Dewhurst Torevell

Asset Class & Investment Outlook - Q1 2015

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	*Base rates remain well below inflation and the UK Base Rate has remained unchanged at 0.5% since March 2009. However, the consensus among managers that we have spoken to is that interest rate increases will be gradual and that rates will remain fairly low compared to historical levels.*
Conventional Gilt	1.91%	No	Negative	Some	No	No	*UPDATE: Despite the improvement in economic activity, fears of deflation persist and benchmark 10-year gilt yields have continued to fall in consequence. They are now around 1.50%. This is a peculiar situation and one that we do not believe can persist even if markets are pricing in interest rate increases that are only modest. Eventually high capital values are likely to decline and yields are likely to increase. We therefore remain very cautious because many gilts are at risk of an irrecoverable loss of value.*
Index-Linked Gilt	2.26%	Yes	Negative (at present)	Some	Yes	No	*Inflation remains very subdued and these bonds remain comparatively expensive whilst real yields are unattractive across the curve. Demand remains high for these bonds even if the real yield is negative because of the need for defined benefit pensions to match liabilities, which is distorting the market.*
UK Corporate Bond (Investment Grade)	3.30%	No	Negative	Some	No	No	*UPDATE: On a historic basis, yields on UK corporate bonds remain low, and this makes returns challenging and stock picking crucial. Low issuance (other than in the financial sector) is keeping valuations high and we have concerns regarding liquidity and trading capacity if there are large scale outflows from corporate bond funds, despite the measures that some managers have taken to guard against this.*
UK Corporate Bond (High Yield)	4.29%	No	Negative	High	No	No	*The outlook for bond defaults is favourable while the corporate earnings outlook is 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. Market liquidity also remains a concern.*
International Corporate Bond	1.87%	No	Negative	High	No	Yes	*UPDATE: There is a big differential in valuations between Sterling, Dollar and Euro denominated bonds and investors may not be sufficiently compensated for taking the risks associated with Euro denominated bonds, although the ECBs €1.1 trillion QE operations are likely to inflate this market in the coming months. US markets may be insufficiently prepared for the possibility of an interest rate hike in 2015 and we retain a very cautious view as it may be difficult to exit positions during times of market stress.*
Emerging Corporate Bond	4.68%	No	Negative	Very high	No	Yes	*Hard currency denominated emerging market debt continues to perform the best, assisted by the recent strength of the US Dollar. Local currency bonds are less appealing because individual currency and economic factors need to be scrutinised. Lower commodity prices have created risks in some countries and opportunities for others. There may be idiosyncratic opportunities but we remain negative on this sector due to its volatility, poor liquidity and ongoing currency risks.*

Asset/Investment Area	Income (Current Yield)	Rising Income	Long Term Real Capital Growth	Volatility	Inflation Protection	Currency Risk	Commentary
UK Equity (Equity Income)	3.70%	Yes	Yes	High	Yes, med term	No	*UPDATE: The UK economy continues to strengthen. The UK Equity Income managers that we have met with do not anticipate cuts in dividends in general and also expect dividend increases for some stocks. These factors make us positive on high quality, cash generative UK Equities, although we do acknowledge that there are political risks in the run up to the general election in May 2015 and that the rapid decline in oil prices may ultimately threaten the dividends paid by some energy stocks.*
UK Equity (Other)	3.20%	Yes	Yes	High	Yes, med term	No	*UPDATE: Although the market level overall corrected in the autumn of 2014, there remains a significant divergence in the valuations of individual stocks. The decline in oil prices and commodity prices has been detrimental to some sectors and we would only consider well diversified funds with strong prospects for capital growth.*
Global (Equity Income)	2.40%	Yes	Yes	High	Yes, med term	Yes	*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. The strength of the US Dollar should be a tailwind for returns once they are translated into Sterling.*
European Equity	2.42%	Yes	Yes	High	Yes, med term	Yes - €	*UPDATE: Exporters are benefiting from a weaker Euro and QE operations will provide liquidity to markets, although structural reforms in many economies remain imperative in the long term. It is important to remember that there are a number of European countries that are not members of the Euro and these face mixed fortunes, with Switzerland in particular facing a tough time in the short term due to the National Bank's cessation of linking the currency to the Euro and greatly expanded balance sheet. European equities remain attractively valued but we remain cautious because of political uncertainties and the weak economic fundamentals that could weigh on markets. We are also reviewing our fund choices because a number of fund manager changes have taken place recently or are pending in the coming year.*
North American Equity	1.34%	Yes	Yes	High	Yes, med term	Yes - $	*The market remains relatively expensive but favourable economic growth trends should continue to support corporate earnings. Corporate cash is being used for share buy backs and merger and acquisition activities and we are disappointed not to see a greater amount of these balances being deployed to capital expenditures and dividends.*
Asia ex Japan Equity	1.74%	Yes	Yes	Very high	Yes, med term	Yes	*UPDATE: Optimism regarding reforms and stimulus measures have lifted investor confidence although economic data from China remains mixed. Slowing commodity demand has affected countries such as Australia. Long term growth prospects are good but it is essential to choose well-diversified funds investing in high quality companies with strong corporate governance.*
Japan Equity	1.42%	Yes	Yes	High	Yes, med term	Yes - ¥	*UPDATE: Structural reforms remain outstanding but the large scale quantitative easing operations of the Bank of Japan and plans to cut corporation tax rates are supportive to equity markets at present. Markets have been driven by exporters fuelled by a weaker Yen, but we regard this as little more than a currency play. We retain a negative view based on poor demographics and the very high level of government debt.*
Emerging Market Equity	2.05%	Yes	Yes	Very high	Yes, med term	Yes	*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. Lower oil prices have also created "winners and losers". 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.*

Asset/Investment Area	Income (Current Yield)	Rising Income	Long Term Real Capital Growth	Volatility	Inflation Protection	Currency Risk	Commentary
UK Commercial Property	3.29%	Yes	Yes	Cyclical	Yes	No	*UPDATE: The recovery in the economy, combined with low levels of development, means that the balance between demand and supply is now in favour of landlords. London continued to lead in 2014. However, investment outside of London is recovering, especially in the other major cities. Yields look comparatively attractive to some other sectors, although taxes can reduce the yield that is ultimately received. For this reason only tax efficient funds would be considered. From a valuation perspective these funds do not look attractive as inflows have been strong in the last year and we retain a neutral view for this reason.*
Listed Infrastructure	1.84%	Yes	Yes	High	Yes, med term	Yes	*UPDATE: The US has shown the best regional performance recently with toll roads, ports and railways all benefitting from economic growth, although pipelines have suffered with the decline in oil price. Regulated utilities remain vulnerable to rising bond yields once interest rates are raised in the stronger economies. It remains to be seen whether the QE operations commenced by the ECB will feed through into increased economic activity with a related upswing for certain infrastructure sectors such as transport.*
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 to commodities 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. Oil prices have fallen dramatically and it remains unclear where equilibrium will ultimately lie in this market.*

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
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 FTSE 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)
Commodities - TR/Jefferies CRB Index

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

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The value of investments can go down in value as well as up, so you could get back less than you invest. It should be remembered that past performance is not necessarily a guide to future performance.

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