

Investment committee: Home truths

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The Fund Strategy Investment Committee asks if austerity has worked and the UK economy has turned a corner



Committee chairman: Adam Lewis, editor, Fund Strategy

It is a year since the first Fund Strategy Investment Committee convened and we have travelled around the world looking at the prospects for various countries and asset classes. One region we have not considered is the one closest to home.

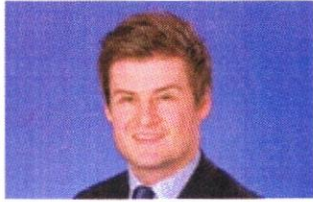
In last month's Budget it was revealed that the OBR has upgraded its economic forecast for the UK in 2014 from 1.8 per cent to 2.7 per cent – the biggest upward revision (between Budgets) for 30 years. Growth will drop back to 2.3 per cent in 2015, the OBR predicts, then rise to 2.6 per cent for 2016/17 and return to its long-term trend of 2.5 per cent by 2018.

At the Fund Strategy Investment Summit in March, Capital Economics founder and chief economist Roger Bootle predicted UK growth rates of 3 per cent in both 2014 and 2015, reflecting a generally bullish outlook for the economy. Indeed, according to Chancellor George Osborne, the UK is now the fastest-growing advanced economy and in six months' time will be larger than it was before the collapse six years ago.

At the same time, unemployment is falling and the debate now is over when the Bank of England's monetary policy committee will announce the first rise in the base rate? While Bootle does not think it will happen until the end of 2015, former MPC member Andrew Sentence told delegates at the summit that it could happen later this year.

So, key questions for the committee this month are: Should we be as bullish as the economic commentators encourage us to be? Has austerity worked and the economy really turned a corner? And how does this translate to likely performance of the FTSE?

To help tackle these points we are joined this month by Neptune's chief economist, James Dowey. Meanwhile, we ask our regular panellists: are you underweight or overweight in UK equities and what are your fund picks?



James Dowey, chief economist, Neptune Investment Mgt

The UK economy is 'on the road again', to paraphrase the great Willie Nelson. But is it a sustainable trajectory or, as many commentators are warning, too reliant on an engine with limited fuel to burn – the still heavily indebted consumer?

To be sure, it would all look more sustainable if investment and exports were playing a bigger role. But in their absence, it should be emphasised that consumption from mid-2008 to the start of 2013 was abominable. And so businesses have really struggled. It does not surprise me that today they are waiting for undeniable confirmation of a return of the Great British Consumer before resuming investment. Hence, one should expect to see consumption lead the recovery at this stage.

Furthermore, the export picture has been clouded by the eurozone crisis. Actually, non-eurozone exports have been growing strongly. It is just that this has been overshadowed by shrinking exports to the epicentre of the crisis. If European growth improves, UK export growth will start to look better.

Is all this evidence that the Chancellor's austerity programme is working, as he has claimed? It is profitable to think of the Chancellor, whoever he may be at the time, as similar to the captain of a small boat in a raging storm, tightly gripping the tiller. We know one thing: the tiller is not attached to anything. Austerity has had as little bearing on the growth of the past 12 months as it had on the stagnation of the 24 months before that (the major determinant has been the crisis and subsequent calm in the eurozone).

But if the consensus growth forecast for 2014 is right, I believe this would make the Conservatives difficult to beat next May. And it is unlikely the Bank of England will spoil the party.



Mike Deverell, investment manager, Equilibrium Asset Mgt

The UK has finally begun to see real economic growth again. Yet despite the recent improvement, UK GDP is still below its 2008 peak and growth remains below the pre-credit crunch trend. There is plenty of recovering left to do but the economy appears to have momentum.

Monetary policy remains important. Investors are fixated on the date of the first interest rate increase but really they should focus on the pace of increases. The MPC has said rates will increase slowly and settle ‘materially’ below the pre-crisis levels of 5 per cent or so. To me, this says rates will settle below 3 per cent. If this is correct, UK companies with a domestic focus should do well. Small-cap funds could continue their outperformance.

Another way to play a UK recovery is via commercial property. Property funds (bricks and mortar rather than property shares) have had a great run. With rental yields still above 6 per cent, void rates falling and capital values rising, property is producing the best risk-adjusted returns of all the major asset classes. This looks likely to continue throughout 2014.



