DT Dewhurst Torevell

Asset Class & Investment Outlook - Q1 2014

Asset/Investment Area	Income (Current Yield)	Rising Income	Long Term Real Capital Growth	Volatility	Inflation Protection	Currency Risk	Commentary
Cash	1.00%	No	Negative	Very low	No	No	*Interest rates are likely to remain at historic lows for some time yet, in line with the Bank of England's forward guidance. Negative real returns but hold for liquidity and certainty. Awareness of increased solvency risks for certain banks and mindful of the need to monitor deposit providers closely.*
Conventional Gilt	2.10%	No	Negative	Some	No	No	*All the on-going risks to gilts remain. Long-dated yields have increased and are likely to increase further, despite the forward guidance on interest rates provided by the Bank of England. The 10-year benchmark gilt yield was 1.9% in January 2013 and is now around 2.8%. Values remain comparatively expensive after a period of very strong capital performance.*
Index-Linked Gilt	2.73%	Yes	Negative (at present)	Some	Yes	No	*Index-Linked Gilts underperformed in 2013. Quantitative easing has created asset price inflation, but this has yet to spill over into consumer prices. RPI and CPI inflation rates have been sticky, rather than on a clear upward trajectory. Linkers will outperform conventionals if consumer price inflation does move upwards, but to date returns have been driven by demand and not by inflation fundamentals and the sector remains comparatively expensive. The case for investing in this asset class is not strong and some issues offer negative real returns.*
UK Corporate Bond (Investment Grade)	3.50%	No	Negative	Some	No	No	*Volatility has emerged in this sector, which is often a harbinger of a changing trend. Rising gilt yields lead us to remain cautious on investment grade corporate credit, due to concerns about contagion into other investment grade bond markets. After a period of massive inflows and strong capital growth, retrenchment is likely to take place.*
UK Corporate Bond (High Yield)	5.70%	No	Negative	High	No	No	*Default rates remain low and these bonds are less sensitive to interest rates than some other sectors, so demand has been high and is likely to remain so. However, the sector does not offer good value at the present time, duration risks have emerged and high yield could be affected by the wider ramifications of any sell off in gilts. For all of these reasons, we have a negative view on high yield at the present time.*
International Corporate Bond	2.55%	No	Negative	High	No	Yes	*A mixed picture. US corporates may be adversely affected by rising US Treasury yields, although the new Federal Reserve chair Janet Yellen may act to prevent rapid upward movement. European bond yields are supported by low inflation, low interest rates and moderate recovery, whilst some investors are hunting for yield within peripheral economies.*
Emerging Corporate Bond	4.88%	No	Negative	Very high	No	Yes	*US tapering and more "normal" interest rate levels are likely to adversely impact emerging market debt. Additionally, some issuers of international debt have been badly affected when their domestic currency has suffered a steep devaluation. Fundamentals have deteriorated in many countries leading to current account deficits and a real risk of currency or banking crises. There may be idiosyncratic opportunities but we remain negative on this sector due to its volatility, poor liquidity and ongoing currency risks.*
UK Commercial Property	2.88%	Yes	Yes	Cyclical	Yes	No	*Positive capital growth is slowly returning, although the main component of total returns is income. Prime property is robust, but there is demand for higher quality secondary assets and the yield gap between primary and secondary properties is likely to narrow in the next year. Yields are beginning to look comparatively attractive to other sectors, although taxes often reduce the amount ultimately received, meaning that only tax efficient funds would be considered. High cash levels in many funds are dampening returns leading us to maintain our neutral view.*

