Dewhurst Torevell

Asset Class & Investment Outlook - Q3 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	*UPDATE: The UK Base Rate has remained unchanged at 0.5% since March 2009. However, interest rates are expected to rise by mid-2016, despite the very low level of inflation prevailing at the moment. 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. Therefore, the returns available to investors holding cash are likely to remain subdued for some time yet and we retain our neutral position.*
Conventional Gilt	1.87%	No	Negative	Some	No	No	*UPDATE: Gilt markets suffered a pull-back between April and May and the major gilt indices are slightly negative for the year to date. The benchmark yield has moved up to nearly 2% after starting the year at 1.76%. Recent market moves provide a hint of the volatility that may arise when markets have to adjust to interest rate increases and yields rise further. Overall conventional gilts remain vulnerable to irrecoverable capital loss after the huge increases in capital values that were driven by quantitative easing operations and we retain a very negative view.*
Index-Linked Gilt	2.04%	Yes	Negative (at present)	Some	Yes	No	*UPDATE: Inflation remains very subdued and CPI inflation is now below zero, although RPI inflation is still at 0.9% reflecting the inclusion of housing costs. FTSE Actuaries data indicates that these bonds remain very fully valued across all maturities with correspondingly low yields. The market is also distorted by the need for defined benefit pension funds to match liabilities. We retain a negative view based on valuation.*
Sterling Corporate Bond (Investment Grade)	3.12%	No	Negative	Some	No	No	*UPDATE: Investment-grade corporate bonds are very fully valued as prices have been driven up by income seeking investors moving up the curve from low yielding government bonds. Liquidity remains untested and we believe that this area could be subject to contagion from any fall in gilt prices and rise in yields once interest rates begin to rise. We remain very cautious on this asset class.*
Sterling Corporate Bond (High Yield)	4.62%	No	Negative	High	No	No	*UPDATE: The bond default outlook is favourable but market liquidity remains a concern and we are also uneasy about the large amounts of issuance to take advantage of historically low interest rates with low coupons and yields.*
International Corporate Bond	2.31%	No	Negative	High	No	Yes	*UPDATE: Euro-denominated credit has been boosted by the ECB's quantitative easing programme and a low inflation environment. However, we retain a very negative view on European debt due to the large number of bonds with negative yields, including some corporate issues. The situation in Greece requires careful monitoring as this is driving a reassessment of peripheral bonds with a knock-on effect for other markets. We are also wary of Dollar-denominated debt as US interest rates are likely to rise in the near future, driving bond yields up and capital values down in an environment where liquidity is untested.*
Emerging Corporate Bond	4.44%	No	Negative	Very high	No	Yes	*Slower economic growth, a strong US Dollar, weaker commodity prices and an imminent US interest rate rise 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.*

