

# Investment Advisory Board Meeting Minutes Summary

7 January 2014

**Attendees:** Graham Wainer (Chairman)  
James Aitken  
Graham Turner  
Anthony Lawler  
Niall Gallagher  
Tim Haywood  
David M. Solo  
MP Investment Team

**Apologies:** None

## Summary

*The meeting's focus was on the outlook for 2014 and how it was likely to differ from 2013 in terms of macroeconomic developments and investment opportunities. The consensus view was that equity valuations were not obviously cheap and that liquidity conditions in the US would continue to tighten. However, the latter was not seen as an outright negative since the Federal Reserve (Fed) had made it clear that the intensity of the tapering would depend on stronger economic growth. In Europe, peripheral countries are starting to turn a corner, with economic newsflow from Spain and Ireland particularly encouraging. However, there was no expectation of a swift, sharp recovery across the eurozone. Emerging markets were seen as an increasingly diverse group. The varied response to tapering action by the Fed means that their outlook depends more on individual circumstances. For example, Turkey was cited as facing numerous structural and political headwinds, while China and Mexico's reform programmes were singled out for praise. The UK economy was perceived as being on a strong recovery path.*

## USA

The reduction of the Fed's quantitative easing programme, known as 'tapering', was at the forefront of investors' minds for much of 2013. With growth strengthening in the US, the IAB members expected tapering to be completed by the end of 2014, although the Fed's communication of the move leaves room for flexibility. Regardless, the consensus was that there was no need to fear an eventual end of QE, which after all is not the same as an actual tightening of policy. The Fed under new Chairwoman Janet Yellen is likely to err on the side of caution and making sure that growth is heading in the right direction before starting the process in earnest. It

was also seen as important for Yellen to give her view on inflation, which has not been the Fed's focus of late. Meanwhile, the housing market remains a key factor for US economic growth, even if some argue that its main impact is psychological. If citizens feel wealthier as house prices appreciate, many of the 11m households which are still 'underwater' will feel more confident and consumption should receive a sustained boost, creating more jobs as a result. On the other hand, a virtuous cycle like this would accelerate tapering and raise the risk of an outright policy error.

However, with the stockmarket rally of past years strongly driven by loose liquidity, one IAB member cautioned that valuations were impossible to assess until the Fed stops its asset purchase programme. Only at that point would it become clear what investors are actually prepared to pay for equities. The IAB agreed that this increased uncertainty would favour stock-picking approaches as the strong beta rally of 2013 gives way to choppy markets generally.

## Europe

Given the subdued growth prospects for the eurozone, strong equity and peripheral bond market performance may have come as a surprise for some last year. It is especially encouraging that the sharp fiscal retrenchment in many eurozone countries did not manage to blunt growth entirely.

Among many US asset allocators, Europe is still a 'no go', which could be seen as a contrarian support factor for the region's stock markets, given the potentially strong fund flows which could ensue in the event of a change in sentiment. For Europe, just a slightly less negative perception could result in a massive boost for markets. In this regard, there have been encouraging signs from the periphery. For example, property auctions in Ireland have seen higher bids than expected, while the Irish central bank managed in early January to issue enough bonds to cover most of its financing needs for the year. The situation in Spain is also improving. France, however, is battling with a political crisis and an unwillingness to meaningfully reform. Greece is also not out of the woods just yet, although one IAB member mentioned that his personal view from a recent trip was positive in terms of what had already been achieved there. Banks across Europe are proving successful in cleaning up their balance sheets, increasing provisions for bad loans, and achieving strong capital ratios.

In the corporate sector, balance sheets are also robust thanks to years of strict deleveraging. Valuations of European companies also remain at significant discounts to their US counterparts although European equities should be

supported by the trajectory of company earnings rather than price per se. Their trajectory should remain positive on the back of less fiscal drag, improving consumer confidence, stronger consumption and rising capex.

## UK

The IAB was agreed on its positive assessment of the UK economy. Its strength was seen as somewhat of a surprise, with the outlook as good as it had ever been in the past 30 years. Mortgage applications remain strong, consumer confidence is improving and wages are increasing while inflation and unemployment are receding. New, high-quality 'smart' jobs are being created beyond the ubiquitous finance industry as consumption is picking up. This bodes well for the recovery's sustainability. With growth gathering pace, sterling has potential for appreciation, particularly versus the euro. As a trade, it is not yet as crowded as the stronger dollar / weaker yen consensus.

## Japan

Japanese equities were seen as having further upside potential despite the strong run in 2013, while higher inflation numbers were also deemed encouraging. However, many IAB members were not convinced that 'Abenomics' would work in the longer term.

## Emerging markets

2013 was a tough year for emerging markets, both equities and bonds. Following the underperformance, there are potential opportunities to be found in both asset classes as long as careful selection is deployed. Tapering in the US is causing pain for many countries since funding their current account deficits has become more difficult. Turkey is one example. However, higher growth in developed markets should be supportive, for example in Mexico, which is a manufacturing hub for the US and Canada. The country is also pushing through bold reforms, for example in the energy sector, and therefore offers potential for an upward re-rating. China is equally bold on longer-term reforms, although the crackdown on corruption and local governments' powers will mean lower growth in the short term. However, the country has learned from the West's mistakes, and is working hard on the stability of its financial system. This is encouraging. The timing for China's reforms is also good, since it coincides with improving growth rates across developed markets. As a potential protection for portfolios against a

sharper-than-expected Chinese slowdown, shorting the Australian dollar was mooted. Australia's export market is particularly dependent on China, so any weakness there would impact the currency.

## Investment ideas

Early on in the meeting, the IAB agreed that an overweight equity stance remained appropriate for now but the members did agree that across all asset classes, a more selective approach would be sensible since progress in 2014 is likely to be more limited and volatile than last year.

European equities were seen as having further potential given the still negative view and underweight exposures of global asset allocators. In emerging markets, differentiation across countries is vital, since local policies are making a real difference. Mexico, South Africa and Brazil offer very attractive yields in local emerging debt markets relative to their growth and inflation projections, although currencies are a risk factor and should be hedged. Equity volatility via options could also be used for portfolio protection.

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Source: GAM unless otherwise stated. (Unless otherwise noted, where shown, performance is shown net of fees, on a NAV to NAV basis).

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