Asset Class & Investment Outlook - Q4 2014

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: Base rates remain well below inflation and the UK Base Rate has remained unchanged at 0.5% since March 2009. However, the consensus among managers that we have spoken to is that interest rate increases will be gradual and that rates will remain fairly low compared to historical levels. Cash levels have been higher than normal in the last year in response to the extraordinary overvaluation in equity and fixed interest markets, but we are in the process of redeploying some of these balances into equity markets, where appropriate, now that values have retrenched somewhat.*
Conventional Gilt	1.94%	No	Negative	Some	No	No	*UPDATE: Despite the improvement in economic activity gilt yields have reduced since the start of the year. The 10-year gilt yield has reduced from 2.5% in September to 2.2% in late October having fallen below 2% in mid October. This is a peculiar situation and one that we do not believe can persist even if markets are pricing in interest rate increases that are only modest. Eventually high capital values are likely to decline and yields are likely to increase. We therefore remain very cautious because many gilts are at risk of an irrecoverable loss of value.*
Index-Linked Gilt	2.47%	Yes	Negative (at present)	Some	Yes	No	*UPDATE: Inflation remains subdued and these bonds remain comparatively expensive whilst real yields are unattractive across the curve. Demand remains high for these bonds even if the real yield is negative because of the need for defined benefit pensions to match liabilities, which is distorting the market.*
UK Corporate Bond (Investment Grade)	3.63%	No	Negative	Some	No	No	*UPDATE: Attractions such as positive corporate cash flows are increasingly priced in, while contagion from government bond markets is likely to affect total returns once prices and yields begin to react rationally to interest rate increases. Low issuance (other than in the financial sector) is keeping valuations high and we have concerns regarding liquidity and trading capacity if there are large scale outflows from corporate bond funds.*
UK Corporate Bond (High Yield)	5.70%	No	Negative	High	No	No	*Although spreads are tight, the outlook for bond defaults is favourable while the corporate earnings outlook is positive. However, we retain a negative view on valuation grounds and because of the risks associated with the increasing amounts of Covenant Lite debt in issue with less restrictions on collateral, payment terms, and level of income than traditional debt.*
International Corporate Bond	2.63%	No	Negative	High	No	Yes	*UPDATE: A mixed picture. US yields remain low despite the cessation of quantitative easing. So far, markets have withstood the outflows from PIMCO, the world's largest bond fund manager following the abrupt departure of Bill Gross, the firm's co-founder, although liquidity could become an issue. European bond yields are held down by low inflation and ultra-low interest rates, with the German 10-year benchmark bund yield dropping below 1% in the third quarter.*
Emerging Corporate Bond	4.60%	No	Negative	Very high	No	Yes	*UPDATE: Hard currency denominated emerging market debt continues to perform the best, assisted by the recent strength of the US Dollar. Local currency bonds are less appealing because individual currency and economic factors need to be scrutinised. There may be idiosyncratic opportunities but we remain negative on this sector due to its volatility, poor liquidity and ongoing currency risks.*

