Wealth
Management

July 2014

# Quarterly Strategy

We continue to believe the recovery in global economic growth will lead to better earnings growth. We hold overweight positions in equities generally, expecting positive returns this year, specifically in Japan and in Europe, where there are increasingly positive signs that economies are growing and monetary policy is supportive. Valuations in cyclical sectors of markets such as mining, oil & gas and financials are especially appealing.

C. Hoare & Co.
PRIVATE BANKERS SINCE 1672

**Outlook**
As a result of bond markets' strong performance in the first quarter of the year, the low yields available and the likelihood of interest rates rising in the US and UK within the next 12 months, we remain underweight government bonds. We prefer corporate bonds where yields are higher and default risks remain low.

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**Economic & Political News**
Economic news in developed markets has continued to improve. The US seems to be recovering from the temporary dip in the first quarter of 2014, which was caused by extremely bad weather. Unemployment is continuing to fall and consumer confidence is rising.

In the UK the most recent job numbers showed how strongly the economy is growing. There was a 345,000 jump in employment between January and April, the largest increase on record. This has brought the unemployment rate down to 6.6%, below the most recent forecast made in May by the Bank of England's Inflation Report. The proportion of people moving into full-time employment, at almost two thirds, was especially positive. Despite this we believe there is sufficient slack in the economy to prevent pay growth from picking up significantly.

The housing market has been an area of significant concern. There is a gradual recovery taking place across the country but in London and the South East house prices have been rising at an unsustainable rate and for many buying a home has become unaffordable. Tackling this problem by raising interest rates risks affecting other segments of the economy. Consequently, the government is giving a wider range of powers to the Bank of England, for example limiting the size of mortgages to a stricter income multiple.

In Europe unemployment is falling, consumer confidence is rising, loan demand is rising and leading indicators suggest a business spending recovery may be on the horizon. The improvement in global growth that we forecast should also boost exports. Earnings are starting to recover from very depressed levels and valuations in economically sensitive areas of the market such as oil & gas, mining and financial companies are looking inexpensive, while defensive sectors, such as consumer staples with steady earnings are, in our opinion, expensive.

In emerging markets there remain concerns about the growth rate and level of debt in China, but the Chinese equity market is not expensive and we are gaining comfort from the relatively cautious approach of the regime and their commitment to reform, which we expect to show results over time. In key sectors, such as the banks, we believe the Government has the wherewithal to prevent systemic failure.

In India we are looking for signs of structural change following the election. The recent rally has priced in a lot of positive expectations. If the new Prime Minister, Mr Modi, can deliver on these expectations an attractive long term opportunity may open up.

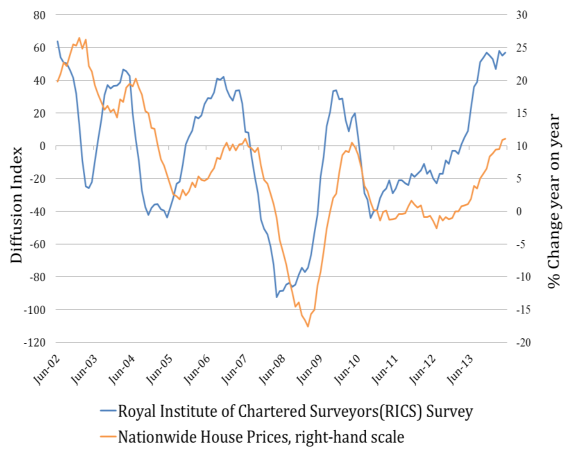
The following table shows our current position in each of the major asset classes and regions, as well as an indication of what our next portfolio change might be.

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

Key to symbols used in above table:

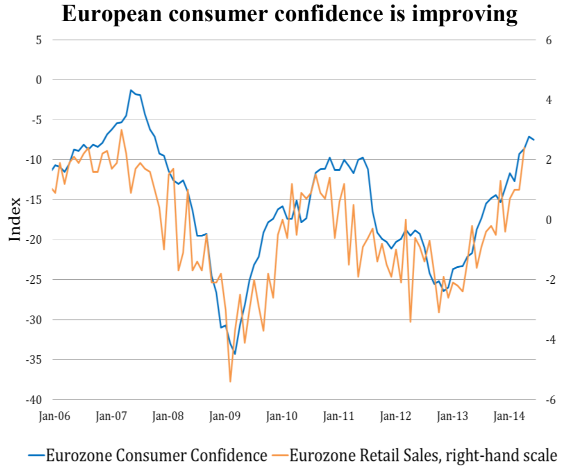
| | | | |
|---|---|---|---|
| + | 1-3% overweight | - | 1-3% underweight |
| ++ | >3% overweight | - - | >3% underweight |

**UK housing market seeing a recovery around the country**




*Source: Bloomberg, as at 30th June 2014*

**European consumer confidence is improving**




*Source: Bloomberg, as at 30th June 2014*

Elsewhere conflicts in Ukraine and the Middle East are concerning but currently are having little impact on markets. The exception is the oil price, which has risen recently, but remains within its medium term trading range.

