BERRY

ASSET MANAGEMENT PLC

A MEMBER OF THE BORDIER & CIE GROUP

Investment Update

Spring 2014

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Overview

Global stockmarkets have begun the year in rather shaky mood, but somehow they have scraped through the first quarter without too much damage being done and without any derailment of the general market confidence that has been building steadily over the past couple of years. It is good to see the UK stockmarket still within striking distance of its all-time high of December 1999, and America's S&P 500 Index already achieving new levels, but it would be even better if we could break through with less of the anxiety that has been a dominant feature since the start of the year. Like many others, we had expected global markets to spend the early part of 2014 preoccupied with the pace and extent of unwinding the massive monetary stimulus. As it happens, this has been rather overshadowed by other events, principally emanating from emerging markets. Several issues remain unresolved that could continue to impact the stability of global markets in the near term, but equally they could mean that the stimulative monetary conditions that have helped propel global stockmarkets to current levels could continue for even longer, producing further attractive returns for investors.

Mark Robinson
Director
Chief Investment Officer

Last year was a relatively easy one for investment managers, with around 85% of the UK's 350 largest companies seeing an increase in their share prices. As valuations become a little more stretched, companies whose earnings do not match or fall below expectations can expect to see their share prices punished. This is therefore likely to be a year when active managers really earn their keep and the index-huggers are left by the wayside.

Mark Robinson
2 April 2014

Emerging uncertainty

The principal catalyst for the recent period of investor risk aversion was another bout of uncertainty emanating from emerging markets. When we sold down emerging market exposure from portfolios last autumn, it was the impact of actual QE tapering that we feared most, based upon the drain of capital from these markets that we had seen when a reduction in QE was first mooted earlier in the year. As we now know, the unwinding of QE, which finally began this January, has been a side-show compared to an amalgam of highly specific emerging market events that have permeated right through into developed markets and reduced investor risk appetite.

The prospect of weaker than expected growth from China has been an undercurrent, but a currency crisis in Argentina and political unrest in Turkey, Thailand and latterly Ukraine have all contributed to market uncertainty. On top of this, there has been focus on the so-called 'fragile five' countries of Brazil, India, Indonesia, South Africa and Turkey, economies identified by Morgan Stanley as having particular vulnerability due to their twin fiscal and current account deficits. Whilst the Russia/Ukraine situation remains unresolved, we can probably expect market anxiety to fade as a combination of limited sanctions and diplomatic solutions are found in the coming weeks. We should not forget that neither Russia nor the West can afford to let the Ukraine situation spiral out of control: Russia needs access to foreign capital whilst Europe needs Russian energy. Furthermore, the West does not want to sacrifice too much for Ukraine, or risk unhinging the current economic recovery by damaging the profitability of major multinational companies doing business with Russia. Hopefully diplomatic initiatives with Russia over the Ukraine situation will have some success, but if not then the US still has one key indirect sanction up its sleeve – the Strategic Petroleum Reserve, a reserve currently comprising around 700 million barrels of oil. The US could release some of this rather than importing oil, effectively diverting oil to Europe in the process, reducing the oil price and thereby squeezing Russia's much needed energy revenues. It is thought that releasing around 500,000 barrels of oil from this reserve would reduce the oil price by over $10 a barrel. Care would be needed, however, in taking this action – a fall in the oil price would hit US oil company profits and may only be a temporary solution. It would, however, send a clear message to Russia that it does not hold all the cards.

China's debt – a looming crisis?

There are also some good reasons for markets to have been quite anxious about the Chinese economy, where the implications of artificially supporting an annual 7.5% economic growth target, if that is what the authorities are doing, could be far-reaching. Borrowing levels have escalated significantly and there are worries of a financial collapse if China's credit-fuelled boom is not brought under sensible control. We need to watch closely, for example, the level of debt issued to China by banks outside the region, as escalating defaults could ripple through the Western financial system.

On balance, however, China's economic growth is likely to moderate but, with the exception of big resource-exporting economies, this is unlikely to throw the global recovery off course given the more self-sufficient recoveries in many other parts of the world. China does remain an economic test case: to some extent we should consider some of its issues as the normal growing pains of a maturing and liberalising economy which is juggling open market reform whilst maintaining rapid economic expansion. It will not get everything right, but China's powerful demographic and consumption story alone should continue to maintain a very high economic growth rate, albeit slightly lower than in the past.

Economic pick-up

On the economic front in the US and UK a general acceleration in economic activity is under way, despite the best efforts of the weather on both sides of the Atlantic in the early part of the year to disrupt business activity. It seems that both the US and UK economies are now growing at a rate closer to 'escape velocity', a level where little external stimulus is required.

Unemployment rates are falling and manufacturing and service sector surveys are improving. Furthermore, with inflation seemingly under complete control we now have the prospect of real wage growth for the first time in some years. This should help improve consumer confidence and enable economic growth to be self-sustaining as business growth and confidence also improves. We also have better news emanating from Europe where, if recent reductions in bond yields are anything to go by, the troubled periphery is showing signs of repair.

A potential parting of the ways

We do need to be alert to the fact that after almost six years of fairly united action to repair and then stimulate the global economy, the Fed and ECB could be about to go their separate ways on policy.

Unless it is modified, the process of QE removal in the US will be over in the final quarter of this year, whereas in Europe there is talk that a further round of stimulus may be necessary. How markets will cope with the prospect of a divergent approach remains to be seen, but at least it should provide some form of a platform from which the US dollar can stage a comeback. Expectations for a self-supporting US recovery and the need for higher interest rates at some point in the future should make the currency more appealing, whilst deflationary mutterings and more anaemic activity in the European periphery should allow a more accommodative stance for longer.

Best Wealth Management Firm

At the recent Money Marketing Financial Services Awards we were the proud winners of the Best Wealth Management Firm 2014.

Money Marketing reported that; “Best Wealth Management Firm has always been a high-profile award but the category has become even more important since the RDR and the growth in outsourcing of investment management.

Entries are judged on many criteria but this category comes down to one main factor – investment performance.

This year’s winner Berry Asset Management stood out among some strong contenders with what one judge described as “an outstanding long-term track record”.

We were praised for our clear and structured approach to investment management and the clarity and transparency of our service. It was noted that we offer four levels of service for different client types but the judges said all clients benefit from the “transparency of client access to performance” and from a strong communication process”.

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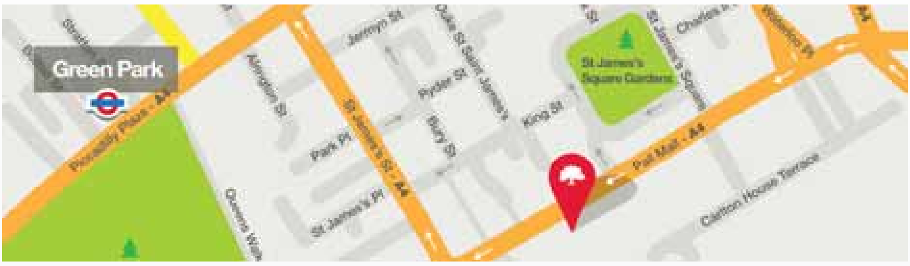

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