DT Dewhurst Torevell

Asset Class & Investment Outlook - Q2 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	1.80%	No	Negative	Some	No	No	*Despite the improvement in economic activity, benchmark gilts yields remain suppressed at around 1.50% following an extraordinary era of monetary policy. 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	2.37%	Yes	Negative (at present)	Some	Yes	No	*Inflation remains very subdued and CPI inflation is now zero. 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.*
Sterling Corporate Bond (Investment Grade)	3.10%	No	Negative	Some	No	No	*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.*
Sterling Corporate Bond (High Yield)	4.58%	No	Negative	High	No	No	*UPDATE: Strong demand from income-seeking investors continues to drive this market and default rates remain low. However, market liquidity remains a concern and we also consider the market to remain rather over-valued.*
International Corporate Bond	2.64%	No	Negative	High	No	Yes	*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	4.73%	No	Negative	Very high	No	Yes	*UPDATE: Slower economic growth, a strong US Dollar, weak commodity prices and the possibility that US interest rates will soon begin to increase increases the likelihood of default in the emerging market debt sector. 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)	3.54%	Yes	Yes	High	Yes, med term	No	*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, especially when bond yields remain so compressed. However, 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)	3.17%	Yes	Yes	High	Yes, med term	No	*UPDATE: UK equities have demonstrated good returns so far this year and although volatility may lie ahead in the run up to the general election, mid-cap stocks may prove less sensitive to political developments than large-caps. We will only consider well diversified funds with strong prospects for capital growth.*
Global (Equity Income)	2.54%	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. According to the latest Henderson Global Dividend Index report, global dividends grew 10.5% to $1.167 trillion in 2014, a new record. The continued strength of the US Dollar should be a tailwind for returns once they are translated into Sterling.*
European Equity	2.44%	Yes	Yes	High	Yes, med term	Yes - €	*UPDATE: The commencement of quantitative easing operations has fuelled European equity markets in the short term and it is anticipated that QE will reduce deflation risks, mainly through the impact of a weaker Euro, although this benefit has yet to be felt. Nevertheless, a number of uncertainties remain, mainly centred upon political risks and concerns regarding the monetary transmission mechanism in the Eurozone. We therefore retain a neutral view on Europe. Additionally, our fund choices remain under review following the announcement of various changes to management.*
North American Equity	1.26%	Yes	Yes	High	Yes, med term	Yes - $	*UPDATE: U.S. stocks continue to reach new highs and valuations are no longer cheap. In fact, the S&P 500 has generated a total return of around 150% in Sterling terms since its lowest point, in 2009. These returns have been driven by steady economic growth, strong corporate earnings and improving investor confidence. However, the strength of the US dollar has recently been a drag on the 45% of US companies who generate their revenues overseas. We retain a cautious view based on valuations and the possibility of interest rate increases at some point in 2015.*
Asia ex Japan Equity	2.05%	Yes	Yes	Very high	Yes, med term	Yes	*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	1.37%	Yes	Yes	High	Yes, med term	Yes - ¥	*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	2.16%	Yes	Yes	Very high	Yes, med term	Yes	*UPDATE: Emerging markets continue to lag developed market recovery. Reliance on external finance exposes many emerging markets to shocks and the sector tends to underperform during periods of US dollar strength. Volatility is a feature of the sector and we continue to prefer to gain exposure to the long-term growth and rising affluence in emerging markets through high quality developed market companies that generate a proportion of their revenues from these countries.*

Asset/Investment Area	Income (Current Yield)	Rising Income	Long Term Real Capital Growth	Volatility	Inflation Protection	Currency Risk	Commentary
UK Commercial Property	3.62%	Yes	Yes	Cyclical	Yes	No	*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 property 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	1.82%	Yes	Yes	High	Yes, med term	Yes	*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 because of their complexity.*

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

Disclaimer:

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