**Currencies & Interest Rates**

The US and UK have enjoyed near zero interest rates for over five years now and both central banks are preparing the market for eventual rises. This comes as no surprise to the market as a whole, but there are still question-marks over the timing and extent of increases. In the face of stronger than expected economic growth, in particular strong labour markets, the risk is that this may happen sooner rather than later. Our central case is that the Bank of England will, despite Mr Carney's recent comments, wait until next year.

In an environment where there are expectations of interest rates rising in the US we expect the US dollar to rise in value and, on balance, the euro should weaken. We also expect the Japanese yen and emerging market currencies to weaken as their governments look to stimulate growth and Japan moves out of the deflationary environment that has dogged it for over 20 years.

**Bond Markets**

Government bond yields in the US and the UK have over the past six months fallen from over 3% at the beginning of the year to around 2.5% in mid-May. Since then yields have risen as economic growth has improved, in line with our expectations. We think yields will continue to rise from here as central banks get closer to raising base rates. We are expecting inflation pressures to remain muted in developed economies, except perhaps in the US where inflation could surprise on the upside.

For now, we still prefer corporate bonds, although credit spreads (the difference between low risk government bonds and higher risk corporate bonds) have shrunk, the extra yield still looks attractive as the risk of companies defaulting on these bonds remains low.

**Equity Markets**

We believe Japanese equities remain attractive given improving economic momentum. Inflation remains positive and there are more jobs available than applicants; both important indicators for corporate spending and consumer confidence. There is also potential for further strong earnings growth and the yen should weaken, helping the profitability of exporters. We continue to think expectations for corporate profit growth are too low and will be given an extra boost by corporate tax rates being cut from 35% currently, to below 30%.

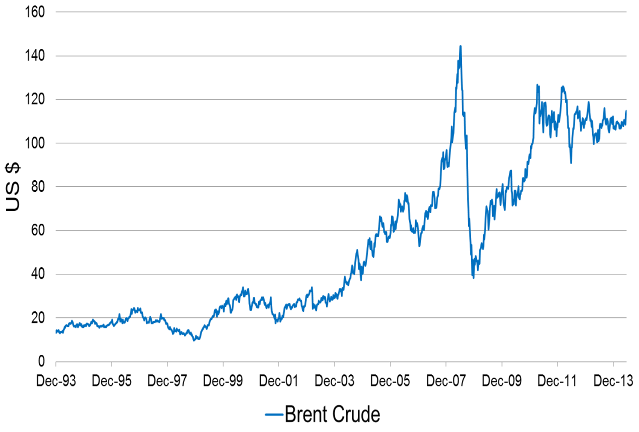
While the economic outlook remains good in the US, the equity market is more expensive than other markets, consequently we are looking to increase our exposure to the less expensive companies.

In the UK we have reduced our exposure to smaller companies. They have been outperforming for many years and valuations have increased relative to larger companies. The proceeds have been reinvested in economically sensitive larger capitalisation equities.

**Alternatives**

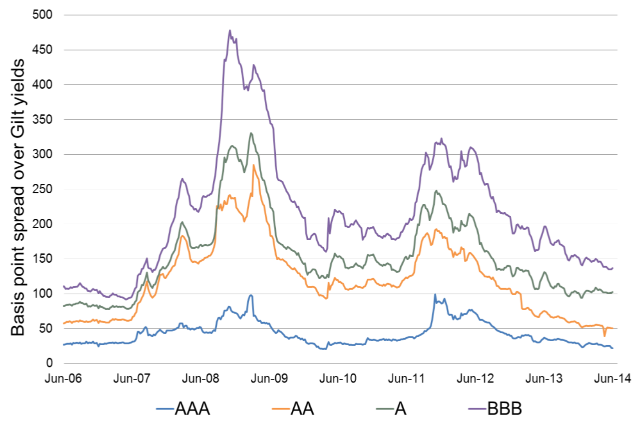
A more active market for company mergers and acquisitions may provide opportunities for stock pickers in the hedge fund sector. In addition, investment funds with market neutral strategies should perform well, given that current variations in equity valuations would normally provide a good opportunity for stock selection.

**Oil Prices are rising but remain within medium-term trend**



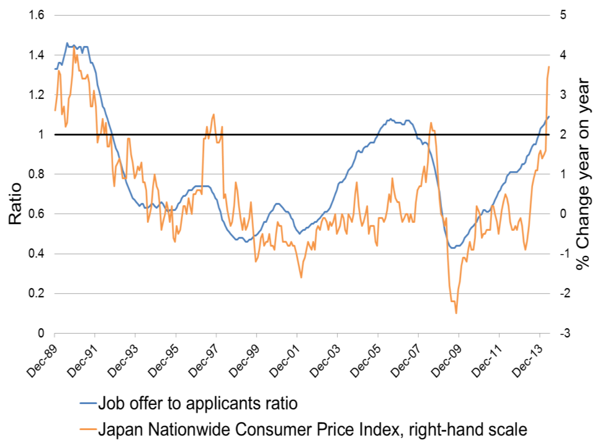

*Source: Bloomberg, as at 30th June 2014*

**UK Corporate bond spreads have narrowed but remain attractive compared to government bonds**




*Source: Bloomberg, JP Morgan as at 30th June 2014*

**In Japan more job offers are being made than there are applicants and inflation is likely to remain positive**




*Source: Bloomberg, as at 30th June 2014*

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**Important Information**



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