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# ELECTION JITTERS



COMMITTEE CHAIRMAN


**Laura Suter**
EDITOR  
FUND STRATEGY

With the general election looming next month the Fund Strategy Investment Committee has been looking at the likely impact the campaign, and the election itself, will have on markets and portfolios.

The latest polls show that one party winning a clear majority is an unlikely scenario. This means the nation must turn to the prospect of another coalition – perhaps accompanied by another cosy announcement in the Number 10 garden.

If that proves to be the result, the question remains: what would such a coalition look like and which party will take that second place, with the Scottish National Party vying for a place alongside Ukip and the Lib Dems?

What seems certain is that until the result becomes clear the UK markets are in for a rockier ride, with volatility likely to rise. Winning and losing companies and industries will emerge from various policy announcements coming from all parties. Future crackdowns on the banking sector or energy firms, for example, if announced in party manifestos, are unlikely to go unnoticed by the markets.

Many will choose to ride out this potentially painful volatility in the hope that, once election day has come and gone, markets will settle. They are banking that their bets, based on the fundamentals of markets and companies, will be borne out after election fever has passed.

However, the election period might not all be doom and gloom: last month's Budget – seen as the Tories' big chance to win over more floating voters – sent the FTSE rushing past the 7,000 mark. The rise was due to buoyed investor sentiment as well as an uplift for some financial firms.

Whether you're taking a long-term view or hoping to make short-term profits off the back of volatility, one thing's for sure – there's unlikely to be a dull moment.

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**James  
Calder**
HEAD OF  
RESEARCH,  
CITY ASSET  
MANAGEMENT

May's general election, according to pundits, will be the closest and most unpredictable since the end of the Second World War. I am frequently asked if City Asset Management has made any portfolio changes in anticipation of the outcome. The short answer is no. Not that we are not concerned about the result or the likely increase in stockmarket volatility. We are, but considering that the lead-up to the election is a short-term event, our preferred option is to ride out the volatility, despite it being painful. The impact of politics on markets has become more pronounced since the financial crisis, but markets typically favour a weak government to a strong administration proposing radical policy change. I suspect the best we can hope for is a minority-led government where significant changes to policy, whether austerity or referendum orientated, are put on the back burner and we achieve a continuation of the status quo. So it comes as no surprise that while most fund managers I have spoken to are making adjustments to portfolios, the changes they are making are minor.

After a six-year bull market in which we have seen the FTSE 100 finally break through the magical 7,000 barrier, and a meaningful rise in the FTSE 250 and Small Cap Indices, given their potential for growth and possible mergers and acquisitions from their larger brethren, we might be nearing the point when protecting your portfolio from downside risk and volatility would be a prudent decision; particularly as we head towards an unpredictable general election, a currency that is likely to experience further volatility in the election run up, and a market that could easily give up some of its recent return. There are various strategies that an investor could implement, such as having exposure to a long-short fund or an asset class that is uncorrelated to UK equities and the market. Or investors could consider UK residential or commercial property, gold bullion, the short-dated UK gilt market, or a higher weighting towards cash; all these options would give wider portfolio diversification and some defence against a brutal correction from the UK equity market.

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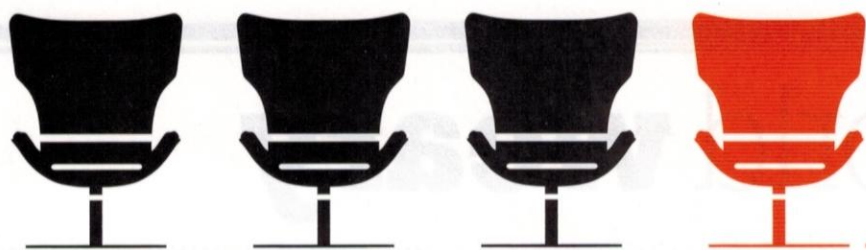

**Lee  
Robertson**
CHIEF EXECUTIVE,  
INVESTMENT  
QUORUM

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**Tim  
Cockerill**
INVESTMENT  
DIRECTOR,  
ROWAN  
DARTINGTON

George Osborne signalled the start of electioneering proper with his Budget speech. The market's reaction has two sides to it: the first, those initiatives that boost companies' earnings, such as the rise in Hargreaves Lansdown's share price. The second, and broader, reaction suggests the market thinks the chances of a Conservative victory have risen, with the focus on savers and middle earners in the Budget helping their case. The market dislikes uncertainty, so anything that suggests a more definite, positive outcome will go down well. However, polls indicate neither Tories nor Labour will win enough seats to control Parliament, so another coalition looks likely. No doubt volatility will rise as we get closer to polling day, but looking beyond the election, the UK economy is growing and wages are rising, so market disruption is likely to be short lived and should simply present buying opportunities. Some sectors could be vulnerable to a change of government, but it is all guesswork. We prefer to look at the fundamentals of companies and the bigger global picture.





