Economic Commentary – August 2015

Overview

Global equity markets corrected sharply during the month due to renewed concerns regarding growth prospects for China. After a period when valuation of many stocks have been stretched this will have provided opportunities for long term investors, such as the managers of the funds we have carefully selected, to buy stocks on their "wish list" at more attractive prices and this should provide some comfort to investors following the recent volatility. We also feel vindicated in having retained a cash cushion within portfolios to provide some protection against the inherent overvaluation which had arisen in both equity and bond markets.

Markets stabilised somewhat following monetary policy action in China and the FTSE 100 is now at 6,247 having started the year at 6,566. In total return terms the index has made a loss of 2.1% in the year to date, a similar loss to the S&P 500 which has lost 2.5% in the year to date in US Dollar terms.

Whilst the outlook for capital growth within equity markets remains uncertain, the outlook for dividends is encouraging. Although the latest Henderson Global Dividends report notes the ongoing detrimental effect that a strong US dollar has had on dividend payments, the report forecasts global dividend payments of $1.16 trillion in 2015 driven by strengthening underlying dividend growth. The report also notes increased dividend payouts in certain sectors such as financial services.

Bonds and Cash

Demand for "safe haven" sovereign bonds increased as equity markets corrected leading to a new wave of low yields as their prices increased. Yields on 10-year UK Gilts and US Treasuries are around 2%, whilst comparative German Bunds are just 0.72%. We retain our negative view on fixed interest and continue to believe that ultimately these bonds will be anything but a "safe haven" when prices inflated by quantitative easing and low interest rates come to more realistic levels, with a corresponding rise in yields.

The UK Consumer Prices Index has been almost flat for the past six months, having turned negative in April for the first time since 1960. The rate was mildly positive in July at 0.1%, but with renewed downward pressure on oil prices recently the inflation outlook remains comparatively benign. This is good news for cash holdings where only very limited erosion of purchasing power will have taken place.

US

US second quarter growth data was revised upwards to 3.7% and employment data continues to improve. This has helped to underpin equity markets. The Federal Reserve may delay raising interest rates following the recent equity market volatility but the strengthening US economy means it cannot continue to delay an increase indefinitely.

We still have a cautious view on the US based on equity market valuations, despite the recent correction.

Europe

Worries regarding Greece have receded for now, following agreement of additional funding by the ECB. Ultimately there will need to be a robust solution to the issues of Greek debt and competitiveness, however painful, rather than a series of interim measures.

Eurozone inflation remains low at 0.2% and growth in the second quarter was disappointing at 0.3%.
On the positive, according to Barclays Capital, Eurozone corporates have grown their earnings by 18% year on year in the second quarter of 2015, accelerating from 11% in the first quarter.

Growth remains very uneven within the Eurozone and structural issues remain. We therefore continue to favour funds which also invest in non-Eurozone countries.

Asia Pacific and Emerging Markets

We retain a negative view of China's partially command economy, in particular the government's attempts to intervene in stock markets. The funds we invest in within the region have greater exposure to India and also to developed markets in the region such as Australia. Whilst these economies are not without their own problems we have faith in the fund mangers' stock choices which are focussed on well-established, defensive companies with good corporate governance.

We maintain a negative view on Japan and on emerging markets.

Alan Torevell and Georgina Ogilvie-Jones