# Economic Commentary – February 2015

**Overview**

Starting with a broad view we note that the recently published 2015 edition of the Barclays Equity Gilt study once again makes the case for long term investment in equities. From 1960 to 2014 in the UK the average real return on equities has been 5.3% a year, assuming dividends are reinvested. Gilts have offered about half that rate, at 2.7%, even taking into account the strong performance of recent years when yields have fallen and prices have risen substantially. It is reassuring to once again see our investment philosophy, with its strong bias towards equity income, vindicated by this well regarded and widely read annual study.

Turning to recent market movements, on 24 February the FTSE 100 passed the peak of 6,930 it previously achieved in 1999 to close at 6,949 (although this is purely in capital terms, if reinvested dividends are taken into account a new peak would actually have been reached in 2006). The index today is nowhere near as overvalued as it was in 1999 at the height of the technology bubble, when it traded at over 30 times historic earnings. It is about half that level now. Additionally, the earnings of the companies included in the index have doubled since then. Overall, compared to gilts, UK equities still look relatively good value, despite the QE-fuelled bull run of recent years.

Sovereign bond yields continue to be at very low levels with the yield on 23% of all Eurozone sovereign debt below zero in nominal terms. The potential for permanent capital loss in this asset class remains. Our asset allocation views are therefore unchanged with UK and Global Equity Income forming the foundation for portfolios together with a cash cushion. We retain a very cautious view on fixed interest.

**US**

The US economy continues to strengthen assisted in part by low oil prices. Employment and wage growth is rising and this positive environment is driving expectations that interest rates will be increased in the second or third quarter of 2015. Economic growth should support corporate earnings to a point, although the strength of the US dollar and wage growth will have an impact. We retain some caution on the US, in part because of the comparatively low dividend yield available in this market with the S&P 500 paying out 1.96% compared to 3.3% for the FTSE All-Share.

**UK**

The UK economy grew 0.5% in the final quarter of 2014 and inflation remains low. We retain our focus on high quality, income generative companies and would view any volatility which arises in the run up to the general election as short term "noise" which should not distract us from long term objectives.

**Europe**

Anticipated liquidity from forthcoming quantitative easing operations has driven Eurozone equities up and caused the Euro to weaken further against other major currencies. Whilst we recognise that the

European economy could surprise on the upside this year we retain a cautious approach, only investing in funds which focus on high quality companies with global revenue streams and which also have exposure to countries in Europe with independent currencies.

**Asia-Pacific and Emerging Markets**

We maintain a cautious view of the Asia-Pacific region and continue to avoid direct investment in emerging markets.

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