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MADE IN THE USA?

COMMITTEE CHAIRMAN

Adam Lewis
ASSOCIATE EDITOR
FUND STRATEGY

For the first investment committee of 2014, we revisit the prospects for the US, an area last looked at by the panel back in July last year.

At that time, the prospect of the Federal Reserve tapering quantitative easing was seemingly casting a shadow over the bright spot of an improving US economy.

Indeed, just the very mere mention of the word taper would send markets in a spin. It lead to the perverse situation in which markets seemed to like poor economic data because it could delay tapering.

However, despite these worries, 2013 proved to be a bumper year for the S&P 500, returning a shade under 30 per cent. The year then ended with the Fed surprising many by announcing tapering would begin in January, a sign the economy was in rude health.

So with tapering now under way, the key question is what can investors expect from the region in 2014?

How likely is it US equities can repeat the trick of 2013 or are valuations now looking stretched, given how far the S&P has run.

And what of the economic prospects? The US was the poster boy of the developed markets in 2013 as the emerging markets struggled, so what of the possible growth rates in 2014?

Schroders' chief economist Keith Wade, this month's independent panellist, will tackle some of those points.

For our other panellists, I ask if they were overweight the US, are they going to remain so, given the start of tapering, and which are the best parts of the US market to hold – large, mid or small cap?

Also, are there funds in particular they would highlight?

Mike Deverell
INVESTMENT MANAGER, EQUILIBRIUM ASSET MANAGEMENT

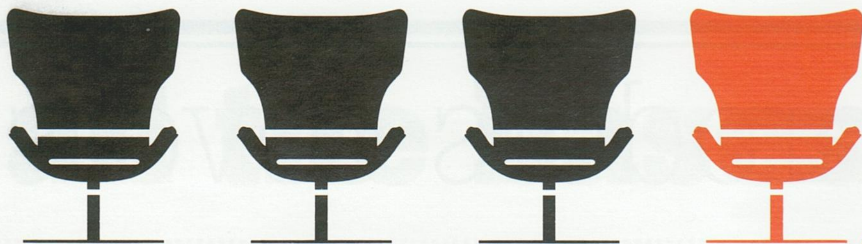
"After a fantastic run for US equities, the market is starting to look expensive. Many commentators have noted the oft-quoted Shiller CAPE (cyclically adjusted price/earnings ratio) measure for US equities looks worryingly high. The continuing usefulness of this measure is being debated, with critics pointing out that averaging earnings over 10 years may be misleading when we have been through such a deep recession. Others say the increasing use of share buybacks by US companies distorts the measure. While this may be true, this rather misses the point that other measures are showing similarly high valuations. In my view, it is time to underweight the US. While I would not necessarily agree with doomsayers who say we are due a correction, I would expect it to underperform relative to other equity markets. We have used trackers in the US as it has been difficult to find an active fund which consistently outperforms. If you are going to use active funds, I would look for quite defensive funds concentrating on quality companies with good income.

Jonathan Davis
MANAGING DIRECTOR, JONATHAN DAVIS WEALTH MANAGEMENT

"As far as we are concerned, US (and UK and German) share prices have disconnected from reality. That is a definition of a bubble. Prices have gone parabolic in recent months. Price/earnings are at huge levels. New York Stock Exchange margin debt is at all-time highs – even higher than 2000 and 2007. Investor sentiment is at multi-year highs, as indicated by portfolio manager surveys and by the multi-year lows in the VIX, a measure of the implied volatility of the S&P 500 index options. Finally, falls often happen at extreme highs in bullishness. While we saw US prices soar, those of emerging markets plummeted, as did commodities. Our view for 2014 is that there will be a reconnection between them. So US shares could fall (strongly) while emerging markets and particularly precious metals' shares could rise strongly. As such, we are cautious to bearish on US shares. We are not convinced that the reduced QE will be sufficient to keep driving the S&P, etc, up and up. Also, if we see emerging markets rising, money is likely to flow out of US equities into them.

James Calder
HEAD OF RESEARCH, CITY ASSET MANAGEMENT

"2013 witnessed some truly dreadful politics in the US, which had a negative, albeit short-term impact on the economy and the market, all of which was self-inflicted. However, it was the central bank that held the decisive card – tapering. The market's reaction to actual tapering was muted compared with its reaction over the summer to potential tapering. In our view, tapering is a precursor to tightening but it is only the starting shot in a very long game. Our outlook for the US remains positive as the economy continues to grow. We favour managers with a multi-cap approach, with CF Miton US Opportunities fitting this criterion, with its ability to invest across the market cap spectrum. Manager Nick Ford has had success as a US small cap manager, which makes this a very attractive opportunity. For those with a lower attitude to risk and a bias to income, we favour the Aviva US Equity Income fund II. We will continue with our short to medium-term positive outlook for the region but as other regions become more attractive, this position will change.



