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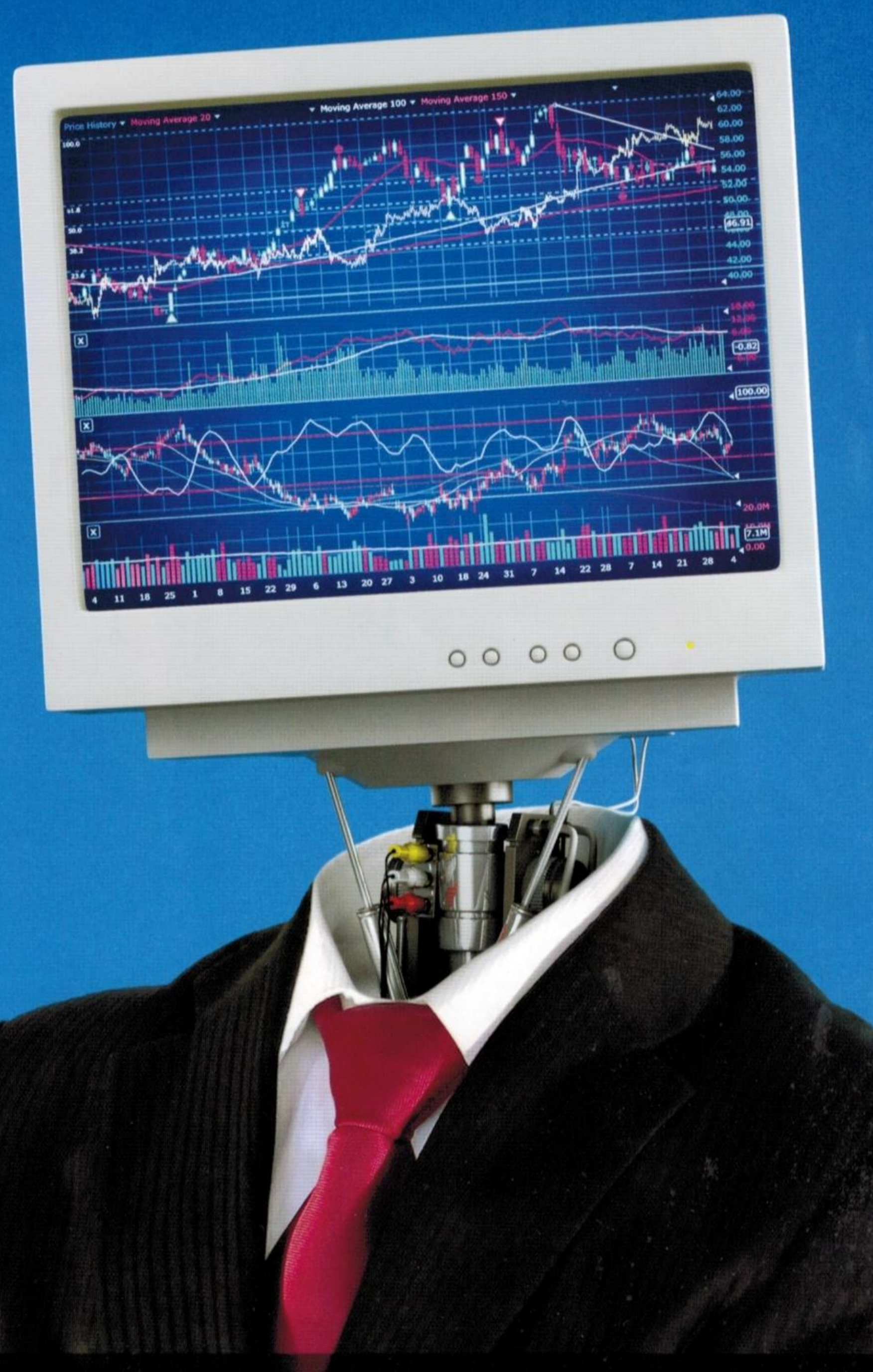

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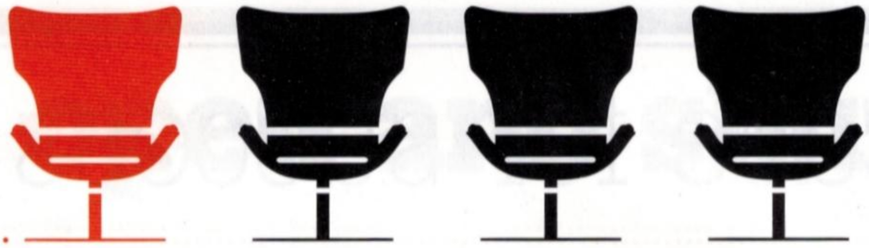


COMMITTEE CHAIRMAN

Adam Lewis
EDITOR
FUND STRATEGY

With summer soon to become a distant memory, the nights drawing in and the winter coat being dusted off, this month's investment committee seemed an ideal opportunity to consider the prospects for the few remaining months of 2014.

