asset management
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10 years, 2004 - 2014
International Perspective, Independent Advice

Global Market Strategy – January / February 2015

Anaemic growth to continue = Positive environment for shares

Volatility returned to the markets in a huge way in December. Volatility, or "Vol" as it is known in market-speak, was incredibly subdued in 2014 but over 7 trading days in mid-December as much as $900 billion was wiped from the valuations of companies on the S&P500, and then subsequent to this, during two trading days before Christmas $800 billion was reinstated.

Increase in vol usually means a rough ride for investors as more take fright at the thought that gains can be erased, and losses accrued, quicker than the time it takes them to persuade themselves to hold their nerve. Yet hold their nerve they probably should during 2015. Growth in developed markets is likely to stay 'anaemic' (due to banks' restrictive lending practices, tight labour markets and misplaced fear of rising interest rates) but that should mean conditions for equity investors remain positive (because of low oil prices, low interest rates and low inflation).

However, in order to try to equalise to some extent the growing social divide brought about by those in work growing richer and those out of work growing poorer, the rich face being squeezed by fiscal tightening, although probably not until after the general election in the UK. Spain has already seen stringent fiscal tightening with the workforce being asked to pay far higher levels of social security, and having already miserly levels of private pension saving incentives cut by between 20 and 40% in 2015, depending on age.

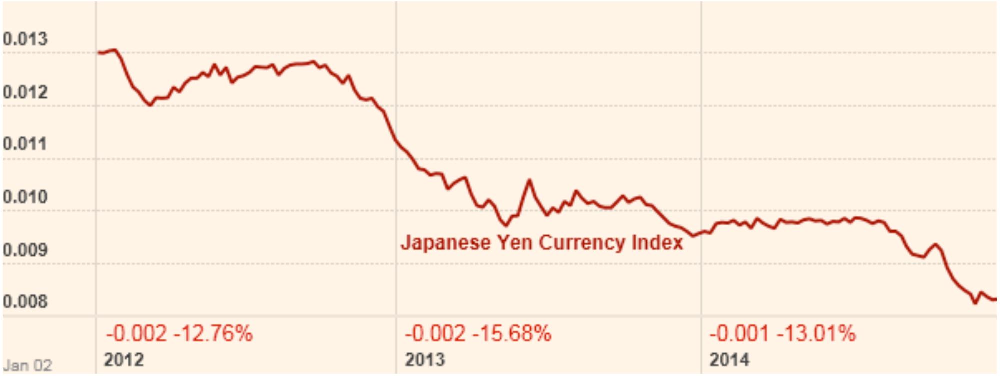
Reflecting a little on 2014, would that we had all our money in Egypt! Their market rose 30% last year and is up 100% in 2 years, in contrast to Germany which fell 9.3% in 2014, France which fell 9.1%, the UK, down 5.8%, and Spain, down 3.8%. Poor old Portugal's stockmarket fell 37.2%. The US market rose 14.5%, helped by renewed evidence that their economy is recovering broadly, and ironically, thanks to the strong performance of the dollar. which rose against the euro, sterling, the yen and 13 other currencies, the first time in 14 years that it has achieved such gains. Part of the reason for the gain is due to expectations of higher interest rates in the US, however with the employment 'participation' rate remaining stubbornly around an historic low of 63%, if interest rates do rise they will be do so very slowly. Analysts expect the dollar index to be strong again in 2015, rising 4% over the year, and with the index already over 90 (once it passes 80 there are normally warning bells ringing in the equity markets), the proximity of the wall of worry should put a cap on any US equity investment complacency.

Source: Financial Times

The euro and the yen both fell 12% last year, aided respectively by Draghi's apparent determination to launch full QE during 2015, and by Shinzo Abe's successful snap election win which endorsed his own bond-buying program. Two years ago when the yen was 85, there were whisperings of the yen falling to 200 to the dollar. In the last three years the yen has fallen 60% against the greenback. Now that the rate is 120, those 200 level whisperings are growing a little louder, as is the 20,000 level on the Nikkei by the end of 2015 (currently 17,450, January 3rd). Any thought of deploying a 'follow the money' strategy in Japan and Europe, has to be weighed against the certainty, at least in the short to medium term, of a weaker associated currency. Yet well-chosen fund managers in the Japanese and European markets have produced good results for sterling investors, particularly for the former over the last 3 years and for the latter over the last few months.

January 5th 2015

A stronger dollar is likely to make commodity investment an especially tough ride, which is why precious metals investment, bar a worsening geopolitical environment, could face severe headwinds. (Both gold mining and energy related stocks are showing extreme oversold levels according to chart analysis and both could therefore rebound before the end of the year, subject to a weaker US dollar and a supply/demand imbalance.) Water and timber should be two exceptions to the bearish fundamental outlook for commodities.



There is a case for the UK to raise rates in 2015. Similar to the US as far as inflation is concerned (ie benign), and despite the employment market tightening, the Bank of England is frightened of falling 'behind the curve' and raising rates only once inflation has already taken off, so there could well be a small interest rate increase toward the end of the year, not only to put a foot on the neck of inflation but also to remind the housing market that interest rates can rise, and that if base rates must rise to more traditional levels of around 4%, many property owners could struggle very suddenly. As in the US, the BOE has to be careful though, not to snuff out the 'green shoots' of economic recovery.

In the emerging world, economic recovery has been sluggish at best, and this theme could become more pronounced over the year ahead. EM growth will continue to be influenced by a variety of factors, including exposure to the US and China, dependency on commodities and progress on structural reform. Broadly speaking, emerging markets with close links to the resilient US economy, rather than to China, are likely to deliver better growth outcomes, with the likes of Mexico and Korea therefore better positioned than Brazil and Indonesia. Commodity dependence is another key factor. Net importers like India and Thailand can benefit from lower prices, while exporters may continue to suffer.

Most important to longer-term EM growth success is structural reform. Many countries are at a crossroads: face up to the urgent structural reforms needed to improve growth prospects internally, or risk spiralling further into a state of sluggish growth. It is the progress made here that will help separate winners from losers over time. As ever, timing entry and exit into investment is nigh impossible to get right, but after nearly five years of poor returns from an area representing 80% of world growth, where companies have capacity to grow at twice the pace of those in the developed arena and where valuations are extremely tempting, we must be close to a turning point. Asia could well surprise to the upside in 2015.

Favoured investment plays:

Nil risk:	USD & GBP cash (in preference to Euro cash)
Cautious risk:	Structured / AAA Corporate / Government bonds (short duration)
Balanced risk:	Managed funds
Market risk:	**UK, European**, US equity
Adventurous risk:	**US / Asia** / Global Real Estate, **Japan** equity
Speculative risk:	**Palladium, Sugar, Timber, Vietnam**, **China,** India, Africa & Middle East, **European Telecoms**

Disclosure:

Nicholas Chappell has the following personal investment exposure: Technology (US) 19%, US equity 5%, UK equity 16%, Iberia 2%, European equity 6%, European Telecoms 4%, Latin America 4%, Japan 8%, Asia 11%, China 4%, Vietnam 4%, Timber 2%, Precious Metals 1%, Sugar 1%, Energy 6%, Pharmaceuticals 7%

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