DT Dewhurst Torevell

# Economic Commentary – November 2013

Quantitative easing operations have inflated asset prices but have so far had little impact on consumer prices and wages. This has led some commentators to suggest that we are in a "sweet spot" of modest growth, low inflation and extremely accommodative monetary policy. As a result equities have enjoyed strong gains in the year to date, with the FTSE All-World up 21%, the S&P 500 up 25% and the FTSE 100 up 18%. Due to the comparatively benign environment many markets hit multi-year highs in October 2013.

Following yet another temporary resolution to the US debt crisis, debate in the United States has reverted once again to when the Federal Reserve (Fed) may begin to taper its quantitative easing operations. Weaker economic data is making it increasingly unlikely that tapering will commence before the end of the year, but the lack of clarity on the timeline for tapering continues to be a source of uncertainty for investors and to create short term movements in equity markets.

Economic data from Europe was a little softer in October but continues to point towards recovery, although inflation within the Eurozone was just 0.7% year-on-year in October as a result of falling wages and weaker demand. This has led the European central bank (ECB) to cut interest rates to 0.25%, which should provide a tailwind to equity markets in the region. However, considerable structural challenges remain, including the uncertainty surrounding the ECB's banking reforms.

The UK economy continues to strengthen with GDP expanding by 0.8% in the three months to September 2013. The government is aiming to stimulate housing demand but there will need to be real improvements in broader sectors of the economy to create a strong and sustainable recovery.

The sell-off in emerging markets that began in May has reversed somewhat but these markets remain vulnerable to any reduction in liquidity from the Fed. Looking East, the Chinese economy is improving with expansion at an annualised pace of 9.1% in the third quarter. However, the government still faces the difficult task of rebalancing the economy to a more sustainable consumer-demand driven model. In Japan, aggressive monetary easing has achieved positive results so far, but the government faces substantial challenges to repair its fiscal position whilst also eliminating deflation. The increase in consumption tax will be a headwind to economic recovery unless it is successfully offset with tax breaks for companies.

Turning now to asset allocation, JP Morgan have identified a modest recovery in flows to fixed interest following the very heavy selling of this asset class in the summer. They estimate that more than 70% of these global inflows to fixed interest represent outflows from money funds reflecting the extremely poor returns offered by cash. This is probably largely attributable to the Fed's surprise move not to begin to taper its asset purchases in September 2013, a development which has provided a short-term crutch to fixed interest markets. Despite this new evidence, we continue to have a negative house view on fixed interest, on the basis that so many investment grade bonds are overpriced and are ultimately vulnerable to the winding down of quantitative easing operations by the major central banks and to increased interest rates. This vulnerability creates the potential

for significant capital loss. We also consider that it is necessary to hold some cash, despite further deterioration in the rates of interest offered on deposits, to cover any required expenditure, and to provide some protection from stock market volatility.

Our strongest conviction remains with funds investing in high quality income generative companies. If markets gain a lot of ground, it is likely that these stocks will make gains, although they might lag the market index. However if markets were to pull back we would expect these high quality stocks to hold up better than more indebted or cyclical companies.

**Alan Torevell and Georgina Ogilvie-Jones**



Dewhurst Torevell & Co. Ltd, 5 Oxford Court, Manchester M2 3WQ. Tel. 0161 281 6400.
www.dewhurst-torevell.co.uk