## The most unpredictable general election in recent times could give the stockmarket a volatile ride. Should investors sit it out?

The idea that a general election in (little) UK normally has a material impact on the investment outlook is not one to which we subscribe. For instance, everyone says the correction in London house prices and the sharp pullback in sales is down to 7 May, whereas in our view the boom of the past few years was down to the Russians and Chinese; and the same for the fall. They are not bothered by our election. However, in Greece the stock market fell 40 per cent in the year to its general election in January – even though the economy was strengthening. So there might be something to it. However, we have made no changes because of next month. As at 18 March: there is still disinflation/deflation, China is still slowing down, the dollar is still in a bull market, and commodities continue to collapse. This is what is driving our decisions, not the Dave and Nick vs Ed and Nicola show. So, we continue to like US Treasuries and other assets that have collapsed, such as Greek stocks. When oil bottoms, on that hard-to-predict date, we'll move into Russia shares.

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**Jonathan Davis**

MANAGING  
DIRECTOR,  
JONATHAN  
DAVIS WEALTH  
MANAGEMENT

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**Mike Deverell**

INVESTMENT  
MANAGER,  
EQUILIBRIUM  
ASSET  
MANAGEMENT

May's election looks the most uncertain in recent history. If there's one thing markets hate it's uncertainty, so some volatility seems likely. The Budget has reduced the gap between Labour and Conservative spending plans. From an economic point of view the difference between the two main parties is now less marked. However, neither side is likely to win a majority so we'll probably see a coalition or a minority government. The junior partner in any coalition could have a big impact. If the SNP or UKIP were involved there would be question marks over Scotland's membership of the UK or the UK's membership of the EU. This could lead to uncertainty even after the election. Volatility may therefore be more significant in shares of companies that trade with Europe. We may also see big movements in sterling and gilts. Looking further ahead, we would expect equities to recover, as they generally look reasonable value. However, gilts already look expensive, and uncertainty could make them look more risky and could have a longer-term impact.

The UK election is looming, and according to popular polls carried by the national papers an overall majority for either political party seems unlikely at this stage. The latest odds from the spread betting companies denote a similar tale and the difficult task of forming a credible coalition.

What's more, as the final Budget of this parliament showed, the room for wriggle in terms of fiscal spend for whoever takes the keys to No. 10 remains limited. In the meantime, the FTSE 100 index has broken the 7,000 level, surpassing the previous late 1999 all-time high. No doubt helped by the falling oil price, which will more than likely provide a greater global economic stimulus than any money printing schemes, allowing real growth to be revised upwards this year and next. As the major driver of inflation, the decline in energy prices should be positive for consumer demand. Despite the positive economic news, the uncertainty of the election outcome will, at the very least, have some effect on overall sentiment leading up to the ballot box in early May.

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**John Husselbee**

HEAD OF  
MULTI ASSET,  
LIONTRUST

The most important piece of information in the Budget from the macro perspective was that the Office for Budget Responsibility now expects the Government debt to GDP ratio to fall in the next tax year as opposed to continue rising as it expected beforehand. This does not have any major economic implication per se but what it does mean is the Conservatives are now able to claim that they are basically going back down the tunnel at half time, having put in a solid performance in the first half. That was much trickier to do before and so at the margin I believe that this raises the chances of a Conservative-led win in the election.

If the current coalition were to remain in government after the election, then this budget implies a little bit less austerity over the next parliament than was expected previously.

I calculate it at 4.5 per cent of GDP as opposed to the 5.3 per cent expected before. The main part of this is that the austerity would simply end a year earlier – in 2018/19 rather than 2019/20. So, given a continuation of the coalition, or Conservative-led government of another kind, that is very marginally pro-growth, pro-equities and anti-bonds compared to previously.

Note though the big picture here is that the UK still faces a large fiscal headwind over the next few years, which should act to suppress GDP growth, interest rates and the exchange rate.

### THE INDEPENDENT VIEW

**James Dowey**  
CHIEF ECONOMIST  
NEPTUNE

