Macro roundup

QUOTEDDATA

January 2014

A collation of recent insights on markets and economies taken from the comments made by Chairmen and Investment Managers of investment companies – have a read and make your own mind up. Please remember nothing in this note is designed to encourage you to buy or sell any of the companies mentioned.

Global economy

From Ian Barrass and Paul Craig, managers of Henderson Value Trust : HVTR

We believe that we have entered a period of more stable developed economy performance, particularly in relation to the US. The prospects for Europe and Japan may be less clear. The outlook for emerging markets is likely to remain uncertain whilst the timing of tapering of US Quantitative Easing remains outstanding.

From Bankers : BNKR chairman, Richard Killingbeck

Following such a strong year for global equity markets in 2013 it is probably sensible to be cautious for prospects for the year ahead. However, a low and stable interest rate environment, growing investor confidence and a better corporate outlook, especially in North America and the United Kingdom, give grounds to remain optimistic regarding equity returns. Whilst many headwinds remain, Continental European growth being a key one, investor sentiment has turned positive and, with large global institutions repositioning their asset allocation back towards equities for the first time in over five years, support for current market levels remains strong.

From the chairman of F&C Managed Portfolio : FMPI, Richard Martin

As we move into 2014, economic recovery is strengthening in the US and UK whilst in the Euro zone it appears to be stabilising. In contrast, growth in the Asia Pacific region and China has been slowing although from higher levels. Monetary policy is likely to remain broadly stimulative albeit at a gradually reducing rate. At the start of the New Year, economists' forecasts for the developed countries are almost universally positive, which given their poor record for accuracy, is somewhat disturbing.

Nonetheless, rising activity gives more confidence in earnings growth for 2014. Even with bond yields rising, equities remain attractively valued relative to bonds and although no longer cheap they are not expensive in a historical context. On balance, this is an environment which should result in positive returns for equities.

From Diverse Income : DIVI chairman Michael Wrobel

Market trends could be becoming more uncertain. Equity markets have enjoyed a very substantial rise over the last five years, principally due to expansive central bank policy rather than decent economic growth. It may be that the current positive trends persist (*but*) at some point, central banks will have to wind down their policy of Quantitative Easing and some commentators believe that if this happens soon, it might undermine the markets.

From Jonathan Cartwright, chairman of Aberforth Geared Income : AGIT

It is somewhat ironic that the strong recent returns from equities have come against a background of limited, if any, profit growth. Clearly, stock markets are discounting better things to come, and with some justification given the signs of better economic momentum in both the United States and the United Kingdom. Challenges still abound, not least the implications for assets prices in the short term of a reduction in quantitative easing, but there would appear to be reason for greater optimism regarding the world's economies than was the case twelve months ago.

From the managers of Aberforth Geared Income : AGIT

The improving performance of economies around the world, not least the UK's, has challenged the orthodoxy that dominated financial markets in the aftermath of the global financial crisis. Thus the focus has started to shift from the relative safety of bonds' returns to their skimpiness, and there are indications, albeit not yet "great", of a rotation from bonds into equities. Within equity markets themselves, investors now seem more prepared to explore areas that were overlooked in the aftermath of the global financial crisis.

From Ian Barby, chairman, Ecofin Power and Water : ECWO

Looking ahead, the International Monetary Fund (IMF) expects global economic growth to strengthen moderately over the next year, to 3.6% from 2.9% in 2013. It forecasts that this will be driven by faster growth in the developed economies although growth will be held back by a slow recovery in the Euro area. Downside risks remain, however, and these include an impasse on raising the debt ceiling in the United States, further problems in the Euro area and weaker than expected growth in emerging economies. Reduced monetary accommodation in the US - "tapering" of quantitative easing - could also expose financial excesses and lead to greater market volatility. The low interest rate environment, however, looks set to continue which should be supportive of equity markets.

Resources and commodities

From Ian Barrass and Paul Craig, managers of Henderson Value Trust : HVTR

Given the general trend back towards global growth and the apparent resilience of the Chinese economy we believe that retaining exposure may prove beneficial

From Alan Hodson, chairman of BlackRock Commodities Income : BRCI

As we enter the new financial year, global economic growth finally appears to be more robust, particularly in the US. If sustained, this will no doubt boost demand for energy and commodities more generally. New sources of supply, however, are coming on-stream to meet this improving demand. Corporate profitability will continue to be very dependent on cost and capital expenditure management. Energy prices will also remain significantly governed by OPEC's ability to ration output as new supply emerges.

