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# Christmas cheer for property?

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FIRST FOR INVESTMENT STRATEGIES

# LOOK BACK IN WONDER

COMMITTEE CHAIRMAN

Adam Lewis

EDITOR
FUND STRATEGY

**And so it comes to pass that we reach the last Investment Committee of 2014 and, as is customary, a perfect time to review what has happened over the past 12 months.**

**Before we start this review, let's remember how the year started. 2013 was the year of the developed markets, with the S&P 500 index up some 30 per cent, while emerging markets had another tough year.**

**In the US, this naturally led to questions about how stretched valuations looked, and in the first committee review of the year the consensus of the panel was that the US would struggle to repeat the trick of last year, especially after the Fed began its tempering programme in January.**

**Despite these concerns, year-to-date the S&P 500 is up some 16 per cent versus the FTSE All-Share gain of 2 per cent.**

**Emerging markets staged a comeback also, with the MSCI Emerging Markets index up more than 6 per cent year-to-date (compared with a 2.3 per cent drop in 2013).**

**Given the run of performance from the US and UK, especially in the first half of the year, there has been the view that Europe and Japan offered better in the second half. Is this a view any of you shared, or were you put off by the geopolitical concerns that dogged much of the year?**

**Finally, what of fixed income – the asset class that continues to confound the experts with its run of returns?**

**Indeed, over 10 months to the end of October (numbers for the year are not yet available) the top-performing sector is UK Index Linked Gilts. In addition, over the same time period, only two equity sectors placed in the top five. In this environment, which assets have the panel enjoyed the most success in 2014?**

**To help guide us through the year we are joined in this final issue of 2014 by Hermes' chief economist, Neil Williams.**

Mike Deverell

INVESTMENT MANAGER, EQUILIBRIUM ASSET MANAGEMENT

“This year's investment decisions have by and large worked well – in particular our overweight to property. However, a few positions looked dodgy for a while. In the UK, our preference for smaller companies worked against us in April and May; the large-cap index rose sharply while small and mid caps declined. Luckily our funds have outperformed since then, falling less and bouncing quicker during recent turbulence. Our call to top up during the dip also worked well, and some gains have been banked. Our preference for Japan over the US and Europe has been interesting. Europe has underperformed while the US has thrived, so overall we have broken even. However, Japan is getting better all the time. The one issue we really didn't see coming was the rally in high-duration government and corporate bonds – those bonds more sensitive to changes in interest rate expectations. We hold low-duration funds to guard against rate rises, so this worked against us. Now is not the time to change that position as we think rates will rise in late 2015.

Jonathan Davis

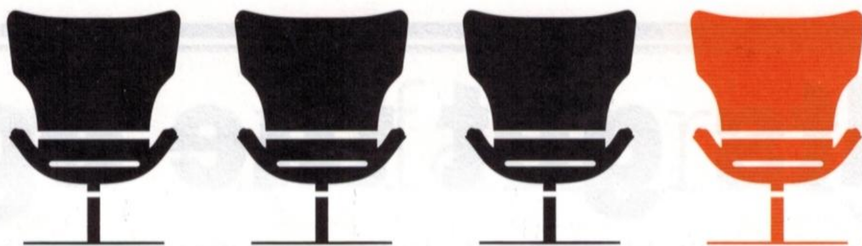
MANAGING DIRECTOR, JONATHAN DAVIS WEALTH MANAGEMENT

“It has been a mildly positive year for our clients (as at 11 November), while the risks to the global economy and shares, in our view, have soared. The bull cycle is over five-and-a-half years old. At the start of the year, according to RBS, three out of 34 OECD countries were in deflation. By November, that had risen to 13. Thus, we have been delighted with the handsome returns on our strongly bullish view on the US dollar and US Treasuries. Our specific commodities, bought after huge falls in the past few years, have been up and down and appear still to be bottoming. We remain bullish on a medium to long term. Although China's economy appears to be slowing rapidly, the Shanghai stockmarket looks to be ending its multi-year bear market. This could be good for our emerging markets holdings, added at the end of 2013. Western shares have been lacklustre and our multi-asset holdings have not been helpful, except for Premier Defensive. I leave you with one thought going into 2015: Is the West turning Japanese? The evidence is building that we are.

James Calder

HEAD OF RESEARCH, CITY ASSET MANAGEMENT

“This should be remembered as one of those years where results did not live up to expectations. Coming off the back of a strong 2013 for equity markets, there was a degree of retrenching despite some markets hitting new highs. The recurring influence of unexpected events – a combinatio of the Ukraine, sanctions on Russia, ISIS, Ebola and a European slowdown (to name a few) – led to a third-quarter sell-off. Many would argue that this sell-off was overdue and blew the froth off markets. But there were points of excellence along the way and our clients benefited from a mix of assets. The following holdings, year-to-date, have returned double-digit performance: Boussard & Gavaudan, the fund of hedge funds: the First State Global Listed Infrastructure fund: and the Twenty-four Income investment trust. We are cautiously optimistic that the US has achieved escape velocity and the UK has entered a new period of GDP growth. However, we would caution that growth expectations for the remainder this cycle will be more muted than in previous cycles.



