

fund strategy

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What challenges does 2016 hold?

After a turbulent year, *Fund Strategy's* experts consider whether the Federal Reserve's expected interest rate raise indicates that the dust has settled

COMMITTEE CHAIRMAN



Laura Suter

Editor,
Fund Strategy

This year was certainly not a quiet one for the markets. The year started with the European Central Bank releasing more QE, surprising markets and boosting European equities. But this was marred by the continued drop in oil and commodity prices, which continued throughout the year. More recently it has stabilised at around \$45 a barrel.

Greece then dominated the headlines, with the 'will they, won't they' debate about whether they will default and leave the Eurozone. While that was bubbling along in the background the UK was hit with general election fever, causing some volatility in UK markets. The surprise outcome of a majority Conservative win boosted UK shares as the prospect of a hung parliament disappeared.

Just as Greece's emergency bailout money had been cashed and with markets looking forward to a quieter summer, the China turmoil hit.

After rapid gains in the year to that point, market drops hit Chinese and global markets. Subsequent currency devaluations by the Chinese Government hit confidence further, hurting emerging markets, which had been having a bad year already. Fears over Brazil and China growth caused fund outflows and drops in investment performance.

The focus is now on the Federal Reserve and rate rises. Although most expect any rises to be very gradual and marginal, markets are still waiting for that first hike, at which point the spotlight will no doubt be placed on the UK's timeline of raises. With such an eventful year around the globe in 2015, what does 2016 hold? We ask our committee.



Tim Cockerill

Investment director
Rowan Dartington

The challenges of this year are going to be with us in 2016. If the Federal Reserve raises interest rates in December, as expected, it will indicate that the US economy has recovered to a point where demand and inflation is becoming a worry and the economy needs to slow down. On the other hand, a rate rise will knock the fixed interest markets for six, not so much in the developed world but in emerging markets where debt issuance has escalated on the back of cheap money.

China will remain centre stage for investors. The economy is slowing, but it is the extent of the slowdown that is important. While the service sector and consumer demand are important factors, China's demand for commodities will remain one of the drivers behind stockmarkets.

I'm expecting the first half of 2016 to be characterised by a slowing global economy, uncertainty and volatility. Russia, Japan and Brazil are in recession, and Australia and Canada hover on the brink of recession too. Europe is likely to climb out of its hole but Greece and the migrant crisis will haunt Europe and the markets.



Lee Robertson

Chief executive
Investment Quorum

We believe that 2016 is likely to be a challenging year, given that we will see a decoupling of central bank policies. The Fed will need to tighten its monetary policy while the European Central Bank and Bank of Japan increase their QE programmes to counteract any further weakness within their domestic economies. Other causes of concern will be the Chinese economic slowdown and the continuing fall in commodity prices.

While this might sound rather gloomy it opens up opportunities. First, weaker currencies in Europe and Japan will act as a tailwind for exporters. Second, interest rates rises in the US will be negligible and therefore US Treasuries and US equities could become popular. Likewise, emerging markets have collapsed but they now look comparatively cheap against the developed markets. In the UK we still favour UK mid and small caps over their larger brethren.

We believe equities look better value than bonds with UK, European and Japanese equities offering better value than the US. Unquestionably, the global economy is on the mend, but growth will remain rather anaemic.



John Husselbee

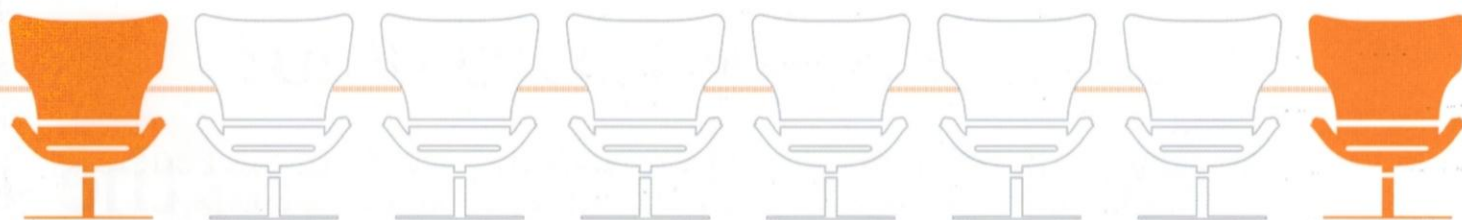
Head of multi-asset
Liontrust Asset Management

I was taught early on that the key to long-term performance was to determine the direction of economic growth and the path of inflation, and to construct an appropriate portfolio.

