DT Dewhurst Torevell

Economic Commentary – August 2016

Overview

The FTSE 100 is now at 6,826 having started the month of August at 6,724 and started the year at 6,242. This time last year we saw significant market turbulence as China's currency devaluation and slowing economic growth created sharp falls in global equity markets. Conversely, the month that has just passed saw surprisingly calm equity markets despite the economic and political uncertainty surrounding the UK exit from the European Union and the US presidential election.

We remain cautious however because markets are yet again being driven by central bank measures to provide liquidity as opposed to any improvement in company earnings or other fundamental measures. Concerns surrounding the rate and veracity of Chinese growth and the continued uncertainty surrounding US interest rate increases provide ample reason for caution.

Currency translation effects have continued to be very beneficial for our UK and global investments and we remain alert to the fact that this may not be sustained. It is interesting to view data from another perspective and when the FTSE World index is measured in Euros and US Dollars in the year to date it has a total return of 4% and 7% respectively, compared to 19% in Sterling terms. This is a good illustration of the strength of the currency effects in play.

We retain our conviction that the best way to ride out any volatility and instability is to focus on high quality, cash generative businesses which our carefully chosen active fund managers have not overpaid for when the position in the stock was established. We retain our tilt towards large cap companies, but many of the fund managers we have recently spoken to also have a degree of exposure to robust mid-cap companies which are more attractively valued and include some innovative and dynamic companies with promising long term prospects.

Bonds and Cash

The Bank of England's interest rate cut to 0.25% and renewed quantitative easing operations have further distorted bond markets. At its August meeting £60 billion in additional gilt purchases each month was announced together with a £10 billion corporate bond purchasing programme. There may be some issues in implementing this new round of easing as indicated by a reverse auction where the bank was unable to buy all of the longer-dated gilts that it wanted. This is the first time this has occurred since asset purchases began in 2009. The failure pushed UK 30-year gilt yields to new historic lows. Three months ago the yield was 2.5%, it is now 1.33%.

We continue to have concerns regarding the potential for substantial and irrecoverable capital losses within bond markets should yields rise and prices correct. We also retain our liquidity concerns regarding corporate bonds and will continue to sit out what we believe to be a "bubble" within bond markets.

Interest rates are now lower than ever and we anticipate that inflation will rise as imports become more expensive in Sterling terms. Nevertheless, we still consider an allocation to cash to be an important part

of our asset allocation to allow for tactical purchases to be made on market weakness and to anchor portfolios against volatility in other asset classes.

UK

UK economic data remains fairly encouraging. UK industrial output rose at its fastest rate for 17 years between April and June this year. Meanwhile in the consumer arena, retail sales have remained strong, rising nearly 6% year-on-year in July, according to data from the Office for National Statistics.

The resources sector, especially oil and gas and mining companies, has led the stock market in sector terms in the year to date and this has influenced the comparative performance of some of our carefully chosen UK funds when looked at alongside the FTSE 100. We do not consider this to be a cause for concern because we favour the fact that these funds either altogether avoid, or have limited exposure to, these more cyclical sectors. Additionally, banks had stronger performance in the last month, but we remain wary because profit margins will be compressed by lower interest rates and so we are also satisfied that we have limited exposure to this area.

Europe

Unemployment within the Eurozone remains stubbornly high at 10.1% and economic growth remains modest. We retain a cautious stance on the region, focused on funds which hold a proportion of their investments outside the Eurozone.

US

US economic data has been mixed; GDP for the second quarter came in below expectations at 1.2% year-on-year, but consumption growth has remained relatively solid. It remains to be seen whether the Federal Reserve will raise interest rates before the end of the year.

US equities have been supported by second quarter corporate earnings which beat expectations. Valuations remain comparatively high and we are therefore still cautious, although the managers of our carefully selected actively managed global and US equity funds may be able to exploit tactical opportunities should markets decline due to influences such as the contentious US presidential election.

Asia Pacific and Emerging Markets

Despite pursuing aggressive quantitative easing operations since 2013, inflation in Japan remains stubbornly low. Japanese economic growth stalled in the second quarter and other than a handful of world class companies which happen to be headquartered in Japan, we remain negative.

We also retain our negative view on direct investment in emerging markets, considering it less volatile and more fruitful to invest indirectly through developed market companies which obtain a proportion of their revenues from these countries.

Our carefully selected funds in the Asia Pacific region focus upon high quality companies with resilient business models.

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