What has taken most by surprise this year is that rather than one versus the other doing well, both bonds and equities have outperformed. The S&P 500 has been on a 64-month bull run, the FTSE 100 has flirted with 14-year highs and fixed income markets generally have performed well, with the yield on 10-year UK gilts hovering around 2.5 per cent.

With many investors returning from holidays and considering their asset allocation, I thought we could stir some debate and explore where, for the rest of the year, do you see the best value?

Are you in the camp that think the US and the UK can continue their run or do they now look fully valued? If so, are there other developed markets you prefer, such as Europe and Japan?

Meanwhile there are signs that after multi-year underperformance, emerging markets are on the path to recovery, so do they look the better bet?

If you are in the camp that prefers bonds over equities, is it UK gilts, US treasuries, or investment grade bonds that are floating your boat?

So, lots to consider, all of which will be largely affected by the global central banks, whose actions the market is closely monitoring for who will be the first raise interest rates, and more importantly, when and by how much. Indeed, is now the time to build cash weightings within portfolios ahead of any central bank decisions?

To help guide us through all this we are this month joined by Neptune's chief economist James Dowey to provide the independent view

Mike Deverell
INVESTMENT MANAGER, EQUILIBRIUM ASSET MANAGEMENT

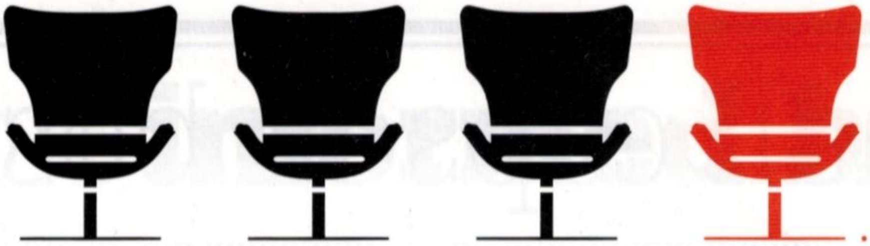
"The FTSE 100 has flirted with 6,900, the highest for 14 years. The S&P 500 in the US has breached 2,000 points. When the FTSE was last at 6,900 the market traded on 24 times earnings. Now the P/E ratio is 16 times historic earnings – by no means cheap, but nor frighteningly expensive. The US trades on 20 times historic earnings. That is getting expensive, but for both the UK and the US the picture is better if we believe estimates of earnings growth. Unfortunately, earnings growth has been weak in the US and negative in the UK of late, so we must be sceptical. Other regions look better value, notably Japan and the emerging markets. Not only do they remain cheap, but revenues in those regions are growing. We particularly favour China, which is priced for full-blown financial crisis. Anything less bad than the worst case scenario makes it attractive. Away from equities, we still favour UK commercial property despite its strong run. With tentative signs of rental growth and vacancies only just beginning to come down, prospects remain positive.

Jonathan Davis
MANAGING DIRECTOR, JONATHAN DAVIS WEALTH MANAGEMENT

"To us it is not bonds or equities. It is some bonds and some equities. So, we continue to like government bonds, and especially US treasuries. The fall in sterling since July (which had nothing to do with a Scotland exit as the pro-Yes polls came out in early September) has boosted the value of our US treasuries which are held in TLT (Long Term) and IBTM (10 year) ETFs. We wonder if the rallies in US treasuries and the dollar tell us there are rising fears in US equity markets. We remain uncomfortable with Western share prices. Also, we are steering clear of high yield corporate bonds, which may be at their most overpriced in history, given their yields (which are rising). However, we love emerging markets shares (and bonds, though not invested). The relative price of emerging markets to US continues to rise significantly. I'd far rather be in assets that had bombed than ones that had soared. Risks rise as prices rise and vice versa. We feel the massive multi-year underperformance of EMs is rapidly reversing. We access EMs via Templeton Emerging Markets Investment Trust.

Adam Barber
INVESTMENT ANALYST, CITY ASSET MANAGEMENT

"At City Asset Management we are focused on strategies that mitigate the most prominent risks we see in the current environment. Namely, impending rate rises alongside equity and credit markets that are fully valued, but not extreme. There is interest rate sensitivity across all assets, given that US tightening expectations have increased. In fixed income we favour floating rate assets to reduce duration. We place great emphasis on the attached credit risk, which we feel is often neglected. While focusing on future rate moves, we are also conscious of the pace of rate hikes the market has priced in; the five-year gilt curve suggests a sequence of gradual rises. However, if the UK economy reacts poorly to the initial increases we feel market expectations may fail to materialise. In equities, richly valued markets have led us to plan a diversification of our long-only exposure through structured products. In-house expertise allows us to tailor products with capped upside, capitalising the potential for more muted market returns in the coming years.