Thereafter, one should follow newsflow carefully to see whether any new information might change that view. Looking ahead to 2016, investors would do well to expect the unexpected. With an Olympics in Brazil and the US presidential election, next year will surely have its fair share of shocks and surprises.

I foresee a period ahead of modest global economic growth and rising inflation, albeit at a pedestrian pace. There are signs that the oil price is beginning to stabilise around the \$45 level, which should trigger further growth for those countries that consume more energy than they produce. This is coupled with a supportive easy monetary environment whereby many global central banks are still looking to loosen rather tighten policy.

Traditional asset classes are not considered to be cheap, but there is relative value for active managers, particularly in equities at the stock and sector level.



James Calder

Head of research
City Asset Management

Our asset allocation is continually evolving and, unless something happens, it is likely that 2016 will reflect our current thinking. As it stands we will remain positive on Japanese and European equities, while remaining neutral on the US and the UK, in addition to adding some long/short exposure here.

Global emerging markets were cut to zero earlier in 2015, with Asia reduced, but we are currently conducting research into these areas in the expectation that we may well reverse our short-term position.

Rate rises in the US and the UK may well lead to some opportunities within fixed interest but, again, I believe our current positioning of strategies and weights is suitable for this environment. The biggest concern I foresee for 2016 is with respect to my overweights in UK commercial property, which is centred on secondary market opportunities.

In terms of outlook it still remains strong for this asset class, however I am mindful of the structural liquidity challenges facing UK commercial property, so would look to reduce the exposure at some point in 2016.



Mike Deverell

Investment manager
Equilibrium Asset Mgmt

"Prediction is very difficult, especially about the future." The words of physicist Niels Bohr are especially pertinent right now. None of the major asset classes look great value. Equities generally trade on higher multiples than long-term averages, but are not scarily expensive either. Bonds and property have much lower yields than historically, but are well above inflation and interest rates. Commodities? Who knows?

In my view, investment returns probably will not be stunning. There are one or two areas which look interesting. In equities, smaller companies in the UK still look attractive, trading on similar multiples to large caps but with much greater earnings growth. Japan also looks cheap relative to the rest of the world and again has stronger profit growth than other major regions.

Away from equities, commercial property will probably provide decent, if unexciting, returns but with some great diversification benefits. In bonds, selective areas of high yield are looking more attractive again.

Asset allocation is always key, but in 2016 it will be equally important to be selective within asset classes.



Jonathan Davis

Managing director
Jonathan Davis Wealth Mgmt

With Wall Street holding a net short of corporate bonds for the first time in years, you have to expect big problems there. The level of debt is off the scale, yet aggregate corporate profits are slipping. This leads to general equity prices at serious risk.

At around 6100 the FTSE is about the same level as four and a half years ago and it looks fragile here, unless intervention takes place. On the other hand government bonds remain a buy, especially after a mild pullback this year. Indicators point to sharply lower growth next year, compared to 2014, and even possible recession.

The US dollar remains strong and appears to be in a multi-year bull market. This is, of course, deflationary.

Prices of commodities and valuations of energy producers are extremely attractive. At some point you have to expect a reversion to mean, which would be difficult with a strong US dollar, but markets do strange things.

The surprise winner of 2016 could well be Greece. The market is at 5p in the £1 compared to 15 years ago and the economy looks to be stabilising, so if the banks are recapitalised it could soar.

INDEPENDENT VIEW



Tom Becket

CIO
Psigma Investment
Management

World markets are at a very interesting inflection point. On the one hand there are the assets that have done well in the past few years, as investors sought safety and certainty; on the other there are the much distrusted investments, in cyclical sectors, high-yield credit and anything considered to be an emerging market.

If the global economy follows our "solid, but unspectacular" projected path next year, we expect US interest rates to rise gently, bond yields to tick higher and a major rotation to take place in markets.

If you have a long-term horizon your asset allocation should be at least more balanced than it has been over the past few years and you should be selling down your defensive assets and refocusing on investments that are cheap and discounting their long-term return potential.

In equities the focus is on Asia, Japan and the periphery of Europe, rather than the US and UK, which look fairly valued. The rabid sinophobia that persists in the western press should not deter investors from seeking opportunities linked to China and India, particularly after the recent scepticism over Narendra Modi's ability to change the country.

Looking at sectors, we like energy, another contrarian bet, while financials should start to improve, aided perhaps by the first few rate hikes in the US. There will also be an opportunity to increase allocations to mining companies and some of the hated emerging markets, such as Brazil. Outside of equities, the extraordinary divergence in performance between higher and lower rated bonds allow "once in a cycle" opportunities in lower-rated debt, for those willing to take the plunge.