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Investment Update

Summer 2015

The Heat is On

Where next for Europe

A quick look back

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Overview

After a reasonable start, the second quarter of 2015 has been a more challenging one in which to make progress, with sentiment oscillating between optimism over the economic recovery on the one hand and nervousness over the next phase of the interest rate cycle, disruption in the eurozone and China's growth trajectory on the other.

Mark Robinson
Director
Chief Investment Officer

However, despite very recent setbacks, investment returns for the year to date are still reasonably healthy, particularly when viewed alongside exceptionally low levels of inflation.

There are some encouraging signals emanating from various leading economic indicators which suggest that various parts of the developed world are beginning to show improving levels of activity: the likely spending and investment habits of businesses in both the manufacturing and service sectors, as evidenced in global Purchasing Managers' Indices (PMIs), generally point towards expansion and recovery, including within the eurozone and Japan where economic stimulus is still very much in progress; there is also evidence of a recovery in US economic activity after the first quarter's weather-related disappointment, as well as signs that real consumer incomes and spending, aided by the fall in energy prices, are beginning to pick up, leading to a more consumption-led recovery. These positives are currently being eclipsed by the near term issues surrounding Greece, but we believe that once these clouds have passed markets will begin to refocus on the positive momentum that is building in the global economy. That said, as economic recovery gathers pace, so the inevitable need to control its advance draws closer: interest rates in the UK and US have been held at rock-bottom levels for over six years now, so the pressure on authorities to get both the timing and action of policy change correct is naturally intensifying. This will be next in the long list of variables for markets to contend with.

Mark Robinson

1 July 2015

Where next for Europe

The twists and turns of Greece's plight have been a significant distraction for markets this year, and as this is written the country continues to teeter on the brink of being expelled from the eurozone. Whether it will survive or not is still too difficult to call, particularly when the leaders of Germany and France, the two most exposed countries to Greek debt, are quite rightly fighting to defend their own financial corners.

But with the authorities making further reassurances that they will do all they can to protect the financial stability for Greek citizens, and both sides seemingly wanting Greece to remain a member of the euro area, then some deal will hopefully be struck soon. We can, however, expect stockmarkets to remain quite twitchy in the meantime, although any such volatile conditions should allow the active stockpicker to find cheap and attractive longer-term opportunities in a region where economic recovery is now gaining some solid momentum. It is reassuring, for example, that since the ECB began its Quantitative Easing programme earlier this year, European markets have largely detached themselves from the unfolding Greek saga, a sign that there is a deeper determination within markets to contain any contagion.

Let's hope it remains that way and we can soon refocus on the more positive aspects of the eurozone's economic revival.

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A quick look back

It is worth reminding ourselves every so often that we have come a long way in the six years or so since the low point for global stockmarkets in March 2009, in the immediate aftermath of the financial crisis. Returns from various asset classes have significantly exceeded their longer term averages – this is mainly a reflection of the low starting point, but also a measure of the huge monetary policy response around the globe that has provided much-needed liquidity and facilitated the economic recovery.

Since early 2009, total returns from larger UK shares, for example, have exceeded 13% per annum, and those from medium and smaller sized companies more than 20% per annum. UK commercial property has also delivered impressive results, with total returns from the Investment Property Databank Index annualising at more than 11% for this period. Even UK gilts have produced an annualised total return of around 5%, despite a tough period in 2012/2013.

Contrast all these returns with annualised pre-tax cash returns averaging, probably, no more than 1%, and investors have been richly rewarded for taking any type of risk across the spectrum of mainstream asset classes. These are impressive returns by any standards, and although flattered by the low starting point, demonstrate the rewards that can come through staying invested during recovery phases and shorter-term periods of market stress.

And into the future

So can we expect similar, heady average returns going forward? Almost certainly not. Although the broad economic backdrop remains quite supportive, it would be unrealistic to expect the magnitude of these returns to be maintained as we move into the next, and perhaps more complicated, phase of this economic cycle. But with expectations for a further recovery in global growth during the remainder of this year, equities still offer good potential for reward, whether it is from capital growth, income or total return via a combination of the two.

We should, however, expect returns to be more modest than they have been over the past few years, particularly if inflation remains contained at low levels, which seems likely for the time being. Keeping one's nose ahead of inflation should be the central objective of any investment strategy - equities continue to play a core role in achieving this goal, and despite their strong appreciation of recent years still offer reasonable value, particularly given the expectation that improved business and consumer confidence should translate into stronger corporate profitability.

For this broad reason we are maintaining equity positioning at the upper end of our various strategy ranges.

Although stockmarket valuations are not as cheap as they were, the recent market setbacks and prospects for corporate recovery do present some good longer term opportunities for the active manager. There are, however, areas where some care is required.

We continue to give general emerging markets exposure quite a wide berth based on risks to capital flows as the monetary cycle changes - last year's so-called 'taper tantrum' for emerging markets is still very much in our memories and a similar exodus and repatriation of global capital is still a possibility, even if it is not so severe.

We also have some concerns over China's ability, for example, to manage effectively the slowdown in its economic growth rate as it grapples with weak domestic demand, falling prices and spare capacity in a number of business sectors.

Although measures have been taken to stimulate activity and restore growth, including reductions in interest rates and increases in infrastructure projects, it is difficult to get a clear picture of what impact this is actually having given the heavy control over official data.

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