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UK Equity (Equity Income)	3.58%	Yes	Yes	High	Yes, med term	No	*UPDATE: We are keeping a close eye on the positioning of our UK Equity Income fund choices to ensure that there isn't too much exposure to overvalued "bond proxies" in sectors such as consumer staples and utilities. We are also aware of the poor dividend cover that some of the major oil companies have and are reassured that the sources of income within our fund choices is well diversified. We maintain our selectively positive view on UK Equity Income based on the perceived long term benefits of investment in high quality cash-generative companies with the potential for both income and capital growth.*
UK Equity (Other)	3.02%	Yes	Yes	High	Yes, med term	No	*UPDATE: Improved economic data is driving markets, but profit margins are coming under pressure from a mixture of currency strength and commodity price weakness. In the medium term, political uncertainty surrounding the EU referendum could become an issue. We therefore retain a neutral view.*
Global (Equity Income)	2.59%	Yes	Yes	High	Yes, med term	Yes	*UPDATE: Many global income stocks are very fully valued because investors have switched from bonds to income generative equities in the hunt for yield. Income growth could be stymied in 2015 by the currency effects of a strong Dollar and a weak Euro. However, taking a long term view we remain selectively positive on this sector and we continue to invest in a range of funds which are complementary and diversified with a focus on achieving total returns from a portfolio of high quality equities.*
European Equity	2.30%	Yes	Yes	High	Yes, med term	Yes - €	*UPDATE: The FTSE Developed Europe ex-UK index has total returns of over 10% in the year to date in Sterling terms. The pace of this liquidity fuelled European equity rally leads us to be cautious where valuations are concerned and implies the need for continued strong earnings growth to sustain the rally and a selective approach to investing in the region.*
North American Equity	1.23%	Yes	Yes	High	Yes, med term	Yes - $	*UPDATE: Economic growth and investor sentiment are supportive. However, valuations are expensive and the strong dollar is driving down overseas earnings. Lower oil prices are benefitting consumers but weighing on investment. We have a slightly negative view based on valuations and the possibility of volatility once interest rate rises get underway.*
Asia ex Japan Equity	1.46%	Yes	Yes	Very high	Yes, med term	Yes	*UPDATE: China has cut interest rates in a bid to stimulate its flagging economy and is also making progress on capital market liberalisation with HK-registered funds now able to be sold directly to investors in mainland China. Both moves have provided short-term support to Chinese equities but we are still cautious on the long-term outlook for China as it transitions to more realistic growth rates and attempts to move to a consumer-led economy. India's economy grew by over 7% in nominal terms in the last year, fuelled by interest rate cuts and lower oil prices. Long term growth prospects for the region are good and we retain a selective approach focused on high quality companies.*
Japan Equity	1.26%	Yes	Yes	High	Yes, med term	Yes - ¥	*UPDATE: The Bank of Japan is taking action to reach its inflation target and its quantitative easing programme is unique in that both equities and bonds are being purchased. Together with pension reforms this is driving equity markets forward but we remain extremely cautious because structural reforms remain outstanding and longer term issues such as negative demographics and the large scale of government debt cannot easily be resolved.*
Emerging Market Equity	2.02%	Yes	Yes	Very high	Yes, med term	Yes	*UPDATE: Economies that are dependent on commodity exports have deteriorated while those with strong domestic fundamentals are improving. Current account positions and monetary policy are other areas of differentiation and this is creating "winners" and "losers" among the diverse group of countries which this sector encompasses. Rather than attempting to pick "winners" we continue to prefer to gain exposure to emerging markets indirectly through high quality developed market companies that derive 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	2.91%	Yes	Yes	Cyclical	Yes	No	*UPDATE: Yields on UK property have fallen in absolute terms in the last 2 years. A positive gap remains between property and fixed income yields, but in-house analysis has found that the yield on good quality Global or UK Equity Income funds is at least as good as, and in many cases is better than, the major UK commercial property funds that we monitor. However, there is potential for capital growth because a more robust economic environment has converted into stronger tenant demand and some uplift in rents.*
Listed Infrastructure	1.42%	Yes	Yes	High	Yes, med term	Yes	*UPDATE: The US continues to lead the way as economic growth has benefitted volume-sensitive areas such as rail freight and toll roads. The mobile towers sector is experiencing structural growth due to mobile data and video demand. Gas transmission and distribution and storage technology for renewables are also growth areas. It remains to be seen whether European QE operations will translate into improved economic activity with an associated uptick for transport and energy infrastructure.*
Commodities	0.00%	No	Yes	Extreme	Yes, med term	Yes	*UPDATE: Various factors influence individual commodity prices including US dollar appreciation, Chinese demand, Middle East tensions and climatic conditions. Oil appears to have found a price floor at around $50 per barrel but prices remain low compared to previous levels. Gold prices are now below $1,200, significantly below the peak of over $1,800 in 2011. We retain our negative view on commodities based on their volatility and the difficulties of obtaining exposure to them with limited physical ETFs available and with a negative house view on synthetic ETF strategies.*

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, Aberdeen Property Trust, M&G Property Portfolio, Henderson UK Property, F&C UK Property 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 FTSE UK 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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