Economic Commentary – April 2015

Overview

We have had a number of meetings with fund managers in recent weeks, including Neil Woodford of Woodford Investment Management, Derek Stuart and Nick Shenton of Artemis, and Richard Pease and Simon Rowe of Henderson (and Crux). We have also seen a number of managers whose funds are not currently held in our client portfolios including Julian Fosh of Liontrust and Carl Stick of Rathbone. These meetings have helped refresh and in some cases reinforce our asset allocation and economic views in addition to providing us with helpful insights on the funds that they manage.

Global asset prices continue to be distorted by extraordinary monetary policy with quantitative easing now centred upon Europe and Japan and with low interest rates continuing to prevail in the other developed economies. Budget deficits remain high in many economies, despite the austerity measures attempted by some in recent years. This high level of government debt combined with a need to keep consumer and mortgage debt payments manageable for the electorate means that a "lower for longer" interest environment is likely, with only modest interest rate increases when they do occur.

Fixed interest markets remain stretched with extraordinarily high capital prices and associated low (and in many cases negative) yields creating the possibility of irrecoverable capital loss when yields eventually rise. German 10-year Bund yields were 1.94% at the beginning of 2014, but fell to a record low of 0.05% earlier in April and remain incredibly low at 0.15%, illustrating the distortions that quantitative easing creates.

We continue to structure our portfolios using funds investing in high quality, income generative equities with a cash element that can be deployed when a more rational environment comes into play.

UK

The initial estimate for first quarter GDP was a little disappointing being 0.3%, which is lower than the consensus estimate of 0.5%. However, the data also indicate that the economy grew 2.4% compared to a year ago and it is important to remember that this initial release is based on less than half of all the available data that comprises the final measurement, which can be subject to heavy revisions.

Although there is an element of unpredictability surrounding the forthcoming General Election, in practice there may well be little impact on the stock market whatever the outcome because so many FTSE 100 companies are internationally orientated, although there could be implications for particular sectors.

US

The US economy has been through a soft patch, although lower energy prices and improving wage growth should assist consumers going forward. On the other hand US equity markets face some headwinds as continued US dollar strength threatens earnings growth for companies with geographically diversified revenue streams.

Europe

Business and sentiment surveys have improved within the Eurozone since quantitative easing operations began, although inflation is still negative and unemployment remains high. The weaker Euro should support earnings growth, a further positive for equity markets already buoyed by quantitative easing. However, political risks remain and are centred upon negotiations regarding the Greek deficit and conflict in the Ukraine.

Asia Pacific and Emerging Markets

Economic growth in China has faltered leading to two interest rate cuts in a quarter and more reductions in bank reserve requirements. This is likely to boost asset prices but may take a while to feed through into the rest of the economy whilst structural change is underway.

Recovery in Japan remains fragile and even larger central bank asset purchases may be required if the 2% inflation target is to be achieved. The government is attempting to encourage corporate reform and some companies are increasing returns to shareholders but we retain a negative view of this market based upon the uncertainty surrounding structural reform, demographics and the high level of sovereign debt. Growth in many emerging market economies is likely to remain challenged by a stronger US dollar and low commodity prices.

Our view on these areas remains unchanged and features a selective approach to Asia Pacific and a negative view on Japan and Emerging Markets.

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