DT Dewhurst Torevell

Asset Class & Investment Outlook - Q2 2016

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: Interest rates remain very low, but we still consider a cash component to portfolios to be important because we remain wary about valuations in both equity and bond markets. Inflation remains subdued at present but the impact of previous commodity price weakness will become less marked over time.*
Conventional Gilt	1.77%	No	Negative	Some	No	No	*UPDATE: Conventional gilts with a 10 year maturity continue to yield less than UK equities and look very expensive relative to equities on an historic yield basis. The yield offered by 10 year gilts is well below its 10 year average and is likely to rise when the Bank of England raises interest rates. An increase in inflation would also be a risk. Ultimately gilt yields will rise and prices will fall, a process which will create irrecoverable capital losses for some and we remain very negative on these bonds.*
Index-Linked Gilt	0.39%	Yes	Negative (at present)	Some	Yes	No	*UPDATE: Index-linked gilts remain overvalued and offer low or even negative real yields. Some funds investing in these bonds do not pay any yield at present because the real yields on the underlying instruments are currently negative thus causing an insufficient accrual basis for dividend distribution. Liability matching requirements for some pension funds creates a ready market, making it unlikely that these bonds will become more realistically priced in the near future and we remain negative at this time.*
Sterling Corporate Bond (Investment Grade)	3.08%	No	Negative	Some	No	No	*UPDATE: Credit spreads have widened and bond liquidity remains a real issue with anecdotal evidence suggesting that many corporate bonds can only be traded in blocks of around £1 million at a time. We retain a negative view overall, although we recognise that there may be pockets of opportunity and continue to have regular meetings with specialists in this area.*
Sterling Corporate Bond (High Yield)	4.52%	No	Negative	High	No	No	*UPDATE: Higher yields are available than in other markets but we consider this market to be especially susceptible to liquidity risk and have a negative view.*
International Corporate Bond	2.21%	No	Negative	High	No	Yes	*UPDATE: Wide spreads have arisen between US and EU corporate bonds due to differences in monetary policy. The ECB decision to begin purchasing non-financial corporate bonds as part of its quantitative easing activities has pushed prices up and yields down and creates further distortions in bond markets. We also have concerns regarding liquidity leading us to retain a negative view.*
Emerging Corporate Bond	4.78%	No	Negative	Very high	No	Yes	*UPDATE: If US yields rise further US dollar denominated emerging market bonds would be at risk. Local currency bonds require careful examination of individual currency and spread factors. We remain negative on this sector due to its volatility, poor liquidity and ongoing currency and interest rate risks.*

