession in more than a century). This is surprisingly high, given the fairly simplistic nature of the analysis, and suggests that EM investors are being far more circumspect about the policies that Mr Trump might pursue than investors in developed market equities and bonds. The Mexican and Malaysian currencies have weakened the most, and their economies have by far the worst vulnerability score. Turkey, Venezuela and South Korea are the next most vulnerable, and these three are also experiencing political unrest of their own.

If Mr Trump abandons his promises of flat-out protectionism and successfully initiates a large public infrastructure programme and stimulates private sector investment by way of tax reform, EM investments should perform well as they tend to correlate with improving global growth. Metals exporters with good financial positions as set out above, such as Chile and Peru, are perhaps among the best placed to benefit.

Mr Trump aside, EMs started to look more and more attractive last year. EM equities started to outperform their developed market counterparts as EM GDP growth started to rise relative to that of developed markets. The latter process appears to have started in mid-2016 and, although it is too early to call the trend definitively, the leading indicators still point in the right direction. Some investors believe that rising US interest rates are bad news for EM equities. This is not empirically accurate: EM equities have outperformed through the past three Fed tightening cycles. As long as the dollar doesn’t soar (and our fundamental analysis, which helps us to assess where currencies may trend over the long term, suggests that the dollar is already quite overvalued versus many EM currencies), financial conditions shouldn’t pose too great an impediment.

As a result, investors face a conundrum. Should they continue to invest in EMs as the fundamental case firms up, or should they protect themselves against the possibility that Mr Trump pursues policies that make life very tough? It’s too early to know, but as our lead article explains, we believe there is a risk that US equity investors in particular are being too sanguine about Mr Trump’s likely policies. That will make 20 January (when Mr Trump will be inaugurated) and the days afterwards particularly nerve-wracking for investors who believe Mr Trump is cast in the mould of President Reagan.

**Figure 3: Vulnerability to the US**

We have ranked 19 EMs in order of vulnerability to the three main ways in which the Trump presidency could affect them.
Too hot, too cold or just right?

Mapping the potential roads ahead for global bond markets

For more than seven years now, bonds have defied expectations and confounded the many investors who repeatedly shunned them as expensive, risky or simply dull compared with other asset classes. Economic growth has been lacklustre as the long-term effects of the global financial crisis have played out, resulting in lower-than-expected inflation.

Indeed, economic conditions in the eurozone and Japan have at times been dangerously close to deflationary. Such scenarios are good for bonds. At times, they have delivered returns that have exceeded equity markets, helped by quantitative easing (QE) in the form of central bank asset purchases.

Bonds make up the world's second-largest financial market after currencies and cover a wide range of underlying securities, including government and corporate debt issued by countries and companies with varying levels of creditworthiness. Although there are features that are common to all bonds, different types of bonds behave differently in any given market environment.

Looking ahead to the next 12 months, we examine how these various bond markets will perform under several different scenarios. We consider the main fixed income markets:

- conventional gilts, which are UK government bonds that pay a fixed coupon regardless of the prevailing level of inflation
- index-linked gilts, whose income and price returns are linked to inflation
- investment-grade credit, which is issued by companies with good credit ratings
- high yield credit, which is issued by less creditworthy companies.

Before the last Fed meeting, consensus expectations were for between two and three increases in US interest rates during 2017, gradually taking rates above 1% by the end of the year. The 0.25% increase in rates to 0.75% announced in December was expected by the market. Less so was the distinctly hawkish shift signalled by chair Janet Yellen. She indicated not only that the Fed expects three more increases this year, but that this is based on current projections of economic activity (figure 4).

If Mr Trump gets Congressional approval for additional infrastructure spending, rates could rise faster still. In practice, given the political challenges, any boost from presidential policies is unlikely to shift the economic dial before 2018 at the earliest, but as investors typically look forward 12 to 18 months, this could still affect financial markets this year.

**Central scenario: Goldilocks economy**

The Fed's forward guidance is slightly at odds with our central view for 2017, which is based on a benign economic environment for the US (and by extension, global markets) with inflation gently ticking up due to wage pressures and food and energy prices, among other factors. In contrast, we do not expect monetary policy to tighten in Europe or the UK and, if anything, fiscal policies could be slightly more expansionary. Why 'Goldilocks'? Like the porridge, under this scenario the economy would be neither too hot nor too cold.