Asset/Investment Area	Income (Current Yield)	Rising Income	Long Term Real Capital Growth	Volatility	Inflation Protection	Currency Risk	Commentary
UK Equity (Equity Income)	3.08%	Yes	Yes	High	Yes, med term	No	*There is an expectation that special dividend payments will substantially reduce in 2014, with the exception of Vodafone. However, if growth continues in the US, UK and Europe, the capacity to pay normal dividends should increase. Fund switches within the sector created by the departure of Neil Woodford from Invesco Perpetual may cause some smaller funds to struggle with inflows. However, we remain selectively positive, favouring seasoned managers with a tried and tested process to generate a progressive income to act as a foundation to total returns.*
UK Equity (Other)	2.80%	Yes	Yes	High	Yes, med term	No	*UK economic data is strengthening, pointing to ongoing recovery and orders from overseas for UK companies are also ramping up as key trading partners recover, creating a more positive outlook for earnings growth. However, relatively little economic rebalancing has taken place so far and the recovery may not be sustained, leading us to maintain a cautious stance at this time.*
Global (Equity Income)	2.09%	Yes	Yes	High	Yes, med term	Yes	*Equity income funds focusing on developed markets are favoured because of the number of cash-generative, defensive stocks with strong balance sheets listed in these markets. However, there has been a significant improvement in the dividend yield of some stocks in Asia and Emerging Markets and we are monitoring this trend closely.*
European Equity	2.20%	Yes	Yes	High	Yes, med term	Yes - €	*Eurozone inflation surprised to the downside, leading to a further cut in interest rates. The ECB is also trying to influence monetary transmission, if this succeeds it will be supportive to markets. Valuations remain attractive but low growth, fiscal programmes and structural reforms all present headwinds.*
North American Equity	1.50%	Yes	Yes	High	Yes, med term	Yes -$	*Economic data continues to improve, although fiscal tightening and higher borrowing costs may present headwinds in 2014. Equity markets have shrugged off US tapering but valuations look quite stretched. US companies have high cash levels suggesting buybacks, dividends and mergers and acquisitions lie ahead.*
Asian ex Japan Equity	1.09%	Yes	Yes	Very high	Yes, med term	Yes	*Good long term growth prospects but likely to be adversely affected by tapering of US quantitative easing in the short term. China has set out a positive roadmap for structural reforms but there are near term worries regarding the shadow banking sector and the friction that will occur as the country switches to a domestic-led demand model.*
Japan Equity	1.60%	Yes	Yes	High	Yes, med term	Yes - Yen	*Aggressive economic and monetary policies have fuelled stock markets but the easy gains have likely been made. Demographics are poor and the economic outlook uncertain. The Bank of Japan's quantitative easing measures should continue to pressure the Yen downwards, increasing corporate competitiveness but creating a need to hedge Sterling-denominated returns.*
Emerging Market Equity	2.00%	Yes	Yes	Very high	Yes, med term	Yes	*Individual countries are diverging, with some benefitting from strong fundamentals and others under pressure from current account deficits and inflation. Civil unrest and political instability have hampered certain countries. All of these factors create volatility within the sector and we prefer to access the emerging markets "growth story" through cash-generative, developed markets players who derive a proportion of their income from emerging markets.*
Commodities	0.00%	No	Yes	Extreme	Yes, med term	Yes	*The outlook for commodities is diverse with the US Dollar, demand from China, geopolitical considerations and climate influencing individual prices. Exposure would only be considered for the purposes of diversifying a portfolio or hedging against inflation. That said, practical exposure is difficult to obtain, with limited physical ETFs available and a negative house view on synthetic ETFs.*

Terms positive and negative represent our current tactical allocation adjustments to an established and well diversified portfolio. No base asset allocation stipulated.

Conventional Gilt - Yield on Vanguard UK Government Bond Index fund

Index-Linked Gilt - Yield on iShares £ Index-Linked Gilts ETF

UK Corporate Bond (Investment Grade) - Yield on Vanguard Investment Grade Bond Index fund

UK Corporate Bond (High Yield) - Average yield of funds in IMA Sterling High Yield sector.

The Yield on iShares High Yield Corporate Bond ETF is skewed by Euro constituents and is no longer a good proxy.

International Corporate Bond - Yield on PowerShares International Corporate Bond ETF

Emerging Corporate Bond - Yield on iShares JPM $ Emerging Markets Bond ETF

UK Commercial Property - Average of Yield Aviva Property Trust, SWIP Property Trust, M&G Property Portfolio and L&G UK Property Trust

UK Equity Income - 110% of the FTSE All-Share

UK Equity (Other) - Yield on Vanguard UK Equity Index Fund (Benchmark: FTSE All Share Index)

Global (Equity Income)- 110% of the FTSE All-World

European Equity - Yield on Vanguard Developed Europe ex-UK (Benchmark: FTSE Developed Europe ex-UK Index)

North American Equity - Yield on Vanguard US Equity Index Fund (Benchmark: S&P Total Market Index)

Asia Ex Japan Equity - Yield on Lyxor MSCI Asia Pacific Ex-Japan ETF (Benchmark: MSCI Asia Pacific Ex-Japan index)

Japan Equity - Yield on Vanguard Japan Stock Index (Benchmark: MSCI Japan Index)

Emerging Market Equity - Yield on Vanguard Emerging Markets Stock Index (Benchmark: MSCI Emerging Markets Index)

Commodities - TR/Jefferies CRB Index

Note: The yield to maturity figure for various fixed income ETFs has been used as a proxy for yields within each sector.
This metric is calculated by aggregating the yield statistics for each of the securities that make up a bond ETF and is, therefore, reflective of yields within the market.

This is an extract from analysis we conduct internally which also considers other factors such as valuations and liquidity.

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