Wealth
Management

April 2014

Quarterly Strategy

While the Federal Reserve began tapering its asset purchases, there were a few economic reports that seemed to conflict with the improving environment.

Markets gave back some of their recent gains in the quarter, as investors took risk off the table.

Despite this blip, we believe that the global economy will continue to show sustainable growth, but that emerging markets will remain exposed to headwinds.

This document highlights our views on the economy and investment markets.

C. Hoare & Co.
PRIVATE BANKERS SINCE 1672

Our outlook and current strategy

We continue to believe in the recovery in global economic growth and are still confident that developed equity markets will perform reasonably well this year. We acknowledge that it is becoming more difficult to find particularly attractive pockets of value in equities, and indeed the risk-reward trade-off between equities and bonds is beginning to move towards a more neutral position. For now, however, we maintain a general preference for equities, but remain ever vigilant for opportunities elsewhere to surface.

Economic and political news

Economic news in developed markets has generally continued to improve. The Federal Reserve started tapering its bond purchasing programme in January, amid growing evidence that the need for stimulus was diminishing.

The path of recovery is rarely smooth, however, and there were a few potholes this quarter. Most of the disappointing US economic data was at least partly down to weather-related factors and, in our opinion, will not be a threat going forward.

We also saw encouraging signs in the UK and Europe. UK unemployment has been falling even faster than the new Bank of England governor expected when he suggested that the Bank would consider raising interest rates when unemployment reached 7%. As that level is already upon us, the Bank has altered its stance. It is now looking at a number of measures to determine spare capacity in the broader economy, which puts the first rate rise still some time off.

In Europe, growth is now more balanced across the region and domestic demand is improving. We also believe the worst of the austerity is now in the past. This should result in more stable economic outcomes, which will lead to rising business and consumer confidence.

The picture is less rosy in emerging markets. There are growing concerns about the Chinese economy, where disappointing manufacturing data pointed to a deceleration in economic conditions. A possible slowdown is coinciding with worries about the country's high level of debt, although we think that both are being overdone in the market. Other emerging markets are also facing more serious headwinds, however, such as the impact of US tapering and prolonged inflationary pressure.

Politics of course played a large part during the quarter, with events in the Crimea dominating headlines around the world. Sanctions against Russia, and any forthcoming response, will keep tension taut, with any escalation likely to impact both the economic and political climate.

In more positive news, we saw the election of the youngest ever Prime Minister in Italy, with Matteo Renzi expected to deliver on his ambitious reform plans. This should be a boost for the Eurozone.

Currencies and interest rates

The US and the UK have enjoyed near zero interest rates for five years now, but central banks are preparing the market for eventual rises. This comes as no surprise, but there are still question-marks over the timing and extent of increases.

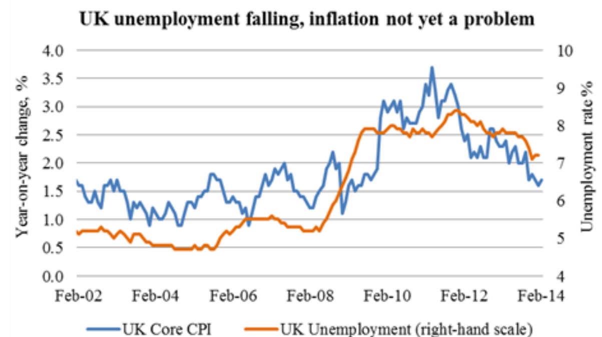
The first UK rate rise is predicted to be in mid-2015, which is also our base case scenario. The risk, in our opinion, is that it comes a few months earlier than this rather than later. The Bank of England has suggested the peak in base rates will be around 2.5% in late 2016 but we think rates could top out at a somewhat higher level. We think a similar picture of slightly faster-than-expected rate rises could be seen in the US.

The following table shows our current position in each of the major asset classes and regions, as well as an indication of what our next portfolio change might be.

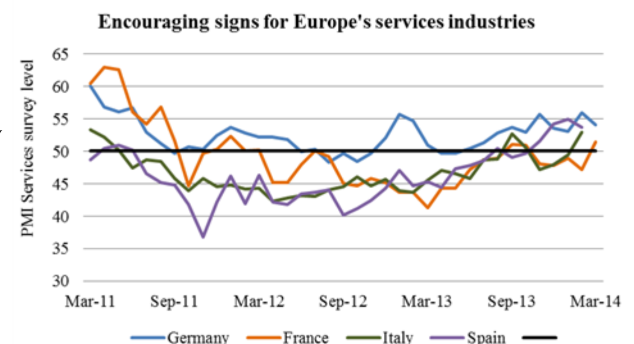
Asset class	Current Position	Expected next move
Equities	+ +	
UK	+	▲
US	neutral	▼
Europe	++	
Japan	++	
Asia Pacific	neutral	
Emerging Markets	- -	
Thematic Equities	++	
Bonds	- -	
Government	- -	
Corporate	+	
Alternatives	-	▲
Property	-	

Key to symbols used in above table:

+	1-3% overweight	-	1-3% underweight
++	>3% overweight	- -	>3% underweight

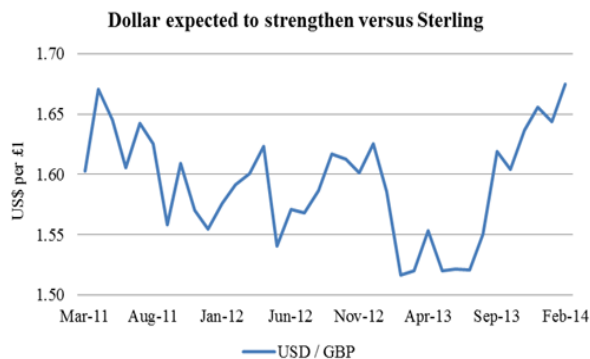


Source: Bloomberg, as at 28h February 2014



Source: Bloomberg, as at 28th February 2014

In an environment where the Federal Reserve continues tapering asset purchases, the US Current Account deficit narrows and talk about US interest rate rises gathers momentum, the dollar should strengthen. We could see some weakness in the euro as the pace of Current Account improvement slows. We also expect the Japanese yen and emerging market currencies to weaken.

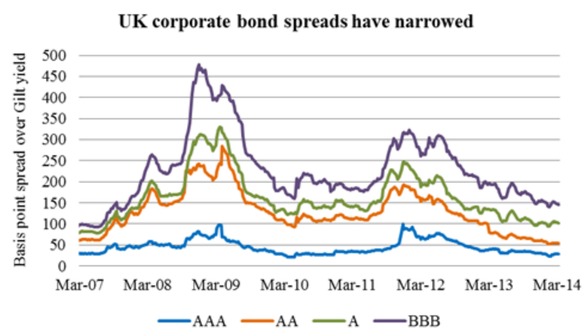


Source: Bloomberg, as at 28th February 2014

Bond markets

Government bond yields in the US and the UK have risen over the past year, to as high as 3% at year-end, although we have seen them slip from that peak as the strength of the economy was called into question. We think yields will rise from here, but that further increases will be more modest and slower than in 2013. Bonds, but specifically those with maturities of around 10 years, could start to look more attractive when yields are at around 3.25%, all else being equal.

For now, we prefer corporate bonds to government bonds, although the former are looking increasingly expensive as credit spreads tighten. Within the corporate bond asset class, we believe that investment grade issues offer more favourable risk-return attributes than high yield securities.



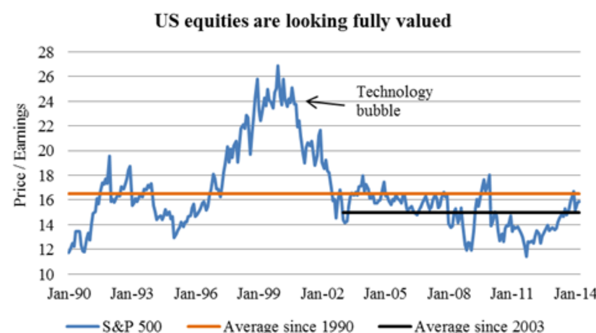
Source: JP Morgan, S&P ratings, as at 14th March 2014

Equity markets

The US market has performed very well over the last couple of years, driven by improving economic conditions and the liquidity injected by the central bank.

The US is now looking relatively expensive, as seen in the Price-to-Earnings ratio compared to the average, and we have been trimming exposure in favour of other areas.

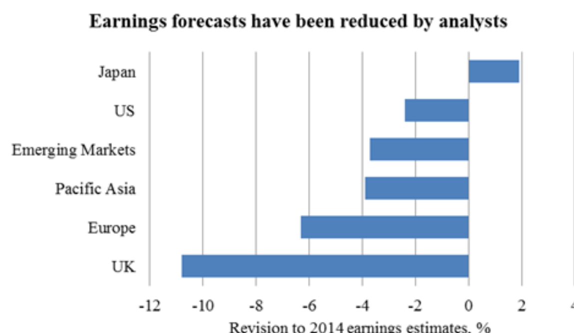
The outlook for the wider equity market will depend very much on corporate earnings. Analysts have continued to cut their earnings forecasts, as can be seen in the following chart of revisions to 2014 estimates compared to six months ago. We will need to see a stabilisation or even an upturn in these expectations before equity markets make any significant gains. We are relatively confident that earnings growth will come through in 2014, through both better revenues and margins. Prospects for a catch-up in European earnings are particularly good.



Source: Bloomberg, as at 28th February 2014

We also believe the recent fall in Japanese equities makes them even more attractive given the potential for further strong earnings growth and yen weakness.

Emerging markets remain exposed to further downside currency risk, however, and we remain out of the asset class for the time being.



Source: Deutsche Bank, as at 28th February 2014

Alternative Investments

Investment funds with market neutral strategies should perform well given that current dispersions of equity valuations would normally provide a good opportunity for stock picking. We also believe that global property holds some attraction, given the potential for rent increases and an improving global economy. The outlook for gold, however, remains difficult given the rising yield environment, although tensions between Russia and the West provide some support at present.

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