In such an environment, investors could expect fixed income markets to deliver returns similar to what they say on the tin. High yield would perform best, if the current low default environment is sustained, followed by investment grade credit. Gilts and index-linked bonds would trail, but could still surprise some commentators if interest rates rise more modestly than expected.

**Hawkish central banks scenario**

Labour markets are close to full employment in the UK and US and most wage growth indicators are pointing higher. Additionally, leading indicators have been climbing across developed markets and talk of fiscal stimulus has taken over from austerity. As the Fed's guidance indicates, central banks may take a more 'hawkish' stance and increase rates more aggressively than anticipated in response to perceived inflationary pressures. These could come from the new president's proposed infrastructure programme ('Trumflation') or further increases in the oil price.

The precedents for such a scenario would be the bond market crash of 1994 and, to a lesser extent, the 'taper tantrum' of 2013, when the Fed signalled it would reduce the pace of its bond-

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*Figure 4: US interest rates are forecast to rise gradually*

The ‘dot plot’ by Federal Reserve policymakers suggests interest rate growth will slow in coming years.

<table>
<thead>
<tr>
<th>%</th>
<th>Federal Open Market Committee member prediction</th>
<th>Weighted average</th>
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Source: Federal Reserve, Bloomberg and Rathbones.
Too hot, too cold or just right?

In 1994, the Federal Reserve (Fed) unexpectedly raised interest rates by 0.25% in February, pushing short-term interest rates up 2.25% by year end. This caused chaos for investors, wiping trillions of dollars off global bond market values.

In our hawkish scenario, government bond markets would sell off in anticipation of higher interest rates. Prices of riskier assets, such as equities, might not be affected because, while higher rates are bad for “risk”, the improving economic climate would cancel out the impact.

High yield debt could suffer, however, as companies struggled to refinance at higher rates and defaults rise. The ultra-low interest rate environment that has persisted over recent years has allowed many companies of a poor creditworthiness to access bond markets. Unless their businesses improved materially, they would not be able to afford more expensive borrowing. While this could be delayed by the scale of the funding secured by companies during this period of ultra-low interest rates, higher rates might affect investors’ willingness to hold high yield.

If it turned out that central banks had got it wrong and moved too early, they could be forced to backtrack and cut rates again or even launch further unconventional monetary policies. Gilts would then be expected to stage a strong comeback as inflation would probably fall as the economy faltered. In contrast, high yield debt would take a renewed turn for the worse if the economic slowdown hurt the companies that have issued it.

Inflation runs hot and central banks remain dovish

Despite the Fed’s recent hawkish guidance, the Bank of England (BoE) may be more willing to be behind the curve when it comes to dealing with rising inflation. Given the economic uncertainty associated with leaving the EU, inflation could be allowed to run unchecked for a while without a sufficient monetary policy response. The weakness of sterling since the referendum is already pushing up inflation and it is likely to rise through the BoE’s 2% target in the short term (figure 5).

Bond investors do not like inflation because it erodes their future spending power and yields would be expected to rise almost in lockstep with inflation. The exception is index-linked bonds, which are hedged against price rises. Also, the stronger economic growth that usually goes with higher inflation (assuming central banks act before inflation gets out of hand completely) can benefit high yield bonds because weaker companies can increase prices, boost earnings and lower debt multiples. Investment grade credit would benefit from better corporate performance too, but prices are tied too closely to gilts to benefit outright from this environment.

Conclusion

In summary, low bond yields at present mean government bonds are likely to underperform equities in many scenarios and the sell-off in gilts seen in the second half of 2016 could be extended. Only our central scenario or a recession sees them earning positive returns, yet as our lead article makes clear we see little chance of recession in the UK, US or world economy in 2017. Despite the obvious risks and increased political uncertainty, our favoured leading economic indicators simply don’t suggest a recession is likely.

Index-linked gilts stand a better chance of delivering a decent outcome for portfolios because they are somewhat protected from higher inflation, while still protecting on the downside (less so than gilts, but they would still help in a recessionary environment).

In conclusion, therefore, we believe investment-grade credit offers the best risk-reward profile going into 2017 with high yield bonds a close (but riskier) second.