From the investment management team of BlackRock Commodities Income : BRCI

It is the Investment Manager's belief that agriculture offers a compelling investment theme and that equities within the sector are capable of delivering additional opportunities in terms of capital appreciation and yield. In the energy markets, oil prices look set to move sideways into 2014. We believe a steady recovery in global economic growth will support demand, which could be offset by a rebound in supply. We would expect OPEC to continue to defend the bottom end of its recent range. In the mining sector, commodity prices in the near term are also likely to remain range bound. We expect improving fundamentals for some industrial commodities as the global economy recovers.

Across the commodity equity universe, companies are trading on undemanding valuations and with many commodities trading at or close to their marginal cost of production, the downside risk has been reduced. With capital expenditure being reigned in and a greater focus on shareholder returns, management teams are guiding investors towards rising free cash-flows. This bodes well for their ability to grow their dividends.

Debt and interest rates

From Henderson Diversified Income : HDIV chairman, Paul Manduca

We see loan prices continuing to be supported by strong investor demand for the asset class given the floating rate return whilst high yield bonds will continue to be our favoured bond asset until there is a rise in interest rates, which we do not anticipate until later in the year.

From Henderson Diversified Income : HDIV managers John Patullo and Jenna Barnard

Given the improvement in the UK economy an opportunity to increase the Company's holdings in sterling loans may present itself (*i.e. prices of such loans may fall*) but much will depend upon the Bank of England's stance on inflation and growth. Their current forward guidance communications strategy is keen to stress that an improvement in the unemployment rate down to 7% is a necessary but not sufficient condition to raising rates.

Europe

From H M Priestley chairman of Jupiter European Opportunities : JEO

A poll of investment managers a year ago indicated that their major concern was Europe. The same poll, taken recently, showed that China was now the major bugbear. This suggests that investors have increased their European weightings and that the area is no longer under-owned. As evidence mounts that Western economies are recovering, admittedly from a low base, and that central banks (in Europe especially) are more concerned with deflation than with inflation and that "tapering" money creation will be a gradual process, it could be that companies offering products or services which are scalable on a worldwide basis will prosper to a greater degree than those which are dependent on domestic demand.

UK

From the chairman of M&G High Income Investment Trust : MHGU

Economic recovery appears to have taken root in the past six months and expectations of further progress in 2014 have become something of a consensus call. Indeed, if current projections by the Office for Budget Responsibility (OBR) are to be believed, growth of 2.4% in 2014 will place the UK well above the average rate for the developed world. This is a far cry from the stagnation to which we have resigned ourselves until very recently.

The real question is whether the UK is on course to a recovery that is both sustainable and which enables the economy to rebalance away from an overreliance on consumption/financial services and towards investment, particularly in manufacturing. Though the jury is still out on these matters, some of the omens are far from reassuring. So far, official policy (ultra-low interest rates and specific encouragement to home buyers) has triggered an upturn fuelled mainly by credit-based consumption and rising house prices, two of the main factors which helped to precipitate the 2008 financial crisis. Policymakers will need to take steps to rein in excesses and to stimulate sustainable development in such areas as infrastructure.

Though rising utility charges continue to feature prominently in the media, inflation does seem to be under tighter control, as demonstrated by the welcome fall over the past six months. The Bank of England has recently adopted a policy of 'forward guidance', aimed at providing greater clarity over the future course of interest rates. It implies that, provided inflation pressures remain moderate, the bank will not consider raising base rates from their current 0.5% level until the unemployment rate (currently 7.4%) slips below 7%. This is unlikely to occur in 2014 and, in any case, even if the bank begins to tighten policy, it is likely to proceed with caution. Accordingly, ultra-low interest rates are set to continue for an extended period.

