Dewhurst Torevell

Asset Class & Investment Outlook - Q1 2017

Asset/Investment Area	Income (Current Yield)	Rising Income	Long Term Real Capital Growth	Volatility	Inflation Protection	Currency Risk	Commentary
Cash	1.00%	Potentially	Slightly Negative	Very low	No	No	*UPDATE: The Bank of England cut the UK base rate to 0.25% in August 2016. This has had serious implications for cash investors, but we still consider a cash component to portfolios to be important at a time when markets are likely to be unsettled. In particular we are holding some tactical cash to be redeployed when equity markets are at more reasonable valuations.*
Conventional Gilt	1.34%	No	Negative	Some	No	No	*UPDATE: Conventional gilt yields have increased significantly since September. They are now 1.34% and getting closer to the 1.56% level they were at in January 2016, despite falling to a historic low of 0.6% in the aftermath of the Referendum. Capital values have declined in consequence. In 2017, investors are likely to be facing an environment of rising inflation, rising interest rates in the US and QE drawing to a close, none of which will be supportive to gilt markets. Irrecoverable capital losses are likely to occur for some investors as prices fall from overvalued levels and yields rise. We retain a very negative view.*
Index-Linked Gilt	-1.77%	Yes	Negative (at present)	Some	Yes	No	*UPDATE: Index-linked gilts remain overvalued despite some adjustment in prices and all bonds in issue have negative yields. A perception that the economic outlook might be deteriorating, an uptick in inflation as commodity prices (especially oil) have increased in the last year and revived quantitative easing operations by the Bank of England should all continue to distort prices and supress yields in this asset class. There is no shortage of buyers for this debt because of the distortions created by forcing pension schemes to engage in liability matching policies. We remain negative.*
Sterling Corporate Bond (Investment Grade)	2.44%	No	Negative	Some	No	No	*UPDATE: Corporate bonds remain overvalued following a long run of heavy demand influenced by investors moving from gilts in search of yield. There has been some adjustment in the last 3 months and the IBOXX UK Sterling Corporate All Maturities index is down 2% in the last 3 months. Yelds have increased as capital values have fallen. This situation could lead to liquidity problems if there is a significant sell-off in corporate bonds, especially given the size of some of the leading Sterling corporate bond funds. Regulation concerning the market-making roles of banks has reduced their involvement in the corporate bond market so beyond other asset managers, there are now fewer buyers for debt and volumes and amounts traded tend to be lower than before the credit crisis. we remain negative.*
Sterling Corporate Bond (High Yield)	4.33%	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 and default risks and retain our negative view.*
International Corporate Bond	2.19%	No	Negative	High	No	Yes	*UPDATE: Bond yields are increasing across the globe as investors act to sell bonds based on expectations that inflation and interest rates will rise. The average yield on the Bloomberg Barclays Global Aggregate Total Return Index increased to 1.67% in December, a significant move from the record low of 1.07% in July. Between September and November, the overall value of the constituents of the index has declined by US$2.8 trillion which is a substantial price correction in line with the upwards move in the yield. Bond markets have become discordant and volatile and we retain our longstanding negative views.*
Emerging Corporate Bond	5.52%	No	Negative	Very high	No	Yes	*UPDATE: Currency is a major influence on this debt and US dollar denominated bonds are tied in with US monetary policy and could come under pressure as US interest rates increase. Local currency bonds require careful examination of individual currency and spread factors. $28 billion flowed into emerging market bond funds in the 18 months before the U.S. election as investors hunted for higher yields. Sentiment regarding emerging market debt has declined following the election of Donald Trump and it is estimated that over $16 billion in debt was sold in November. One of the largest ETFs in the sector, iShares J.P. Morgan U.S. Dollar Emerging Markets Bond had outflows of $1 billion illustrating the extent to which index-tracking funds can influence markets. 