DT | Dewhurst Torevell

# Economic Commentary – March 2017

## Overview

The FTSE 100 made some headway in March, despite volatility along the way, finishing the month at 7,327, having started the year at 7,142. Our more defensively positioned UK equity income fund choices outperformed the market in March with many of the core holdings in tobacco and pharmaceutical companies producing steady returns.

It is impossible to make accurate macroeconomic predictions or know what the ultimate outcome of current political uncertainties will be. Rather than churning portfolios in reaction to short term events, creating transaction costs, or trying to guess outcomes, we prefer to focus on actively managed funds which are managed patiently. These funds predominantly invest in resilient companies which are less sensitive to economic and political influences. We had some very productive meetings with Neil Woodford and Richard Colwell in the last month. In the coming weeks we will meet with Francis Brooke of Trojan Income, Nigel Thomas of Axa Framlington UK Select Opportunities and William Lam of Invesco Perpetual Asian.

## Cash and Fixed Interest

We structure our portfolios on a total return basis, aiming at a reasonable level of income and with exposure to fund managers who aim for a rising level of income over time. Where this is successful, capital growth is also achieved over time. With this in mind we retain a negative view on fixed interest due to markets remaining generally overvalued and at risk of capital losses. To avoid the risk of permanent capital loss and possible liquidity pressures, we retain our preference for cash and dividend paying equities at this time. Whilst we recognise that interest rates are at historic lows and real returns are poor for cash, we believe that cash balances provide a useful source of liquidity and a stable foundation for equity based portfolios with their inherent short term volatility.

We continually review all asset classes and recently met with Harry Richards, Deputy Manager of the Jupiter Strategic Bond fund to obtain an independent update on fixed interest markets across the risk spectrum with detail on individual sectors and geographies. It was extremely informative, and reinforced our view that the asset class has too much valuation, liquidity and default risk to hold at present.

Portfolios must be viewed holistically and low real interest rates on cash should be viewed as supporting the attractive yields provided by exposure to equity income funds and high quality companies with sustainable dividends. At current market levels the FTSE 100 offers a yield of 3.7% and the FTSE World (equity) index offers a yield of 2.4%. Both of these compare positively to a 10-year benchmark UK Gilt yield of 1.06% and to prevailing cash rates.

## US

US markets remain well above their average valuation levels; the overall market has climbed over 10% in both Sterling and Dollar terms since the election of Donald Trump in November. This reflects expectations of stronger growth driven by his deregulation agenda and his plans for fiscal expansion through tax cuts

and infrastructure spending. There is no guarantee his proposals will pass Congress or come to fruition meaning volatility is likely, especially as budget negotiations commence and the details of healthcare policy are confirmed.

Interestingly, energy stocks have been flat in US Dollar terms since the election, influenced by weaker oil prices. This indicates that attempts to restrict supply have not been successful, and that shale oil, and gas producers have become efficient enough to produce at lower prices.

The Federal Reserve once again made a modest 0.25% increase to interest rates at its March meeting. The policy has been so well telegraphed it had little impact on markets.

We retain a cautious view, although we recognise there are some excellent companies with resilient business models and robust financials which just happen to be located in the US.

**UK**

Negotiations for the UK to leave the EU have now commenced, following the formal delivery of Article 50. So far the British economy has held up well since the Referendum and this has been driven by the “safety valve” of weak Sterling, which has assisted earnings for those companies with overseas revenues. There has been some stabilisation in Sterling against the US Dollar in the last month and the UK fund managers we have spoken to recently consider the currency to be undervalued. This has led some subtle repositioning in their portfolios to add to or initiate positions in UK domestic companies whilst they are good value.

**Europe**

Europe is still working through its latest round of political uncertainties. A centre-right victory in the Netherlands reassured investors, but general elections in France (May) and Germany (October) will be a major short term influence on markets.

We are keeping a close eye on the exposure to these countries within our global and European funds. We also choose like-minded fund managers who invest, rather than speculate, and have a patient, long term view. They are not willing to bet on political outcomes or on the path of economic recovery. Instead they look for companies with solid balance sheets, recurring revenues, strong management and either international revenues or a defendable niche business which just so happen to be domiciled in Europe. We look forward to obtaining a detailed update on the region and on portfolio positioning from Richard Pease of Crux Asset Management in the coming weeks.

**Asia Pacific and Emerging Markets**

It is surprising to us that there is so little discussion with regard to the level of debt within the Chinese economy, which is now 277% of GDP. Most of this debt is held at a national or local government level or by corporates, creating the possibility for further intervention as this is a command economy. The sheer scale is sobering though and we retain a very cautious view with regard to China and the economies within the region which are inextricably linked to it through trade.

We are also keeping a close eye on exposure to Hong Kong. The Hong Kong Dollar's peg to the US Dollar means local interest rates move in line with the United States, creating some credit tightening in recent months. A number of liquid, high quality, income generative stocks with good corporate governance are listed there though and they are included in the portfolios of some of our preferred funds due to their positive long term prospects. Once again it highlights the need for active management and careful stock selection.

We retain a generally negative view on emerging markets other than the handful of exceptional companies with stable attributes held as a small proportion of some of our global fund choices.

**Alan Torevell and Georgina Ogilvie-Jones**

*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.*

*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.*

*Issued by Dewhurst Torevell & Co Ltd, 5 Oxford Court, Manchester M2 3WQ. Tel 0161 281 6400. www.dewhurst-torevell.co.uk. Dewhurst Torevell & Co Ltd is a company registered in England 3279315 and is authorised and regulated by the Financial Conduct Authority (FCA number 183210).*