tavistock WEALTH REVOLUTIONARY THINKING

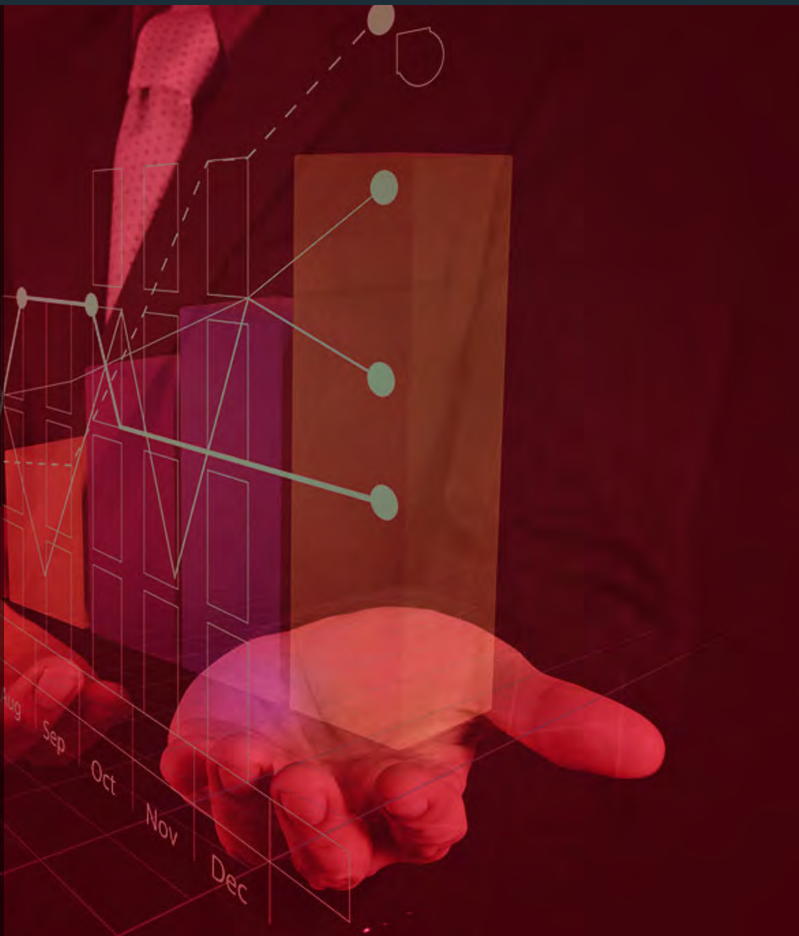
PORTFOLIO DIVERSIFICATION – GO GLOBAL

Christopher Peel
Chief Investment Officer

Diversification within and between asset classes has always been important in spreading risk evenly throughout multi-asset portfolios.

Mainly for historical reasons, investment portfolios have tended to be over-weight equities and bonds of an investor's country of domicile. The exponential growth of the passive index-tracking, exchange traded fund (ETF) market and the relative ease of access to global markets have begun to change this outdated approach. Exposure to foreign markets is on the rise and this can lead to higher returns with lower risk, which is clearly a more desirable outcome.

Given the shifting political landscape and improving global growth outlook, it is time to increase exposure to financial markets outside of the UK. This is not specifically related to Brexit and more a reflection of better investment opportunities abroad. The UK economy has been remarkably resilient since the decision to leave the EU, but the Chancellor's growth forecast is still only 2.0% for this year and the Bank of England is predicting inflation to peak at 2.8% in the first half of 2018. The International Monetary Fund is forecasting global growth to rise to 3.4% in 2017 and 3.6% in 2018. Growth in emerging markets is set to increase this year by 4.5% and 4.8% next year.



Consumer Price Inflation in advanced economies is projected to rise to 1.7% and remain unchanged at 4.5% in the developing economies over the next twelve months.

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It is evident that the economic fundamentals in many parts of the world are likely to be superior to the UK's and portfolios should be re-positioned accordingly.

The entire UK gilt curve is yielding less than the rate of inflation and history suggests that this is unsustainable over any meaningful period. Given that inflation is expected to rise from 1.8% to 2.8% in the next year, bond prices have much further to fall. Returns from long-dated government and corporate bonds will probably be negative and duration should be reduced significantly to minimise capital erosion in the ensuing sell-off. Diversification into foreign bond markets such as global government, investment grade credit, high yield and emerging market debt can provide a similar risk profile, but potentially greater returns in the foreseeable future.

The UK equity markets have performed extremely well over the last year and have benefited from the decline in sterling. Given the magnitude of the fall, the balance of risk arguably remains to the upside, which could be problematic for current valuations. Diversification into equity markets of countries growing above their recent trendline such as the US and China, or sectors such as small cap, infrastructure and emerging markets can offer the possibility of higher risk-adjusted returns in the coming year.

Portfolio diversification in global markets is not a new concept and can lead to higher returns with less volatility.

It is vitally important to **understand the currency implications** of investing in foreign markets to ensure that portfolios remain within specified risk ranges.

Hedging the majority of non-UK assets **back to sterling is an essential** part of the diversification process and aligns an investor's attitude to risk with their investment portfolio.

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1 Bracknell Beeches Old Bracknell Lane Bracknell RG12 7BW United Kingdom www.tavistockwealth.com call : + 44 (0)1753 867000

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