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)	3.81%	Yes	Yes	High	Yes, med term	No	*UPDATE: Currency and a re-rating of resources stocks has been the main driver of UK equity markets in 2016 and this has created a short-term headwind for some of our carefully selected UK Equity Income fund choices. In the longer term our analysis indicates that their positioning in areas such as pharmaceuticals and tobacco has helped drive more consistent returns than the broader market. Currency translation effects for the 70% of non-sterling earnings within the FTSE 100 index has been the main driver of earnings for the market overall. The latest Capita UK Dividends Monitor report indicates that UK dividends were also enhanced by the influence of currency. UK equities continue to look attractive compared to the US, Europe, Japan and other asset classes such as bonds, property and infrastructure. Our recent meetings and calls with a number of leading UK Equity fund managers including Neil Woodford, Mark Barnett and Adrian Frost has once again emphasised the need for selective stock picking to retain a mix of companies with sustainable dividends combined with those with the potential for dividend and capital growth. We retain our selectively positive view on this sector for long term investment.*
UK Equity (Other)	3.64%	Yes	Yes	High	Yes, med term	No	*UPDATE: The Referendum result has created business uncertainty, but economic data has remained firm so far. In the short term, movements in Sterling will determine the relative attractiveness of domestically or overseas exposed companies, but there continue to be a selection of domestically focused companies with strong fundamentals and growth potential that can be identified by talented active managers. We remain neutral whilst the details of Britain's exit from the European Union are determined.*
Global (Equity Income)	2.74%	Yes	Yes	High	Yes, med term	Yes	*UPDATE: 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. Currency translation effects have assisted performance since the Referendum due to the weakness of Sterling. We retain a positive view on a long term basis but have taken some profits at the margins based on the high valuations of many equity markets, in particular the US, and the fact that this has been based on the liquidity created by quantitative easing rather than improvement in fundamentals.*
European Equity	2.51%	Yes	Yes	High	Yes, med term	Yes - €	*UPDATE: The biggest risk for European markets in the year ahead comes from politics, with elections in Germany, the Netherlands, France and Austria. We continue to focus on global leading businesses that happen to be based and listed in Europe or on growth companies which play in a niche area with barriers to entry. Our carefully selected fund choices have substantial non-Eurozone exposure and are orientated towards the stronger performing economies on the continent.*
North American Equity	1.36%	Yes	Yes	High	Yes, med term	Yes - $	*UPDATE: US equities have forged ahead since the election of Donald Trump, with the S&P 500 repeatedly reaching new highs. Markets are being driven by the expectation the new president will cut taxes, reduce regulations and increase infrastructure spending. This is based on sentiment rather than facts and much uncertainty remains about the specific policies that will follow. This would once again lead us to caution on valuation levels within the US equity market and the possibility of retrenchment. The Cyclically Adjusted Price Earnings (CAPE) ratio puts the S&P 500 at a ratio of 28.1. That is significantly higher than the historical mean of 16.7, although the ratio remains below its 2001 dot-com boom peak of 44.2. We retain our slightly negative view.*
Asia ex Japan Equity	1.59%	Mixed	Yes	Very high	Yes, med term	Yes	*UPDATE: 2016 was a year of two halves for the region. It underperformed in the first half due to concerns about the aftermath of China's credit-led boom. The second half of the year saw recovery as there was some upturn in earnings. Reforms are underway in India, but China still has to perform a balancing act to rebalance the economy to a more sustainable path, without completely choking off growth. It also remains to be seen how any changes in US trade policy towards Asia will play out. We remain very selective, with investments concentrated in defensive funds which invest in good quality, resilient companies. Income is rising in some markets but it is important to assess the sustainability of dividends.*

