Economic Commentary – March 2015

Overview

Inflation remains extremely subdued in many developed economies, whilst government bond yields are continuing to fall due to the low interest rate environment and the large-scale quantitative easing operations being pursued by the European and Japanese central banks. Equities therefore remain an attractive source of income for investors and we retain our focus on high-quality, cash generative equity investments combined with an appropriately sized allocation to cash.

Fixed Interest

The European Central Bank intends to buy €850 billion worth of sovereign bonds over the next 18 months. However, the relevant governments only plan to issue around €400 billion of sovereign bonds in this time period, meaning that the ECB will be a “forced buyer” and will need to buy some bonds from existing holders such as pension funds and insurance companies. This is likely to inflate the price of these bonds and therefore to push yields down further. In this environment negative bond yields are likely to become pervasive within Europe. Moreover, European interest rates may be forced further into negative territory as well because the ECB has pledged to buy sovereign bonds in the 2-30 year maturity range provided that their yields are above the deposit rate and cuts to interest rates may therefore become necessary to fulfil this promise. What is clear is that other fixed interest markets which are priced off “safe” assets such as German Bunds will be distorted, in an environment where global fixed interest markets have already been inflated by previous quantitative easing activity on the part of the US, UK and Japanese authorities. Ultimately we see the potential for irreversible capital loss within this asset class and we retain our negative view on fixed interest at the present time.

UK

Consumer Prices Index (CPI) inflation was zero in February 2015 due to lower prices for food and some imports. However, inflationary pressures could re-emerge due to wage growth, including the increase in the minimum wage announced during the budget.

UK markets have forged ahead so far in 2015 with the FTSE 100 up from 6,566 at the beginning of the year to 6,855 and the market’s comparatively high dividend yield remains attractive in a global context. The general election is too close to call and this could lead to volatility in the lead up and aftermath but as long-term investors we have not changed our selectively positive view on this market.

US

The US undoubtedly has the strongest developed world economy and a number of world leading companies are domiciled there but stock market valuations look stretched and a strengthening US dollar is presenting a headwind for multi-national companies. We therefore retain a cautious view on the US at this time.

Europe

The ECB's quantitative easing operations have provided support to the region's equity markets, whilst a weaker Euro may assist exporters. High quality, dividend paying companies with robust cash flows are likely to benefit as investors hunt for yield outside of the fixed interest asset class and our Global Equity Income and European fund choices should be well-positioned to benefit. The main risks are political as Greece renegotiates its deficit and with the possibility of a UK referendum on EU membership on the horizon.

Asia Pacific and Emerging Markets

The main achievement of Japanese quantitative easing so far has been a much more competitive yen, which has assisted exporters. The slowdown in China persists and growth targets could be lowered this year. However, India has performed well in the last year on the back of its ambitious reform agenda. Overall we retain a cautious view on the region and would only consider defensive funds which are well-diversified and invest in high quality companies.

Emerging markets continue to lag developed markets in terms of economic recovery. We retain a negative view on direct investment in these markets.

Alan Torevell and Georgina Ogilvie-Jones

Dewhurst Torevell & Co. Ltd, 5 Oxford Court, Manchester M2 3WQ. Tel. 0161 281 6400.
www.dewhurst-torevell.co.uk