Asset Class & Investment Outlook - Q3 2016

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: Interest rates remain very low, but we still consider a cash component to portfolios to be important at a time when markets are likely to be unsettled.*
Conventional Gilt	0.86%	No	Negative	Some	No	No	*UPDATE: Yields have collapsed following the EU Referendum as prices have increased. The 10-year benchmark gilt yield has fallen from 1.96% at the beginning of the year to less than 1%. A range of extraordinary monetary policy will prop up prices in the short to medium term but ultimately markets are likely to correct from their high levels of overvaluation and capital losses are likely for some investors. We therefore retain our negative view on conventional gilts.*
Index-Linked Gilt	-1.43%	Yes	Negative (at present)	Some	Yes	No	*UPDATE: Index-linked gilts remain overvalued and offer low or even negative real yields. Some funds investing in these bonds do not pay any yield at present because the real yields on the underlying instruments are currently negative thus causing an insufficient accrual basis for dividend distribution. Liability matching requirements for some pension funds creates a ready market making it unlikely that these bonds will become more realistically priced in the near future and we remain negative at this time, despite the fact that inflation is likely to increase due to Sterling weakness.*
Sterling Corporate Bond (Investment Grade)	2.94%	No	Negative	Some	No	No	*UPDATE: Yields have also fallen in corporate bond markets and commentary states that trading volumes are low, indicating a lack of liquidity. Supply of new credit to the market has also been low, which is a challenge for large Sterling Corporate bond funds. Following the Referendum some market makers were unable to price certain corporate bond ETFs in the first few hours of trading, which does not inspire confidence. We remain cautious on these bonds and funds which invest in them due to their untested liquidity.*
Sterling Corporate Bond (High Yield)	4.86%	No	Negative	High	No	No	*UPDATE: Spreads have increased since the Referendum and higher yields are available than in other markets but we consider this market to be especially susceptible to liquidity risk and have a negative view.*
International Corporate Bond	2.23%	No	Negative	High	No	Yes	*UPDATE: European credit is supported by the ECB's quantitative easing programme, although this is constrained by the fact that bonds must yield at least -0.4% to be eligible for purchase. Issuance from major corporates is buoyant to take advantage of high interest rates, but already low yields have declined further following the UK EU Referendum result. Spreads between US and EU corporate debt have widened and the average U.S. corporate bond yields 2.87%, while comparable European debt yields 0.71%, according to Bloomberg data. US yields are low by historical standards but are greatly above EU levels and this has created high demand for this debt. We are very cautious regarding EU and US debt due to distortions in both markets and we retain a negative view.*
Emerging Corporate Bond	5.21%	No	Negative	Very high	No	Yes	*UPDATE: Currency is a huge influence on this debt and US dollar denominated bonds are tied in with US monetary policy. Local currency bonds require careful examination of individual currency and spread factors. 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)	4.13%	Yes	Yes	High	Yes, med term	No	*UPDATE: Our UK Equity Income fund choices have been well positioned for the EU Referendum result due to their large exposure to FTSE 100 companies. The large companies that constitute this index have significant international earnings streams which, following the fall in sterling, are now worth more in UK domestic currency terms. Indeed, around 80% of the FTSE 100's earnings come from overseas. On the other hand we recognise that low or no exposure to resources stocks has proved a headwind for our carefully chosen funds in the short term as oil prices have rebounded from their low of $27 per barrel in January. We retain our conviction in the long term positioning of the funds and their avoidance of more volatile and speculative areas. We retain our view that a significant allocation to UK Equity Income will create comparatively resilient portfolios because they will be centred upon high quality dividend paying companies.*
UK Equity (Other)	3.60%	Yes	Yes	High	Yes, med term	No	*UPDATE: Domestically orientated sectors of the FTSE 250 including housebuilders, financials, property and retailers have been the hardest hit by the EU Referendum result. This emphasizes the need for a multi-cap approach to UK growth investment and for active management so the manager can proactively position the fund for likely market conditions alongside their long term investment strategy. We retain a neutral view whilst the ramifications of the Referendum play out.*
Global (Equity Income)	2.89%	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 should assist performance following the Referendum as the majority of our fund choices in this area have substantial exposure to the US dollar which has strengthened compared to Sterling. We also note that the Euro has been more resilient than expected since the vote.*
European Equity	2.61%	Yes	Yes	High	Yes, med term	Yes - €	*UPDATE: European markets are exposed to political fallout following the Referendum and peripheral countries have suffered following the vote. We continue to focus on global leading businesses that happen to be based and listed in Europe or on growth companies that 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	1.49%	Yes	Yes	High	Yes, med term	Yes - $	*UPDATE: Cyclically adjusted valuations remain high at 26X Price/Earnings despite lower earnings expectations. Profit momentum has slowed at the market level due to the stronger US dollar and currency effects on international earnings. Wage increases may stoke inflation. Political risk is also evident in the run up to the presidential election. We therefore remain slightly negative.*

Asset/Investment Area	Income (Current Yield)	Rising Income	Long Term Real Capital Growth	Volatility	Inflation Protection	Currency Risk	Commentary
Asia ex Japan Equity	1.61%	Mixed	Yes	Very high	Yes, med term	Yes	*UPDATE: China is committed to shifting its economy from resources to services and this will continue to weigh on global trade and to have implications for the entire region. We remain very selective with investments concentrated in defensive funds. The downturn has given fund managers the chance to buy quality companies at reasonable valuations.*
Japan Equity	1.47%	Mixed	Yes	High	Yes, med term	Yes - ¥	*UPDATE: Confidence in reforms is waning. Aggressive monetary policy featuring negative interest rates and quantitative easing has ultimately had limited effects on the real economy. The Yen is regarded as a safe haven currency in the wake of the UK EU Referendum and its strength will act as a headwind to exporters. We retain a negative view on having dedicated exposure to this market but recognise that it is important to keep in mind there are some outstanding multi-national companies in Japan with similar qualities to other developed world peers.*
Emerging Market Equity	2.56%	Mixed	Yes	Very high	Yes, med term	Yes	*UPDATE: Studies have failed to show a link between high economic growth in emerging markets and resultant stock market performance. This is most likely because shareholders have to share the fruits of economic growth with government interests and labour (through increased wages). Rather than attempting to pick "winners" from this diverse group of markets and economies we continue to prefer to gain exposure to emerging markets indirectly through high quality developed market companies that derive a proportion of their revenues from these countries.*
UK Commercial Property	3.09%	Yes	Yes	Cyclical	Yes	No	*UPDATE: Since the Referendum result was announced property has been affected as an asset class. Outflows had already occurred in the sector ahead of the Referendum and several funds have now had to cut their prices following fair value adjustments to the underlying properties; this reinforces our cautious view on property as a sector because of its tendency to experience pricing difficulties whenever uncertainty arises in the property market. In some cases in the past funds have been forced to suspend redemptions for a period of time and investors have been unable to exit even if they would like to do so. We also note that once charges and taxes are taken into account property yields are not compelling and that comparable or better income can be achieved from equity income investments which are very liquid.*
Listed Infrastructure	1.86%	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 yields are not impressive compared to UK and Global Equity Income funds leading us to retain our neutral view.*
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. Oil prices dropped dramatically in 2015 but have begun to recover since February and are up 32% year to date in dollar terms. The gold price has also increased so far in 2016 although this is not attributable to long-term structural drivers and is more a reflection of political and economic uncertainty. Gold prices are now around $1,315, significantly below the peak of over $1,800 in 2011. 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

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