Dewhurst Torevell

Asset Class & Investment Outlook - Q3 2014

Asset/Investment Area	Income (Current Yield)	Rising Income	Long Term Real Capital Growth	Volatility	Inflation Protection	Currency Risk	Commentary
Cash	1.00%	Potentially	Negative	Very low	No	No	*UPDATE: Base rates remain well below inflation, although the improvement in the economy suggests that interest rates will rise fairly soon. However, given the high rate of government and consumer indebtedness rates may rise very gradually and some commentators suggest that the eventual "normal" base interest rate could be below 4% in the medium term. We still regard an allocation to cash as important given the uncertainty inherent within equity and bond markets.*
Conventional Gilt	2.10%	No	Negative	Some	No	No	*UPDATE: Surprisingly yields have declined since January 2014 despite the pick up in economic activity and subdued inflation. This is a peculiar situation and one that we do not believe can persist. Eventually high capital values are likely to decline and yields are likely to increase. We therefore remain very cautious.*
Index-Linked Gilt	2.57%	Yes	Negative (at present)	Some	Yes	No	*UPDATE: Inflation remains very subdued and these bonds remain comparatively expensive whilst real yields remain unattractive across the curve.*
UK Corporate Bond (Investment Grade)	3.53%	No	Negative	Some	No	No	*UPDATE: Attractions such as positive corporate cashflows are increasingly priced in, while contagion from government bond markets is likely to affect total returns once prices and yields begin to react rationally to interest rate increases. Spreads are narrower and provide little cushion against the risks associated with a rise in interest rates. Low issuance (other than in the financial sector) is keeping valuations high.*
UK Corporate Bond (High Yield)	5.30%	No	Negative	High	No	No	*UPDATE: Spreads have narrowed a little but the outlook for bond defaults remains supportive. Yields are still relatively attractive in certain sectors as long as the outlook for corporate earnings remains positive. However, we retain a negative view on valuation grounds and because of the risks associated with the increasing amounts of Covenant Lite debt in issue with less restrictions on collateral, payment terms, and level of income than traditional debt.*
International Corporate Bond	2.51%	No	Negative	High	No	Yes	*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	4.59%	No	Negative	Very high	No	Yes	*Dollar-denominated debt is judged to be good value by various commentators, whilst local currency bonds are less appealing because individual currency 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	3.13%	Yes	Yes	Cyclical	Yes	No	*UPDATE: Valuations for prime property are becoming expensive. Rental growth is picking up in all sectors in line with economic recovery. Cash levels are declining within funds as manager conviction increases. Yields look comparatively attractive to some other sectors, although taxes often reduce the amount ultimately received, meaning that only tax efficient funds would be considered.*
UK Equity (Equity Income)	3.65%	Yes	Yes	High	Yes, med term	No	*UPDATE: The noticeable improvement in the domestic economy has yet to translate into substantial earnings growth at the company level. The strength of sterling is acting as a headwind for many overseas-facing companies and may affect dividends somewhat for some of the largest dividend payers in the UK. However, we still believe in the benefits of long-term investment in high quality companies with strong balance sheets.*
UK Equity (Other)	3.15%	Yes	Yes	High	Yes, med term	No	*UPDATE: The number of IPOs and a high level of merger and acquisition activity suggest that markets could be peaking. We remain cautious despite the improvement in economic activity in the UK.*
Global (Equity Income)	2.68%	Yes	Yes	High	Yes, med term	Yes	*UPDATE: We continue to favour equity income funds that focus on developed markets because of the number of cash-generative, defensive stocks with strong balance sheets listed in these markets. Dividend growth is coming through and some special dividends are being paid, but the strength of Sterling is a headwind at the present time.*
European Equity	2.17%	Yes	Yes	High	Yes, med term	Yes - €	*UPDATE: European markets remain attractively valued and there are some high quality, cash generative multinational companies located within the region. At the macroeconomic level the threat of deflation is still hovering and the European Central Bank has cut interest rates, including the introduction of a negative deposit rate, to try to combat this. We retain a neutral view on the region as we wait to see how its diverse economies react to these latest measures.*
North American Equity	1.43%	Yes	Yes	High	Yes, med term	Yes - $	*Underlying economic data such a consumer spending, housing and business confidence are improving, despite the need to revise Q1 GDP figures downwards. Valuations look quite stretched with US markets repeatedly hitting all-time highs. Volatility as measured by the VIX index is low, but there is no guarantee that this will continue to be the case and we now have a neutral view based on valuation. US companies have high cash levels suggesting buybacks, dividends and mergers and acquisitions lie ahead.*

Asset/Investment Area	Income (Current Yield)	Rising Income	Long Term Real Capital Growth	Volatility	Inflation Protection	Currency Risk	Commentary
Asia ex Japan Equity	1.67%	Yes	Yes	Very high	Yes, med term	Yes	*UPDATE: Indian markets have reacted positively to political changes and investors are reassessing their allocation to the country. Worries remain regarding structural changes in China and the need to stabilise the banking and property sectors. Long term growth prospects remain good but it is essential to choose well-diversified funds investing in high quality companies with good corporate governance.*
Japan Equity	1.56%	Yes	Yes	High	Yes, med term	Yes - ¥	*Aggressive economic and monetary policies have fuelled stock markets but the easy gains have likely been made . There is no guarantee that the recently announced structural reforms will be effective, especially as they are likely to be implemented on a piecemeal basis. 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	2.18%	Yes	Yes	Very high	Yes, med term	Yes	*UPDATE: Performance is increasingly divergent; while some countries benefit from strong domestic fundamentals, others are under pressure from political factors, current account deficits and tighter monetary policy required to stabilise depreciating exchange rates. We continue to prefer to access the emerging markets "growth story" through cash generative developed markets players who derive a proportion of their income from emerging markets.*
Listed Infrastructure	2.09%	Yes	Yes	High	Yes, med term	Yes	*UPDATE: Growth orientated sectors such as toll roads, ports and railways are benefiting from the improving economic climate via increasing volumes and operating leverage. Income orientated sectors such as regulated utilities and energy pipelines have benefited from a reprieve in bond yield levels in recent months but are ultimately vulnerable to the increase in bond yields that will accompany rising interest rates.*
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.*

Notes:

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

The yield to maturity figure for various fixed income ETFs has been used as a proxy for yields within most sectors.
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.
Yield figures have been compiled as follows:
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.
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 index
UK Equity (Other) - Yield on Vanguard UK Equity Index Fund (Benchmark: FTSE All Share Index)
Global (Equity Income)- 110% of the FTSE All-World index
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 - Average yield of funds within the Asia Pacific Excluding Japan IMA sector
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)

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

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