DT | Dewhurst Torevell

Economic Commentary – December 2014

Overview

Having started 2014 at 6,749 the FTSE 100 ended the year at 6,566 meaning that a loss has been made in capital terms across the year, although once dividends are taken into account a modest gain of 0.74% has been made by the index.

However, the 3.5% dividend yield available on the FTSE 100 and the 3.3% dividend yield available on the FTSE All-Share remain comparatively attractive, especially in a world where UK benchmark 10-year government bond yields are 1.77% and where the equivalent German government Bunds yield under 0.6%. We therefore continue to use high quality UK and Global Equity Income funds as the foundation for our portfolios.

Fixed Interest and Cash

The outlook for fixed interest markets is quite difficult to judge. Whilst sovereign bonds are poor value at present, inflation expectations remain very subdued and in turn this makes it unlikely that any of the major developed world central banks will raise interest rates aggressively in 2015. This "lower for longer" scenario has led the UK government to recently announce that it will redeem all 6 undated gilts in its debt portfolio when it is value for money to do so. The perpetual 3.5% War Loan used to help fund the First World War will be redeemed in March 2015, allowing the government to take advantage of historically low interest rates.

Corporate bonds are priced using the sovereign yield curve as a reference point and current spread levels between sovereign and investment grade corporate debt are not especially wide. It therefore seems likely that investment grade credit will not be able to maintain the outsized returns gained in a quantitative easing environment. We also remain concerned about liquidity in this sector of the market.

Overall we retain a negative view on fixed interest at the present time.

Cash rates remain at their historic lows. However, we continue to consider it wise to hold some tactical cash which can be deployed when suitable conditions arise to buy other investments at advantageous prices.

US

The S&P 500 gained over 20% in 2014 on a total return basis in Sterling terms. Looking into 2015, we expect the U.S. economy to remain the principal engine of the global recovery, especially in the light of recent positive economic data showing growth of 5% in the third quarter. Economic activity should continue to accelerate, driven by recovering household wealth and the deleveraging that has taken place. However, equity market valuations are stretched relative to other regions and dollar strength could become an issue. Nevertheless, we remain broadly positive on the US and have considerable exposure through our global funds.

UK

There have been some revisions to UK growth figures with the year-on-year growth rate for the 12 months to 30 September revised down from 3.0% to 2.6%. Third quarter GDP growth was solid, however, at 0.7% and we regard the main risks at present to be political in the run up to the General Election.

The major UK market indices have considerable exposure to energy and commodities and this has hampered short-term performance in the light of the large drop in oil prices since the summer. However, our UK Equity Income choices are defensively positioned with lower exposure, and in some cases no exposure, to these sectors and we remain positive regarding their prospects, especially in the long term.

Europe

Fears of deflation continue to predominate within the Eurozone. In the wake of the European Central Bank's move to negative deposit rates, Switzerland has been forced to intervene to defend its currency cap by introducing negative interest rates on instant access deposits of more than 10 million Swiss Francs.

We retain a cautious view on Europe, but recognise that there are a number of high quality, cash generative businesses domiciled within the region.

Asia Pacific and Emerging Markets

Snap elections in Japan have given Prime Minister Abe a mandate to continue with the reform process that he has started but there is no guarantee this will be successful and the country is placing a huge amount of emphasis on its quantitative easing operations which are leading the country into ever greater indebtedness. We therefore remain negative on Japan, despite the fact that a weaker Yen and increased pension investment in equities are lending some support to markets.

China remains in transition to a consumer-led economy and there is expectation that the government growth target for 2015 will be 7.0%, the lowest level since 1990. We remain very cautious regarding China because of the huge changes required to restructure the economy.

Other emerging markets face mixed fortunes depending on whether they are net importers or exporters of energy. We retain a negative view on direct investment in emerging markets, preferring to get our exposure indirectly through high quality multinational businesses.

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