Asset/Investment Area	Income (Current Yield)	Rising Income	Long Term Real Capital Growth	Volatility	Inflation Protection	Currency Risk	Commentary
UK Equity (Equity Income)	3.58%	Yes	Yes	High	Yes, med term	No	*UPDATE: The UK economy continues to strengthen. The UK Equity Income managers that we have met with do not anticipate cuts in dividends in general and also expect dividend increases for some stocks. These factors make us positive on high quality, cash generative UK Equities, although we do acknowledge that there are political risks in the run up to the general election in May 2015.*
UK Equity (Other)	3.25%	Yes	Yes	High	Yes, med term	No	*UPDATE: The number of IPOs and a high level of merger and acquisition activity suggest that markets could be peaking. We remain cautious despite the improvement in economic activity in the UK and would only consider investment in funds which seek attractively valued, high quality companies with good capital growth prospects.*
Global (Equity Income)	2.64%	Yes	Yes	High	Yes, med term	Yes	*UPDATE: We continue to favour equity income funds that focus on developed markets because of the number of cash-generative, defensive stocks with strong balance sheets listed in these markets. Dividend growth is coming through and some special dividends are being paid. The recent strength of the US Dollar should be a tailwind for returns once they are translated into Sterling.*
European Equity	3.00%	Yes	Yes	High	Yes, med term	Yes - €	*UPDATE: Speculation regarding whether the ECB will pursue some form of quantitative easing to ward off potential inflation is buffeting markets. Economic data remains weak and even Germany is struggling because of a decline in exports to emerging markets. We retain a neutral view on the region pending further announcements regarding the direction of monetary policy but remain positive on the high quality, cash generative companies within the region, especially those which are outside of the Eurozone.*
North American Equity	1.35%	Yes	Yes	High	Yes, med term	Yes - $	*UPDATE: The recent market pullback has moved some US stocks back towards fairer valuations. Strengthening economic fundamentals are driving a steady uptrend in corporate earnings. Corporate cash is being used for share buy backs and merger and acquisition activities and we are disappointed not to see a greater amount of these balances being deployed to capital expenditures and dividends. Despite the pick up in economic activity, we remain cautious that further volatility could lie ahead.*
Asia ex Japan Equity	1.98%	Yes	Yes	Very high	Yes, med term	Yes	*UPDATE: Optimism regarding reforms and stimulus measures have lifted investor confidence although economic data from China remains mixed. Long term growth prospects are good but it is essential to choose well-diversified funds investing in high quality companies with strong corporate governance.*
Japan Equity	1.48%	Yes	Yes	High	Yes, med term	Yes - ¥	*Aggressive economic and monetary policies have fuelled stock markets but the easy gains have likely been made and an increase in the consumption tax is now beginning to bite. There is no guarantee that the recently announced structural reforms will be effective, especially as they are likely to be implemented on a piecemeal basis. Demographics are poor and the economic outlook uncertain. The Bank of Japan's quantitative easing measures should continue to pressure the Yen downwards, increasing corporate competitiveness but creating a need to hedge Sterling-denominated returns.*
Emerging Market Equity	2.07%	Yes	Yes	Very high	Yes, med term	Yes	*Performance is increasingly divergent; while some countries benefit from strong domestic fundamentals, others are under pressure from political factors, current account deficits and tighter monetary policy required to stabilise depreciating exchange rates. We continue to prefer to access the emerging markets "growth story" through cash generative developed markets players who derive a proportion of their income from emerging markets.*

Asset/Investment Area	Income (Current Yield)	Rising Income	Long Term Real Capital Growth	Volatility	Inflation Protection	Currency Risk	Commentary
UK Commercial Property	3.87%	Yes	Yes	Cyclical	Yes	No	*UPDATE: Capital values are supported by rising rental values as the UK recovery strengthens. Investment outside of London is recovering, especially in the other major cities. In the industrial sector the evolution of online shopping is driving take-up of warehouse space. Cash levels are declining within funds as manager conviction increases. Yields look comparatively attractive to some other sectors, although taxes can reduce the yield that is ultimately received. For this reason only tax efficient funds would be considered. From a valuation perspective these funds do not look attractive as inflows have been strong in the last year and we retain a neutral view for this reason.*
Listed Infrastructure	2.32%	Yes	Yes	High	Yes, med term	Yes	*Growth orientated sectors such as toll roads, ports and railways are benefiting from the improving economic climate via increasing volumes and operating leverage. Income orientated sectors such as regulated utilities and energy pipelines have benefited from a reprieve in bond yield levels in recent months but are ultimately vulnerable to the increase in bond yields that will accompany rising interest rates.*
Commodities	0.00%	No	Yes	Extreme	Yes, med term	Yes	*UPDATE: The outlook for commodities is diverse with the US Dollar, demand from China, geopolitical considerations and climate influencing individual prices. Counterintuitively oil prices remain fairly low despite coalition air strikes in the Middle East. Gold prices remain quite volatile and are substantially below the peak of September 2011. Exposure to commodities would only be considered for the purposes of diversifying a portfolio or hedging against inflation. That said, practical exposure is difficult to obtain, with limited physical ETFs available and a negative house view on synthetic ETFs.*

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 - Yield on Vanguard UK Government Bond Index fund
Index-Linked Gilt - Yield on iShares £ Index-Linked Gilts ETF
UK Corporate Bond (Investment Grade) - Yield on Vanguard Investment Grade Bond Index fund
UK Corporate Bond (High Yield) - Average yield of funds in IMA 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, SWIP Property Trust, M&G Property Portfolio and L&G UK Property Trust
Infrastructure - Average of yield on First State Global Listed Infrastructure, CF Canlife Global Infrastructure, CF Macqaurie Global Infrastructure and Lazard Global Listed Infrastructure
UK Equity Income - 110% of the FTSE All-Share
UK Equity (Other) - Yield on Vanguard UK Equity Index Fund (Benchmark: FTSE All Share Index)
Global (Equity Income)- 110% of the FTSE All-World
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 IMA 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

This is an extract from analysis we conduct internally which also considers other factors such as valuations and liquidity.

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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.

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