Economic Commentary – September 2015

Overview

The FTSE 100 started the year at 6,566 and reached an all-time high of 7,122 in late-April, driven by an improving economic outlook and by the impending increased liquidity provided by European quantitative easing. In common with most global equity markets, the UK stockmarket was hot by concerns about the Chinese economy and global growth. The FTSE 100 fell to 5,768 in August (down nearly 20% from its peak) before ending September at 6,061. Asian and Emerging Market stock markets exhibited sharper falls in value.

We believe it is important to ignore short term volatility in markets and to remain focused on the longer term growth potential for high quality cash generative equities. It is heartening that our UK Equity Income fund choices have once again proven to be resilient in adverse market conditions and have performed better than the major UK indices since the beginning of the year.

Bonds and Cash

The recent volatility in markets and uncertainty regarding global growth led both the Federal Reserve and the Bank of England to hold interest rates at their historically low levels in their September meetings. Interest rate rises appear imminent and despite the fact that they are expected by bond markets we do anticipate that they will cause a steady rise in bond yields and a corresponding erosion in capital values because so many sovereign and corporate bonds are seriously overpriced at the present time. We are also concerned that liquidity could dry up in adverse market conditions. We therefore retain our very negative view on fixed interest investments.

We continue to view a cash element in portfolios as important as a “stabiliser”.

UK

A clear upward shift in average earnings growth towards pre-crisis levels has taken place. Headline inflation is low and employment levels are rising, driving consumer confidence to its highest level in 15 years. We are selectively positive on UK equities.

US

On the positive side US economic growth remains strong but the strength of the dollar and oil price weakness has affected earnings growth for US stocks. We retain our cautious view of this market based on these factors and because US equities still look overvalued despite the recent market falls.

Europe

Data from the Eurozone is consistent with ongoing recovery. GDP growth estimates for the first half of the year have been revised higher and peripheral economies have produced some of the strongest data in the second quarter. For instance, Spain's GDP rose by 1% and Ireland's GDP rose 2% quarter-on-quarter.

We remain focused on well diversified European funds which invest a portion of the portfolio outside of the Eurozone.

Asia and Emerging Markets

Emerging market equities have been underperforming compared to developed market equities since Chinese growth peaked in 2010. The challenges China faces are persistent and are likely to continue to weigh on emerging markets and commodity producers for the foreseeable future. We have a negative view on emerging markets and continue to focus on Asia Pacific funds which invest in high quality, defensive stocks.

Despite a massive quantitative easing programme Japanese inflation remains low whilst government debt rises ever higher. We retain our negative view on this market.

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