DT Dewhurst Torevell

Asset Class & Investment Outlook - Q2 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	*UPDATE: Interest rates remain at their historic low, although forward guidance from the Bank of England indicates that they are likely to rise by the second quarter of 2015. Real returns are negative but cash is held in portfolios for liquidity and certainty. We are aware of the increased solvency risks for certain banks and are mindful of the need to monitor deposit providers closely.*
Conventional Gilt	2.12%	No	Negative	Some	No	No	*All the on-going risks to gilts remain as economic growth picks up whilst inflation remains low. 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	2.70%	Yes	Negative (at present)	Some	Yes	No	*Inflation remains subdued in the UK and demand for linkers has been driven by demand and not by fundamentals, making the sector 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)	3.55%	No	Negative	Some	No	No	*Positive corporate cash flows are likely to be priced in whilst 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)	5.30%	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	2.61%	No	Negative	High	No	Yes	*UPDATE: A mixed picture. US corporates may be adversely affected by rising US Treasury yields, although the Federal Reserve will act to prevent a rapid upward movement in yields. European bond yields are supported by low inflation, low interest rates and moderate recovery, whilst some investors are hunting for yield within peripheral economies, although this re-rating is causing spreads to tighten.*
Emerging Corporate Bond	4.83%	No	Negative	Very high	No	Yes	*UPDATE: Dollar-denominated debt is judged to be good value by various commentators, whilst local currency bonds are less appealing because individual cuurency and economic factors need to be scrutinised. 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	2.94%	Yes	Yes	Cyclical	Yes	No	*UPDATE: Positive capital growth is slowly returning, although the main component of total returns is income. Rental growth is beginning to pick up in all areas, in line with economic recovery. 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. Cash levels have reduced in some funds, but remain high in others, dampening returns.*
Infrastructure	2.18%	Yes	Yes	High	Yes, med term	Yes	*We have begun to research the burgeoning global infrastructure sector, with a focus on listed assets in developed markets. Such investments have the potential to offer capital growth and inflation-protected income. We are focussing on funds which invest in companies with robust business models, predictable cash flows, pricing power and high barriers to entry. Rising bond yields and regulatory burdens could be a headwind for some sectors, notably utilities.*
UK Equity (Equity Income)	3.71%	Yes	Yes	High	Yes, med term	No	*UPDATE: The FTSE All-Share yield has been buoyed by Vodafone's huge special dividend payment but many funds have taken steps to limit the effect of this one-off bumper payout by accounting for it as capital rather than income. Underlying dividends will eventually pick up but this will not occur until strong and sustainable earnings growth materialises. However, we remain selectively positive on this sector and retain a focus on funds which invest in high quality, cash generative companies with strong balance sheets.*
UK Equity (Other)	3.34%	Yes	Yes	High	Yes, med term	No	*UPDATE: Detailed UK GDP data for Q4 2013 has revealed a more balanced picture of growth and the Bank of England has upgraded its expectation for 2014 growth to 3.4%. The strength of Sterling has weighed somewhat on exports but overall recovery is now underway. Rising house prices could lead to market intervention if a bubble appears to be developing. Real wage growth has yet to come through constraining consumption, whilst profit warnings from various UK companies raise questions about the validity of earnings growth forecasts. For these reasons we retain a cautious approach to this sector.*
Global (Equity Income)	2.75%	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.*

Asset/Investment Area	Income (Current Yield)	Rising Income	Long Term Real Capital Growth	Volatility	Inflation Protection	Currency Risk	Commentary
European Equity	2.30%	Yes	Yes	High	Yes, med term	Yes - €	*UPDATE: Valuations remain comparatively attractive and competitiveness has improved in many countries but fiscal programmes and structural reforms remain headwinds whilst the loose monetary policy pursued by the European Central Bank has not yet fed through to a number of sectors.*
North American Equity	1.50%	Yes	Yes	High	Yes, med term	Yes -$	*UPDATE: Underlying economic data such a consumer spending, housing and business confidence are improving, although fiscal tightening and higher borrowing costs present constraints to grow. Valuations look quite stretched. US companies have high cash levels suggesting buybacks, dividends and mergers and acquisitions lie ahead.*
Asian ex Japan Equity	1.00%	Yes	Yes	Very high	Yes, med term	Yes	*UPDATE: 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 more sustainable growth levels driven by domestic consumption.*
Japan Equity	1.50%	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	2.31%	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*

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. Yield of 6.65% does not reflect the market.
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 the Yield on Aviva Property Trust, SWIP Property Trust, M&G Property Portfolio and L&G UK Property Trust
Infrastructure - Average of yield on First State Global Listed Infrastructure, CF Canlife Global Infrastructure, CF Macqaurie Global Infrastructure and Lazard Global Listed Infrastructure
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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