## Our experts seem agreed on two things about 2014: the year did not pan out as expected, and geopolitics played a crucial part

Tim Cockerill

HEAD OF COLLECTIVES RESEARCH, ROWAN DARTINGTON

"For investors, 2014 has been a year of surprises. Politics have played a big part, as have the economic numbers. The year started optimistically but with muted expectations for equity returns, given how strong 2013 had been. Yet the S&P 500 has delivered over 16 per cent year-to-date while the FTSE 100 is up less than 2 per cent; quite a surprise given that the UK normally follows the US. The improving economies of the West suggested interest rate rises were close, which was bad news for bonds. But the FTSE Gilt All-Stock index is up over 9 per cent. The jury is still out on when those elusive interest rate rises will happen. Active managers had a tough year; the sharp growth-to-value switch that started in April damaged performance for many, so moving to protect portfolios was necessary when it became clear it wasn't a blip. Asia has been our best active position – we increased exposure early in the year following the mini emerging/Asia crisis when currencies went haywire, since when it has paid off nicely, helped by the Indian election – politics once again.

John Husselbee

HEAD OF MULTI ASSET, LIONTRUST

"The script at the start of the year talked of steady global growth, rising government bond yields and modest equity returns. Months passed before signs that the US economy had thawed after its winter freeze. Meanwhile the eurozone struggled to find growth, with increasing tensions in Ukraine acting as a further restraint. Fearing deflation rather than a euro break-up, investors drove bond yields sharply down, with Spanish 10-year debt yields trading below the equivalent gilts. This, coupled with the expectation that interest rate normalisation would be further delayed, helped to support government yields here and in the US. Some of the best returns for asset allocators came from being overweight in fixed interest, an asset class that remains wildly overpriced. Equity allocation was broadly neutral until the divergence in the US and Europe in terms of economic prospects. The dollar strengthened, the S&P 500 continued to new highs as the euro weakened and equity prices fell. The question is whether to stick with the momentum trades or pile into value.

Lee Robertson

CEO, INVESTMENT QUORUM

"To date, it has been a year of markets reacting to geopolitical risks and delivering lots of volatility. The Ukraine-Russia border conflict, ISIS and a softening of growth figures in China have led to some market contagion, particularly in emerging markets. The withdrawal of QE, particularly in the US, has meant investors having to work hard to read the markets. As I write this, however, US markets look much happier, based on improving confidence and economic data. We have remained neutral to overweight equities, particularly in the US and the UK, and our clients have been somewhat rewarded. We have benefited more than expected from fixed income markets, but corporate and high yield bonds have held up delivering better than hoped-for returns, as has property. We continue to invest in Japan and its proactivity has brought rewards, on a tactical basis at least, for investors. Emerging markets have disappointed, South America has been pretty awful and commodities have largely struggled. All in all, not a fantastic year for efforts made and risks taken on behalf of clients.

**While 2014 was all about preserving green shoots and trying to kick the drug of QE, there is a lot more work to be done.**

**Seven years after the first traces of crisis, we have a three-speed recovery. In the fast lane are the US, Canada, New Zealand and Australia. In the middle, the UK's GDP is 4 per cent higher than pre-crisis. But in the slow lane, Japan and the eurozone are barely back to square one.**

**Yet wages have not outpaced inflation. US GDP may be 8 per cent up but its CPI has risen 17 per cent and wages ditto. Worse, the UK's RPI is 23 per cent higher but average wages up only 12 per cent. Real-wage growth seems the missing link.**

**And this after six years of QE totalling $4.4trn (£2.8trn) in the US, £375bn in the UK and an amount by the Bank of Japan that, at 30 per cent, is set to beat the US Fed and Bank of England's ownership of their bond markets. The three now have too much 'skin in the game' to take us off-guard. As a result, expect no more than baby steps towards the policy exits. My macro outlook for 2015 is based on three core beliefs.**

**First, not only will US and UK real policy rates stay negative to 2017, but I believe 'peak' rates, when they come, will be much lower than we are used to.**

**Second, there's no free lunch. Lower peak rates will be delivered by central banks pulling on the second lever – selling back after 2015 some of the bonds they bought under QE.**

**Third, markets are at last focusing on the right thing – a eurozone whose monetary union still lacks sufficient fiscal unity.**

**The labour market will be critical to completing the recovery jigsaw. The issue for central banks is whether to be proactive on rate hikes or wait till the last piece (real-wage growth) has slotted in. We suspect they will do the latter.**

THE INDEPENDENT VIEW

Neil Williams

CHIEF ECONOMIST, HERMES INVESTMENT MANAGEMENT