Our experts appear agreed that this year has not turned out as expected. So how are they approaching its final months?

John Husselbee
HEAD OF MULTI ASSET, LIONTRUST

"At the beginning of the year we expected equities to continue to continue to outperform government bonds and cash. The yield on 10-year UK gilts hovers around 2.5 per cent, a level out of kilter with this stage of the economic cycle. As a rule of thumb, 10-year government bonds should trade around the sum of economic growth plus inflation. This would currently equate to 4-4.5 per cent, based on consensus growth expectations of around 3.0 per cent and inflation of about 1.7 per cent. By this measure, UK gilts are very expensive and could result in capital losses of about 20 per cent on a reversal to these levels. We expect a gradual retreat. In the past, investors have invested in government bonds to generate an income, dampen portfolio volatility and to provide a reliable source of uncorrelated return when protecting against equity market falls. Today we believe that, with yields trading so low, these attributes are far less effective. We have been building cash by reducing bonds and alternatives, while remaining slightly overweight equities.

Tim Cockerill
HEAD OF COLLECTIVES RESEARCH, ROWAN DARTINGTON

"This year has not turned out as most investors expected. The biggest surprises have been how well fixed interest has performed and the sharp move from growth stocks into value stocks. While, for now, I suspect the surprises are done, US earnings have been good, record breaking in some cases, and with the Federal Reserve waiting for unequivocal evidence that the recovery is unstoppable, equities look well supported. Although they may not be that cheap, their prospects seem better than the main alternative, fixed interest. Interest rates will rise, and when they do a new trend will have been set, in which interest rates continue to rise as the economy recovers - straightforward economic policy! The question is: what impact will this have on fixed interest? Logic says: yields rise, prices fall. Some are predicting a sharp correction, but if political uncertainty exists abroad, fixed interest could prove more resilient than expected. Overall the dynamic and opportunities seem greatest in equities, but we are maintaining fixed interest exposure, especially for lower risk clients.

Lee Robertson
CHIEF EXECUTIVE OFFICER, INVESTMENT QUORUM

"Clearly, it has been a decent year for both equity and bond markets, with the developing outperforming the developed. Markets have been driven predominantly by central bank policies, elections and geo-political risks, all of which have become increasingly prominent. Despite this, the world economy appears on track for a modest recovery, with regions such as the UK and US leading the field. The Fed's tapering of its purchase programme will be completed in October 2014 and the first interest rate hikes are predicted for February (UK) and June (US). Both equities and bonds may continue to deliver acceptable returns for the rest of 2014; however, with the US and UK preparing to tighten their monetary policies, bond markets may start to become nervous. Therefore, we remain advocates for equity investing for the foreseeable future. In terms of asset allocation we favour Europe and Japan – where the central banks continue to be accommodating and the currencies weak – along with adding to our Asian and emerging markets exposure.

For the rest of 2014, Japanese and continental European equities both look good. Obviously, some worrying geopolitical developments are taking place at present but the opportunity cost of being defensive at this stage is still too high. So under the base case where the geopolitics do not deteriorate drastically, Japan and Europe should do well.

The Bank of Japan has proven that it can raise inflation quite effectively with quantitative easing. Japanese CPI back in March 2013 was -0.5 per cent; today it is 1.3 per cent (after adjustment for the VAT hike). It was not obvious at the start that this would be the case because QE in the US – apart from the first round, which was about alleviating distress in the acute stage of the crisis – had a fairly weak effect. But in Japan it is working.

We believe the main reason for this difference is that the labour market in Japan today is quite tight, whereas in the US during QE years unemployment was high. During the past few months, however, inflation in Japan has rolled over a bit, so the Bank of Japan is likely to redouble its efforts to hit its 2 per cent target. And this will boost Japanese equities. At the same time the dollar is strengthening, and dollar strength has favoured Japanese equities recently.

In Europe, we also see a monetary policy impetus for equities. Over the next few months the ECB will begin to deploy its targeted long-term refinancing operations (TLTROs) and asset-backed securities (ABS) purchases and will announce the results of the asset quality review (AQR) and stress tests. At the same time it has opened the door to QE as an effective put option if needed. The 'QE put' is useful for equities because it wards off deflation risk.

Valuations in both markets look good.

THE INDEPENDENT VIEW

James Dowey
CHIEF ECONOMIST, NEPTUNE INVESTMENT MANAGEMENT