Asset/Investment Area	Income (Current Yield)	Rising Income	Long Term Real Capital Growth	Volatility	Inflation Protection	Currency Risk	Commentary
Japan Equity	1.18%	Mixed	Yes	High	Yes, med term	Yes - ¥	*UPDATE: Aggressive monetary policy featuring negative interest rates and large scale quantitative easing has failed to combat deflation or to have noticeable effects on the real economy. In Yen terms Japanese equities made a modest loss of 0.3% in 2016. On the positive side we also note the change in attitudes towards paying dividends by companies, with a 15% increase in dividend payments in 2015 and a similar increase anticipated for 2016. On the other hand a number of leading companies such as Sony, Panasonic, Toshiba and Hitachi have actually cut dividends so we are monitoring the situation to see how stable dividends are and whether the dividend increases have longevity or are merely a reaction to extraordinary monetary policy. At present we retain a negative view on having dedicated exposure to this market.*
Emerging Market Equity	2.50%	Mixed	Yes	Very high	Yes, med term	Yes	*UPDATE: Emerging markets continue to be volatile, after positive returns to the end of October, albeit from a low base, sentiment turned following the election of Donald Trump. Currencies like the Turkish Lira and Mexican Peso devalued against the US Dollar, while stock markets in the Philippines and Brazil dropped more than 4%.Whilst we recognise the rising share of telecoms, technology, consumer and healthcare companies within the leading stock markets in this group (which remains very eclectic), we also note that many areas are still tied to commodities and more cyclical investments. We continue to prefer to have very minor direct exposure to this area through the few robust stocks that our carefully selected global fund managers have included in their portfolios. Analysis reveals there is sufficient indirect exposure through the revenues of the leading multinational companies in our global and UK funds which will allow us to capture the long term structural growth and rising affluence of many of these countries.*
UK Commercial Property	3.10%	Yes	Yes	Cyclical	Yes	No	*UPDATE: The UK commercial property sector had a difficult second half to 2016 following the Referendum. Investors rushed to redeem units and a number of funds had to close for a period of time to sell properties in order to facilitate redemptions. Funds also had to make significant downward "fair value" adjustments to pricing. The situation reinforced our view that property is not suited to daily traded funds due to its illiquidity. Additionally, the income provided by the major funds in the sector is at best comparable to a good quality equity income fund once fees and taxes have been taken into account. We therefore retain our negative view on this sector.*
Listed Infrastructure	2.30%	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 are further increasing on hopes of fiscal stimulus encompassing infrastructure projects in major developed markets. Additionally, yields are not impressive compared to UK and Global Equity Income funds leading us to retain our neutral view. It is also worth noting that a number of our carefully selected UK and Global Equity Income funds have small allocations to individual infrastructure stocks and it is now a moot point whether a dedicated allocation to this sector is necessary.*
Commodities	0.00%	No	Yes	Extreme	Yes, med term	Yes	*Various factors influence individual commodity prices including relative currency levels, Chinese demand, Middle East tensions and climatic conditions. Gold prices have dropped considerably from their peak of $1,895 in 2011 and are now around $1,179. Additionally, gold does not provide income. Oil prices advanced considerably in 2016 and Brent crude was up 57% in US Dollar terms. Longer term data gives a fuller picture and shows the volatility of the oil price which is down 34% in US Dollar terms and 48% in Sterling terms on a 5-year view. Overall 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 - UK 10-year benchmark gilt yield
Index-Linked Gilt - Average yield for UK Index-Linked Stock 22 November 2027, 22 March 2029 and 22 July 2030.
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

Disclaimer:

This document reflects the general views and opinions of Dewhurst Torevell & Co. Ltd only and these are subject to change without notice.
This document and its contents do not constitute advice or a personal recommendation and do not take into account individual client circumstances or needs.

If you are unsure about the suitability of any investment you should contact us for advice.

Our research is undertaken and views are expressed with all reasonable care and are not knowingly misleading.
Any information provided in this document is obtained from sources that we consider to be reasonable and trustworthy but accuracy cannot be guaranteed.

The value of investments can go down in value as well as up, so you could get back less than you invest. It should be remembered that past performance is not necessarily a guide to future performance.

Dewhurst Torevell & Co. Ltd, 5 Oxford Court, Manchester M2 3WQ. Tel. 0161 281 6400. www.dewhurst-torevell.co.uk