Jonathan Davis, managing director, Jonathan Davis Wealth Mgt

The UK will have good growth this year, but what has this to do with the stockmarket? When economies are strong, that tends to be the topping, and vice versa. There is no way our economic problems are sorted.

We have growth because we still have the ‘emergency’ base rate, because the Government is borrowing massively and because of Help to Buy, which I call Help to Sell. Next time there is a global economic shock the UK will in no way be insulated.

The one thing the MPC cannot do is slash the base rate. ‘Everyone’ says, long term, rates will rise. Yet long-term gilt yields have been falling since the start of the year (as of early April). I would not be surprised if we are #TurningJapanese (as I say on Twitter) – that is, being in an era of disinflation – maybe even outright deflation.

So, long-term gilt funds are not nonsensical right now. I am not comfortable with UK equity prices at present levels. We’ll wait for a sizeable fall before we re-enter, using L&G IM’s Equity Income fund. Other markets are far more interesting, coming off low bases. Why be interested in assets that have soared for five years?



James Calder, head of research, City Asset Management

We increased our weight to the UK in mid-2013 as the economic data began to surprise on the upside. As we invest on a real return rather than relative basis, this move highlighted our increased confidence in producing an attractive return from the UK market. If UK data improves markedly through this year, a rate rise is likely before the next election.

However, on the balance of probability, rate rises are more likely to begin towards the end of 2015 as unemployment continues to fall. The real issue will be to manage inflation versus the housing market. Inflation appears to be contained over the short term but it may return with a vengeance.

When assessing the UK market one has to differentiate between the real economy and the stockmarket and, within the latter, the various elements of it. Mid- and small-cap companies are more reflective of the real/domestic economy, and for this reason we favour funds not hindered by the large cap-dominated index. These include the Ardevora UK Equity, the R&M UK Equity Income and the CF Miton Smaller Companies funds.



John Husselbee, head of multi asset, Liontrust

The view from the IMF is that the UK will be the fastest-growing economy of the G7 this year. The pace of UK recovery has surprised most commentators; some even predict that interest rates will rise here ahead of the US.

However, the recovery remains narrow and immature and is still vulnerable to external shocks. In the meantime, the agenda for the monthly MPC meeting remains fairly short, with little prospect of change while unemployment remains above 7 per cent.

Inflation is not high and expectations are not rising above target. A third of the seats on the MPC are due to change over the summer, which may cause a shift in the debate. However, this is more likely to be triggered by falling unemployment. With the recovery moving at a respectable speed, rate rises are more likely to occur after next year's election.

The UK equity market is more attractive than bonds and real value is beginning to emerge in some large-cap stocks. This is a stockpickers' market, with decent rewards for those who carefully consider sectors and stocks.



Tim Cockerill, head of collectives research, Rowan Dartington

If economists were paid by the accuracy of their forecasts there would not be many of them. There is no doubt, however, that the UK economy has picked up significantly.

In a recent news item a UK manufacturing company said exports were up 70 per cent, which says something about where the growth is coming from. Headline economic numbers such as the employment rate can be misleading. In an economy based on consumer spending, the large increase in part-time and zero hours contracts is not a recipe that is going to properly stimulate consumption.

Other factors have also been at play. PPI compensation claims have stimulated the UK economy by about £12bn, and by allowing pensions to be drawn down the Chancellor seems determined to keep the momentum going, but at what longer-term cost?

For now, the economy has turned a corner, and the stockmarket has reacted positively, yet we need clear evidence of economic improvements coming through in earnings and profits to justify the markets' optimism and take it higher.



Lee Robertson, CEO, Investment Quorum

With the IMF making such positive noises on the UK economy, and with the recent good news from the FTSE, it would be easy to think that everything is working out well. George Osborne has been given a gold star by the IMF's prediction that the UK would top the G7 economies this year for growth.

This is the same IMF that a year ago was trying to award him the dunce's cap for too much austerity and too little commitment to growth. While it does appear that Britain has delivered fiscal and economic reform, which has benefited through growth – meaning we remain overweight UK equities – we remain at the cautious end owing to the potential for shocks to the system.

We may yet see more trouble from the situation in Ukraine and the potential for deflation in Europe. Inflation also continues to fall in the UK and the US. However, we are optimistic, and to benefit from our growth stance we are using the Lindsell Train UK Equity, Schroders UK Opportunities, Franklin UK Smaller Companies and Henderson Growth and Income funds, among others.