**Figure 5: Inflation expectations are increasing**

The outlook is for inflation to pick up throughout 2017 and possibly break through the Bank of England’s 2% target.

In summary, low bond yields mean government bonds are likely to underperform equities in many scenarios.
UK commercial property has been resilient despite Brexit uncertainty

UK commercial property values increased by 2.4% over the first six months of 2016, according to the IPD All Property Index. Yet these gains were eradicated in the immediate aftermath of the EU referendum – the index fell by 2.8% in July alone. Although total returns were negative in the third quarter, the rate of decline slowed and returns for the whole of 2016 were just above zero (figure 6). The sector has been more resilient than many expected, but uncertainty surrounding Brexit and its impact on business sentiment remains a key risk.

Following a very quiet period immediately after the referendum, according to the latest figures from Property Data, there were £9.5 billion worth of commercial property transactions in the third quarter. Although respectable given the circumstances, this is still 20% lower than in the second quarter. Transactions were supported by sterling weakness and increased interest from overseas buyers, who accounted for about half of all transactions.

Open-ended funds provide a further sign that market conditions appear to be returning to normal. Initially, to discourage outflows all daily dealing funds placed levies on investors looking to redeem. Eventually, most funds were forced to suspend transactions as a way of ensuring they did not run out of cash to meet redemptions. With transactional activity returning, these punitive levies have all been removed and most funds have reopened.

Individual managers are still disclosing the prices at which they sold assets to meet redemption requests from investors. It appears that prime properties were sold close to their pre-referendum values, and secondary assets or properties with short lease terms were sold at 5% to 10% discounts.

At the sector level, offices have been most heavily impacted by the fallout from the EU referendum. In particular, central London offices have been affected by uncertainty over whether financial institutions and other multinational businesses could move their head offices to continental Europe.

High-street retail and shopping centres have continued their long-term downward trend as consumers continue to favour online shopping. This shift has underpinned the sustained appetite for out-of-town warehouses and logistics centres. Property assets with longer lease terms and revenues that move in line with inflation (such as hotels and petrol stations) have mostly held up given investor appetite for steady income streams.

The outlook is less clear

Despite a better-than-expected response to the result of the referendum, the longer-term outlook for UK commercial property remains unclear. According to Capital Economics, capital growth forecasts for 2017 vary from 0% to -10% with rental value growth from 2% to -3%. There has been increased interest in property investment through funds because the outlook for higher inflation is positive for real assets like property that can incorporate an element of inflation protection in its lease income.

Meanwhile, the weakness of sterling makes UK assets more appealing to international investors.

Although vacancy levels are below the long-term averages, it is too early to know how office leasing activity will be affected by financial institution and multinational company sentiment. The longer the uncertainty, the greater the risk of lease terms shortening at lower rental levels.

Tesco’s clash with Unilever over its attempts to push up wholesale prices also highlights how inflation from weaker sterling could be a further headwind for retailers. Property managers are keen to highlight the higher relative income of property over government bonds. As we have seen in 2016, if government bond yields continue to rise, commercial property yields may look less attractive in the longer term.

High-street retail and shopping centres have continued their long-term downward trend as consumers continue to favour online shopping.

Figure 6: Pause for thought

The IPD Index shows UK commercial property markets have recovered since the Brexit vote but remain more or less unchanged over the whole of 2016.

Source: MSCI/IPD and Rathbones.
The green revolution is driving towards an electric future

Electric vehicles (EVs) have existed since the 19th century, but have been most prevalent in niche applications such as mobility scooters and forklifts. Recent technological innovations, such as improving battery chemistry, electric power train and drive-by-wire/brake-by-wire technology (replacing traditional mechanical and hydraulic control systems with electrical sensors), coupled with the associated fall in costs, are bringing EVs closer to disrupting the internal combustion engine’s dominance.

The total cost of owning EVs compared with traditional petrol and diesel cars is becoming increasingly attractive, yet consumers still tend to focus on the initial price of buying an electric car. Mass adoption will require this upfront cost to move closer to parity with petrol and diesel cars. Other factors standing in the way of mass adoption today are range anxiety (the fear of an EV’s battery running out of charge on a long journey), lack of charging infrastructure and concerns about the length of time it takes to charge the batteries.