Our industry experts give their views on the prospects for the US market and discuss their pick of the funds

Most investors are questioning how much further the US equity market will rally. The answer lies in your view of whether we are mid or late cycle and whether inflation remains benign. Thus far, the unprecedented amount of liquidity has not resulted in any signs of inflation. With the economy recovery now showing signs of being self-sustainable, fundamental stock analysis has taken centre stage and as a result there is greater dispersion in share prices. This environment has and will continue to favour the stockpickers. However, one of the key determinants of returns in 2014 will be the plight of the US dollar. Its recent weakness has diluted returns for sterling investors, a reversal is to be expected as the Fed begins the process of normalising monetary policy. As a result, we have recently added to US equity weightings at the margins to the portfolios to maintain the appropriate balance consistent with our risk-based strategies.

John Husselbee
HEAD OF MULTI ASSET, LIONTRUST

It seems unlikely the US stockmarket will repeat the bumper performance of last year, the S&P 500 having risen 29 per cent on a total return basis. 2013 saw the market re-rate from what can now be seen as a low base but this was a one-off. From now on, the market will need to see earnings and sales growth to make serious forward progress. This progress will very much depend on the economic performance of the US economy and while this has been steadily improving, it does not appear to be strong enough yet to guarantee broad earnings growth. The fact the Fed is slowly tapering and that it could still be tapering in 2015, according to some commentators, indicates the economy is not yet ready to stand on its own two feet. So now does not seem to be the time to go overweight. Consequently, we have moved our stance to neutral from positive. Investor focus should be returning to fundamentals and as such there is the potential for good performance from US funds but it will be a genuine stockpicker's market, so not an easy environment.

Tim Cockerill
HEAD OF COLLECTIVES RESEARCH, ROWAN DARTINGTON

The decision by the Fed to begin its tapering programme has ramifications for the US equity and bond markets but in reality it is continuing its QE strategy throughout the majority of 2014 although it is reducing its monthly asset purchases by $10bn a month but this remains supportive of markets. In terms of valuations, the market is now noticeably more expensive as it has come a long way in a relatively short time. The US economy is still showing signs of recovery so we will be keeping our current weighting towards this region but believe 2014 will be more about stock sensitivity to the US recovery. Sectors such as financials industrials, information technology and consumer discretionary should do well, especially companies with strong balance sheets and rising dividends. Unquestionably, it will be more difficult this year and we have selected proven fund managers such as Clare Hart, manager of the JP Morgan US Equity Income fund, and Stephen Kelly, manager of the Axa Framlington American Growth fund, to support our allocations to the US.

Lee Robertson
CEO, INVESTMENT QUORUM

Towards the end of last year, the US Federal Reserve finally took the plunge and decided to trim asset purchases to $75bn per month, a reduction of $10bn evenly split between treasuries and mortgage-backed securities. This is about as dovish a taper as could be imagined. However, on the basis that the Fed trims $10bn at each subsequent meeting, then asset purchases would be over by October. Bernanke has every right to be cautious after the experience of the past few years but there are signs that the US has embarked on a new phase of growth.

We remain positive on the US economy and think that if anything it might surprise on the upside. This should be supportive because it means earnings will get a good base to drive off.

On the growth side we are expecting GDP growth of 3 per cent this year, with the risks tilted toward the upside as there is scope for a stronger consumer, given the rise in wealth over the past year. We also expect unemployment to fall further in coming months, reaching 6 per cent by the end of the year, an outcome which would put pressure on the Fed to take a more hawkish stance.

While payrolls may not accelerate a great deal from here, the participation rate could well fall further, thus driving the unemployment rate lower. Consequently, our bias is toward tapering ending earlier rather than later, with similar risks for the first rate rise.

Against this backdrop, there is likely to be some volatility in markets, with interest rate expectations and bond yields likely to reset at higher levels. Equity markets may prove to be more resilient but overall it promises to be a tricky start for Janet Yellen as Fed chair.

THE INDEPENDENT VIEW

Keith Wade
CHIEF ECONOMIST, SCHRODERS