DT Dewhurst Torevell

Economic Commentary – December 2015

Overview

Equity markets were quite volatile in 2015, with the FTSE 100 going through 7,000 for the first time ever to achieve a record high of 7,122 in April, before slumping to a low of 5,768 in September amid uncertainty over global growth. The index finished the year down by just over 1% on a total return basis, following on from a flat year in 2014. A review of the data reveals that most major developed markets have been lacklustre in 2015 when currency effects are stripped out, for instance, the S&P 500 returned under 1% in dollar terms in 2015. The exceptions were Europe and Japan, both of which are fueled by quantitative easing at present.

Once again active management has apparently proven its worth in volatile market conditions. It is pleasing to note that the vast majority of our carefully selected UK and global Equity Income funds have greatly outperformed the most relevant index of the FTSE 100, FTSE All-Share and FTSE All-World in 2015, with the only notable exception being M&G Global Dividend, which is being carefully monitored.

Commodity prices have continued to weaken, in particular oil, where prices have fallen over 30% across the year. Individual sector and company returns within the FTSE All-Share have shown great polarity in 2015 with sectors such as consumer goods up nearly 18% and oil and gas and mining down over 15% and 45% respectively. The Equity Income funds we invest in have a focus on sustainable dividends, which automatically excludes a number of companies, especially in the resources sectors, where dividends will be tested in the coming year.
Looking forward to 2016, it seems the developed economies are set to continue their gradual and modest recovery against a backdrop of very low inflation and slowing global trade volumes. Monetary policies are diverging with quantitative easing in full swing in Japan and Europe and with interest rate increases underway in the US, with the UK likely to follow. Interest rate increases are likely to be incremental, well telegraphed and fairly low rather than sudden hikes which should provide some support to markets.

Fixed Interest and Cash

2015 was a difficult year in corporate credit markets and spreads widened compared to sovereign debt. Concerns over liquidity came to the fore in the last month when two high yield bond funds in the US had to suspend redemptions due to a high level of sales ahead of the US interest rate rise. Around £4 billion was withdrawn from high yield bond funds in just one week and tremors were also felt within the fixed interest exchange-traded fund market.

We remain negative on the outlook for fixed interest across the credit spectrum and continue to believe that a cash “cushion” is essential within portfolios.

UK

The UK’s unemployment rate fell steadily in 2015. Exceptionally low inflation, driven largely by falling oil prices and supermarket price wars has boosted household finances and consumer spending has grown.

Yet the pace of UK economic growth overall slowed in the third quarter of the year and sector performance is mixed. Services are growing robustly but manufacturing and construction are struggling. The referendum on whether to remain in the European Union is one of the biggest risks for the coming year and has the potential to detrimentally influence markets.

US

The US labour market is tightening and wage increases could stoke inflation in the coming year.
A recent Barclays report revealed that companies in the S&P 500 have repurchased $2.6 trillion of stock in the last 5 years, more than the Federal Reserve spent on quantitative easing and equating to 15% of the market capitalisation of the S&P 500. Buybacks have acted as a prop for US equity markets and US earnings growth has stalled, while profit margins continue to moderate. We remain vigilant on US markets because they look very overvalued.

Europe

There are some signs of recovery in Europe, but unemployment remains high, especially among young people. The outlook for 2016 is an uneven recovery with growth averaging just over 1%. Low inflation, large amounts of debt, and a lack of structural reform in the financial sector all represent headwinds to growth. Quantitative easing has lifted asset prices, but the real economy has yet to follow. We therefore retain a cautious stance on Europe.

Asia and Emerging Markets

China continues to face some troubles as it switches from an industrial to a consumer-led economy. A number of commodity producing emerging markets have been hit by the slump in commodity prices. Overall we remain circumspect with regard to Asia with a focus on quality companies and retain a negative view on emerging markets.

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