Economies of scale, innovation and the adoption of lithium-ion battery technology have driven a two-thirds reduction in the cost of EV batteries in five years, making EVs more affordable. These developments have also dramatically increased battery energy density, which enables ongoing improvements in range, acceleration and charging time. General Motors and Tesla are planning to launch electric cars with ranges of 200 to 300 miles for around $33,000 (£26,800), which is the average cost of a new American petrol car.

**Sustainable targets**

Regulation in the form of fuel economy standards around the world require increased electrification if targets are to be met. EVs deliver impressive energy efficiency, converting 60% of electrical energy to power at the wheels, compared with a 20% conversion rate for internal combustion engines. Many governments are devising measures to incentivise both manufacturers and consumers towards EVs in an attempt to reduce pollution.

The Chinese government, in particular, is heavily subsidising EVs (figure 7), having announced this as an industry of national importance, and is targeting a 10-fold increase in the number of EVs sold to 3 million per year by 2025. In London, EVs are exempt from the Congestion Charge, reducing total cost of ownership. Meanwhile, the mayors of Paris, Madrid, Athens and Mexico City have pledged to ban diesel vehicles from their city centres from 2025. Car manufacturers have also announced bold targets: BMW is targeting 100,000 EV sales next year and Nissan estimates 20% of its European vehicle sales in 2020 will be electric (currently 6%).

An equally disruptive recent technology that goes hand in hand with EVs is vehicle autonomy. Autonomous cars can be thought of as computers with wheels that require data to be transferred from various sensors (such as radars and cameras) back to the computer, which then analyses the data and sends out driving signals to steer, accelerate and slow the vehicle. These two technologies are complementary because EVs will by default contain similar architecture (driving- and braking-by-wire features).

Over the next decade, as the cost and battery range of EVs improve, consumers are likely to begin switching to greener technology, potentially at a faster pace than is currently assumed, pushing EVs’ global market share significantly above the current 1%. The question remains over whether this will be a gradual shift, with hybrid EVs (such as the Toyota Prius) being adopted in force first, or whether this stepping stone will be skipped in favour of full battery EVs.

The implications of the expansion of EVs are far reaching. The extent to which demand for petrol and diesel falls will affect the oil price. Battery requirements for lithium and other minerals will impact the mining industry. Utility companies will be affected by developments in EV charging infrastructure.

In addition, drivers will have to decide if individual ownership makes sense, particularly in towns and cities, or whether a combination of Uber and car clubs like Zipcar make better financial sense. Manufacturers will need to evaluate their business models against the opportunities and threats of this technology and changing consumer habits. Recent trends are already beginning to show that the winners and losers will be sharply defined over time.

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**Figure 7: New registrations of electric vehicles**

China is growing in importance within the overall electric vehicle market as new registrations rise rapidly each year.

<table>
<thead>
<tr>
<th>Year</th>
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Source: International Energy Agency ‘Global EV outlook 2016: Beyond one million electric cars’
Financial markets

With the election of Donald Trump, populism and anti-establishment sentiment continued to gain ground around the world during the fourth quarter of 2016. The main concern was that an increase in protectionism could lead to less international cooperation and more restrictions on the free movement of goods, services, capital and people. Despite political upsets and an uncertain outlook, the world economy continued to expand.

The reaction of equity markets to the result of the US presidential election was similar to the EU referendum result – an initial sell-off followed by a swift recovery. Following the election, investors were positive about the impact on the US economy of tax cuts and increased government spending on infrastructure.

A buoyant mood
Equities performed well over the rest of the period. Stock markets remained buoyant as investors anticipated that Mr Trump’s presidency will reduce regulations and boost growth. The S&P 500, Nasdaq and FTSE 100 share indices rose to new record highs.

Conditions in fixed income markets were less positive. Selling resumed as investors digested the impact of the Trump presidency. The sell-off in 10-year gilts pushed the yield up to its highest level since the Brexit vote in June.

Sterling fell sharply immediately after the EU membership referendum and remained depressed over the fourth quarter. As a result, the cost of imported goods has increased, which in turn pushed up the rate of inflation over the period. According to the Office for National Statistics, prices were 1.2% higher in November than a year earlier, which is the largest increase in two years.
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