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Investment themes for 2015

January 2015

We are entering a low return world

- Many asset classes, but notably bonds, are priced to offer low absolute rates of return.
- We may all have to adjust to lower investment returns compared to recent years, in a low inflation environment.
- Identifying pockets of growth will be more important than ever:
  1. Equity
  2. Sector
  3. Geographic
- Yield attractions on specific equities are compelling compared to bonds.

Low inflation

- The world has too much debt and debt reduction is deflationary.
- In many countries inflation remains well below central bank targets.
- European bond yields have fallen to record lows.
- Investors wary of sectors and markets with falling selling prices.
- Focus on businesses with pricing power.
- Companies with attractive yields and progressive dividend policies are likely to out-perform.
- Property.

A broadening recovery but divergence of developed economies

- We expect 'more of the same' from the USA the anchor of global growth.
- Divergence in growth between the USA and Europe.
- The US Fed ended tapering in October, the ECB is still to embark on QE.
- China is likely to slow further.
- Japan likely to improve. US Dollar strength - beneficial to UK overseas earners/exporters.
- Emerging Market debt is a concern.
- As economies diverge, identifying the correct investment strategy when investing in overseas markets remains key.

Lower energy costs

- We will see a prolonged period of low oil prices and as a consequence all energy bills.
- This will result in clear winners and losers.
- Good for the global economy.
- Wealth is transferred away from oil producing countries.
- Shift towards consumer driven, developed economies.
- Overall lower energy costs will be very helpful to a number of industries and countries.
- Global Emerging Markets to struggle, notably Russia and other oil focused Frontier Markets.
- Energy consuming nations such as Japan, the EuroZone and India should benefit from lower oil prices.
- Lower energy bills are likely to be a cause for concern for the alternative energy sector.

Political uncertainty

- General Election, due in May 2015.
- Increase the chance of another coalition.
- Britain’s position in the EU questioned.
- Labour risk to tobacco and energy providers
- The Scottish independence vote, power is devolved from Westminster.
- ‘United States of Great Britain’
- Further Sterling weakness against the US Dollar.
- Good news for UK exporters and overseas earners.
- European political risk resurfaces with the Greek snap election.

US and UK interest rate rise deferred & consumer spending

- Benign inflation outlook in both the USA and UK
- Lower oil prices
- Consumer spending outlook remains encouraging.
- The US housing market supporting US consumer spending.
- In the UK, two-tier market with house prices.
- London house prices should continue to cool in 2015.
- First BoE interest rate hike deferred late into 2015.
- Real wage growth would be the real kicker.
- Irish economy is the fastest growing in the EU investment, exposure to UK and Irish consumer.

China slowdown

- Slowing export markets.
- Anti-corruption reforms.
- Slowing of the Chinese economy.
- Result excessive build-up of debt within companies and local authorities and a housing market with significant inventory.
- Headline GDP growth challenge to 6%-7%.
- Ongoing resources challenge.
- Global impact across Asia and EU – Germany.

Structural strains

- The things we don’t expect, that catch all of us out.
- October’s flash crash in the US Treasury's.
- Financial crisis has led industry regulators to reconsider their ‘too big to fail’ mentality.
- Unexpected introduction of risk to an investment, possible ‘black swan’ event.
- UK FTSE 100, over exposed to a few dominant sectors.
- Lower commodity prices, particularly oil expected to drag on FTSE.
- Diverse FTSE 250 and Small Cap indices are less constrained.

The World will remain a dangerous place

- Things don’t always work out as investors and economists expect.
- Geopolitics.
- Far reaching implications of oil price correction.
- Fresh economic challenges to many oil producing nations.
- Tensions remain in the Middle East, rise of Islamic State.
- Russia and countersanctions to hurt the Eurozone.
- Political risk has reignited in Europe with the Greek Snap Election.

Expect M&A activity to continue

- Companies will be challenged more than ever to keep growing.
- Acquiring businesses, can deliver attractive returns.
- Consolidation, driven by more challenging trading conditions.
- Defensive mergers to be a feature.
- Potentially trigger higher valuations.
- 2014 mega-merger due to tax inversion loopholes now closed.
- 2015 to see continued M&A activity.
- To trickle down into the UK mid-and small-cap sectors.
- Companies with high free cash flow yields should benefit from ongoing M&A activity.

And finally…

With the S&P 500 currently hitting all-time highs, will the FTSE 100 make progress?

- Major structural differences between the US and UK stock markets.
- IT sector is 20% of the S&P 500 compared to 1% for the FTSE 100.
- Apple the largest US index constituent, stands at almost 4% v's HSBC 7%.
- The top 10 companies making up 18% of the S&P.
- The FTSE 100, the top 10 companies account for 40%.
- Two heavyweight sectors, Oil and Mining are likely to act as a drag.
- The UK is closer to Europe, any rally likely to be dependent on oil or the ECB.
- Mr Draghi was going to give us QE for Christmas, but it looks as if everyone will have to await bargains in the January sales instead!
- Will Greece give us a New Year's hangover?

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