Share prices have risen strongly over the past 18 months or so and with few serious interruptions, despite considerable uncertainties and continuing downgrades by analysts of company profits growth. The abundant supply of central bank liquidity and extremely low interest rates on cash have encouraged investors to prefer equities to other asset classes. Any hint of a change in central bank policies could prove challenging for markets. Companies have retained a cautious view, preferring to conserve their financial resources and to increase dividends and share buybacks rather than raise capital investment. This could well change if company managements see opportunities for profitable investment. While equity valuations are no longer at bargain basement levels in absolute terms, they still appear cheap relative to cash and government bonds. Good value can still be found, but fund managers will need to work harder to identify individual companies and sectors that offer the best opportunities for capital growth and rising dividends

From Jonathan Cartwright, chairman of Aberforth Geared Income : AGIT

Profits among small companies experienced a slight decline in 2013, but this did not prevent good dividend growth, as company boards took comfort from strong balance sheets and high dividend cover. These characteristics remain in place and should continue to support a growing dividend stream for the portfolio as we look forward.

Given the extent of the recent run enjoyed by the shares of small companies, it is natural to be more circumspect about the outlook for returns in the immediate future.

From the managers of Aberforth Geared Income : AGIT

Interest has started to broaden from the exclusive cadre of mid-caps whose secular growth characteristics or underlying steadiness of business model appealed in a financial world craving certainty. Companies not displaying such "quality" and whose valuations were consequently penalised are now attracting interest.

Given the strength of recent returns, it is natural to question the attractiveness of today's valuations. Your Managers take heart from what seems still to be a wide value stretch. Moreover, there is evidence of broader valuation anomalies still in place within the Numis Smaller Companies Index ex Investment Companies. “Smaller small" companies remain more lowly rated than the mid cap components of the index. There is also evidence that the craving for certainty continues to affect the valuations of companies with more volatile share prices: since the global financial crisis, companies with more volatile share prices are valued at a discount to those with lower volatility; prior to 2009, the reverse was the case.

With global debt levels still elevated and the precise effects of quantitative easing difficult to assess, a normalisation of the financial world is not without risk, but your Managers struggle to see "tapering" as anything other than good news for equities in general and the value style in particular over the medium to long term.

From Neil Hermon, manager of Henderson Smaller Companies : HSL

Equity markets (*have*) perform(*ed*) strongly helped by more positive economic tailwinds. These tailwinds remain in place and on balance the global economic situation continues to improve.

The equity market, and particularly small and mid-caps, has enjoyed two very strong years of performance. With little earnings growth generated by the corporate sector over this period there has been a major re-rating of equity valuations. One could argue the equity market has gone from being cheap to more fairly rated and is now more in line with long term averages. To see the market make further progress, we need to see earnings growth accelerate, a situation, with improving economic conditions, we believe is likely to happen.

Balance sheets are strong and dividends are growing. Mergers and acquisition activity in 2013 has been exceptionally quiet. However as corporate confidence continues to improve, M&A will increase, especially as little or no return can currently be generated from cash and debt costs are historically low. This is a trend which will help smaller companies in particular as M&A activity tends to be focused in this area.

Qatar

From the manager of Qatar Investment fund : QIF

Economic growth in Qatar is expected to remain modest in the coming years, after growing at around 6% in the last three quarters. The QNB Group expects Qatar's real GDP to grow 6.5% in 2013 and growth is estimated to pick up further to 6.8% in 2014, driven by non-hydrocarbon sector. Implementation of large infrastructure projects and fast growth in population, boosting domestic demand, should drive the non-hydrocarbon sector growth. Healthy growth in population should create opportunities in areas such as financial services, transport and communications, and tourism. The Investment Adviser believes strong domestic demand will continue helped by strong investment spending, an expansionary fiscal stance and a continuing inflow of workers. The banking sector activity should remain strong in the coming months driven by public sector loan growth. The Banking sector is expected to benefit from the business generated by real estate development and infrastructure projects.

Qatar's near to long term growth prospects should remain healthy driven by a strong infrastructure pipeline, expansionary fiscal spending, and supportive demographics. The Investment Adviser believes that the near term catalysts for the Qatari market include the recent upgrade to the MSCI Emerging Market index, upcoming IPO activity, and healthy dividend pay-outs against a background of attractive valuations.

Vietnam

From the chairman of the manager of Vietnam Holding, Jean-Christophe Ganz

Our outlook on the stock market for 2014 continues to be positive, based on the following catalysts:

Fundamental growth of the economy thanks to (i) the continued strong inflow of FDI, largely into manufacturing; (ii) sturdy budget spending in infrastructure development; (iii) a cyclical pickup in market demand in parallel with a corresponding recovery in manufacturing production; and (iv) the Trans-Pacific Partnership (TPP) agreement finalization, which is likely to benefit several specific industries and support general market sentiment.