Asset/Investment Area	Income (Current Yield)	Rising Income	Long Term Real Capital Growth	Volatility	Inflation Protection	Currency Risk	Commentary
UK Equity (Equity Income)	4.11%	Yes	Yes	High	Yes, med term	No	*UPDATE: There is evidence of declining dividend cover for many of the top dividend paying companies in the UK which is a source of concern as the dividend yield of the FTSE 100 is concentrated in relatively few companies. It is important to realise that the picture is nuanced, with the situation for the market as a whole being very different to the positioning of our favoured funds. We have discussed the outlook for dividends during our regular meetings with UK and global equity income managers in the last few months and several have adjusted their portfolios to remove any holdings where dividends could be vulnerable and to rotate into stocks which have good long term dividend growth potential. We also believe that stocks which pay dividends should prove comparatively resilient if volatility arises as a result of the upcoming EU referendum.*
UK Equity (Other)	3.74%	Yes	Yes	High	Yes, med term	No	*UPDATE: Short-term political uncertainty must be weighed against domestic economic strength. Active management , selective investment and a focus on quality companies is essential because a large proportion of the wider market is susceptible to weaker commodity prices, slowing emerging markets and more stringent bank regulations.*
Global (Equity Income)	2.90%	Yes	Yes	High	Yes, med term	Yes	*UPDATE: Recovery in developed markets is broadly on track and we believe equity market weakness at the beginning of 2016 is attributable to over emphasis on the possibility of recession. We remain focused on funds investing in high quality companies that are likely to sustain profit margins and deliver returns through the economic cycle and which offer growing and sustainable dividends.*
European Equity	2.65%	Yes	Yes	High	Yes, med term	Yes - €	*UPDATE: On the macroeconomic front, GDP figures showed the Euro-area economy maintaining its recovery momentum at the end of 2015, though displaying some divergences across the region. European equities are more fairly valued than US equities and are being spurred by the European Central Bank's quantitative easing measures. We remain cautious due to political uncertainty and a lack of structural reform.*
North American Equity	1.52%	Yes	Yes	High	Yes, med term	Yes - $	*UPDATE: Valuations remain high at 22X P/E despite lower earnings expectations. Profit momentum has slowed at the market level due to the stronger US dollar and weaker commodity prices. Wage increases may stoke inflation. Political risk is also evident in the run up to the presidential election. We therefore remain slightly negative.*
Asia ex Japan Equity	1.71%	Mixed	Yes	Very high	Yes, med term	Yes	*UPDATE: China is committed to shifting its economy from resources to services and this will continue to weigh on global trade and to have implications for the entire region. We remain very selective with investments concentrated in defensive funds. The downturn has given fund managers the chance to buy quality companies at reasonable valuations.*
Japan Equity	1.52%	Mixed	Yes	High	Yes, med term	Yes - ¥	*UPDATE: Confidence in reforms is waning. Aggressive monetary policy featuring negative interest rates and quantitative easing has ultimately had limited effects on the real economy. We retain a negative view on having dedicated exposure to this market but recognise that it is important to keep in mind there are some outstanding multi-national companies in Japan with similar qualities to other developed world peers.*
Emerging Market Equity	2.63%	Mixed	Yes	Very high	Yes, med term	Yes	*UPDATE: Studies have failed to show a link between high economic growth in emerging markets and resultant stock market performance. This is most likely because shareholders have to share the fruits of economic growth with government interests and labour (through increased wages). Rather than attempting to pick "winners" from this diverse group of markets and economies 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	3.02%	Yes	Yes	Cyclical	Yes	No	*Economic growth and overseas investment are supporting the market. Yields remain attractive compared to fixed interest, but unimpressive compared to what could be achieved through investment in a good quality UK or global equity income fund, especially once charges are taken into account. We therefore remain neutral.*
Listed Infrastructure	1.40%	Yes	Yes	High	Yes, med term	Yes	*UPDATE: The asset class has delivered downside protection in choppy markets and continues to have attractions such as barriers to entry, pricing power and predictable cash flows. The investable universe is still expanding due to privatisation and sales from conglomerates and private equity. Valuations remain quite high and yields are not impressive compared to UK and Global Equity Income funds leading us to retain our neutral view.*
Commodities	0.00%	No	Yes	Extreme	Yes, med term	Yes	*Various factors influence individual commodity prices including US dollar appreciation, Chinese demand, Middle East tensions and climatic conditions. Oil prices dropped dramatically in 2015 but have begun to recover since February and are up 10% year to date in dollar terms. The gold price has also increased so far in 2016 although this is not attributable to long-term structural drivers. Gold prices are now around $1,230, 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 - Average yield on funds in Gilts sector, excludes ETFs
Index-Linked Gilt - Average yield of funds within the Index-Linked Gilts sector; excludes ETFs
UK Corporate Bond (Investment Grade) - Yield on Vanguard Investment Grade Bond Index fund
UK Corporate Bond (High Yield) - Average yield of funds in IA 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 and CF Macqaurie Global Infrastructure
UK Equity Income - 110% of the FTSE All-Share yield
UK Equity (Other) - Yield on Vanguard FTSE UK All-Share Index
Global (Equity Income)- 110% of the FTSE All-World yield
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 IA 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

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