Stabilized macro conditions resulting from (i) positive balance of payment and stable currency as a result of strong FDI inflows and remittances; (ii) inflation projected at less than 8%, which is considered sustainable in the current development stage of the Vietnamese economy; and (iii) continuation of the government's slow but steady reform efforts in expanding bank loan restructuring, implementing SOE reform, and allocating the approved US$1.4bn package to support the real estate sector.

Supportive measures benefiting the stock market such as (i) the Foreign Ownership Investment Limit selective increase from the current 49%,; (ii) divestment by the state of its stakes in already equitized SOEs and the IPOs of large state owned groups; (iii) new regulations on local open ended funds; and (iv) potential M&A activities in the banking sector.

Utilities

From Ian Barby, chairman, Ecofin Power and Water : ECWO

Political risk and regulation remain issues in Europe but valuations are cheap and sentiment toward the utility sector is improving. In North America, valuations are higher but are supported by yield and good opportunities exist for the Company to invest in energy infrastructure, such as gas pipelines, on attractive terms

From the managers of Ecofin Power and Water : ECWO

Although challenges remain in the global utility sector, the outlook is improving and the sector is attracting more investor interest after underperforming the broader equity markets for many years. Although the global infrastructure and energy sectors have not experienced the difficulties encountered in recent years by the utility industry in Europe and North America, they are being affected by fiscal constraints on governments and the dramatic changes taking place in the energy sector, particularly in North America. As a consequence, new investment themes are emerging in the United Kingdom, Continental Europe and North America and corporate strategies and managements are, once again, becoming important differentiators of performance.

In the Continental European power sector, demand is weak, energy commodity prices are flat and the growth of renewable energy generation is adding to supply, keeping power prices low and disrupting traditional utility business models. Yet managements are responding to the new business environment and the trough in the sector's earnings may be passing while company valuations are undemanding and the yields on offer are attractive and look sustainable. The changes are also creating investment opportunities in the renewable energy and transmission industries. While political and regulatory risk remain issues, much of this is discounted in the market and there is a growing recognition by policy makers that plans to integrate national energy markets into a pan-European smart grid will require huge new investment and, not least, the co-operation of the power and energy industries.

The United Kingdom faces a challenge of how to reconcile the three policy objectives of securing energy supply, reducing carbon emissions from electricity generation and keeping power prices affordable. This is particularly challenging given that power plants are closing for environmental reasons, the nation's nuclear plants are coming to the end of their lives and reserve margins are falling. As a result, massive new investment in power generation in the UK will be needed but, with a general election due in May 2015, political risk is rising, not only with respect to electricity supply but across the utility sector.

In North America, the electric power, energy and energy infrastructure industries are being transformed by the production of gas, gas liquids and oil from shale deposits; the 'shale gas' revolution. As a result of the new extraction technologies, gas prices have fallen from c.$13 per million British Thermal Unit ("BTU") in mid-2008 to $3.50 at 30 September, 2013. The consequences of the availability of this cheap energy will be far reaching and will play out over decades. Much of the new electricity generating capacity built in the US will be gas-fired, US industry will enjoy internationally low power and energy costs, the domestic petro-chemical industry - which uses gas as one of its feed stocks - will recover dramatically and gas will find new, unconventional uses, such as in transportation. The United States is also set to become an exporter of gas - in the form of liquefied natural gas ("LNG") - over the coming years. These developments will require a massive new investment in the country's energy transmission and supply infrastructure which is underway and creating a wide range of investment opportunities. State and federal government support of renewable energy generation is also transforming the electric power industry.

Reinsurance

From the managers of DCG IRIS : IRIS

After a quiet US wind season, the lack of a market turning event has continued to put pressure on premiums. Going into the New Year we expect to see some pricing pressure at the 1 January renewals but are cautiously optimistic about the year ahead. We continue to see large inflows of capital in the Cat Bond space depressing pricing in the sector on a risk adjusted basis. From our perspective, private transactions in the traditional market continue to offer some of the best value for investors.

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