

# Investment Advisory Board Meeting Minutes Summary

14 March 2014

**Attendees:** Graham Wainer (Chairman)  
James Aitken  
Graham Turner  
Anthony Lawler  
Niall Gallagher  
Tim Love  
Tim Haywood  
Andrea Quapp  
MP Investment Team

**Apologies:** Jack Flaherty

## Summary

*The backdrop to the first quarter's Investment Advisory Board (IAB) meeting was one of relatively more stable financial markets after late January's volatility. Encouraging sentiment indicators have been welcomed by investors, suggesting positive long-term opportunities. However, short-term risks continue to lurk, with geopolitical tensions between Russia and the Ukraine the latest source of uncertainty.*

*Across developed markets, the interest rate rhetoric of 'lower for longer' has become the new norm. In the US, adverse winter weather conditions have created some uncertainty around the accuracy of the latest set of growth indicators. Despite some housing market jitters, the overall trend is positive. In Europe, the UK is currently leading the pack in terms of recovery, while Spain and Italy have also made considerable progress. China dominated the conversation on emerging markets, since the country's growth trajectory continues to adjust downwards. Lessons from the past should aid the Chinese government in handling the slowdown while a significant market shock is unlikely. Pockets of opportunity exist elsewhere in emerging markets, and the cheap cost of hedging can make the risk / return profile more attractive.*

**Investment ideas** are highlighted throughout this document.

## USA

Data surrounding the housing market is frequently cited as a leading indicator for the US economy, but the IAB noted that any short-term peaks and troughs in the sector were unlikely to be insightful. Other data points were highlighted as more reliable indicators of macro developments, such as the rise

in business investment spending, and particularly equipment spending, with investment in software recently topping new highs. The winter's polar vortex weather conditions were blamed for a muddying effect on recent data readings. The true trend of growth would become clearer in the next round of releases.

Turning to interest rates, the board agreed that zero had become the 'new norm' in the US, and inflation numbers were expected to remain low, having consistently fallen since May last year. The board noted that new Fed governor Janet Yellen was adopting a relatively quiet approach to her new role, reflecting her desire to re-establish the credibility of the central bank by taking the time to observe and reflect before unveiling any significant policy announcements. It was the IAB's view that there was little to be gained from heavily speculating on Fed activity at this stage, since it is currently following a clearly defined path and is likely to do so for some time yet.

The IAB noted January's correction in the S&P 500 index. However, it was also acknowledged that the index provides a liquid way to partly hedge against emerging market risk.

## Europe

While the long-term prospects for Europe remain positive, recent market moves do not reflect the sound fundamentals of many of the underlying index constituents. Many of the statements about valuations made at the previous meeting remain current, with companies continuing to trade at a significant discount. To date, most of the region's economic recovery has been centred around structural growth – such as manufacturing in Italy and the rise of both consumer and business spending in Spain – while a 'second stage' of cyclical growth is yet to properly initiate. The board noted how the eurozone has become less reliant on China as a buyer of its exports, instead diversifying trade activities across a broader range of emerging markets.

One IAB board member stressed the best approach to eurozone investing in such an environment was through **bottom-up stock picking, which allows the specific targeting of true growth opportunities**. Money is still flowing into the market and the current scenario offers the opportunity to pick up quality stocks in businesses that will ultimately benefit when the region's economy fully recovers.

## UK

The UK economy is currently among the strongest in Europe, and in contrast to the US, much of the growth is being driven by the rise in consumption. Housing and construction sectors are also displaying strength. With UK house prices following a steady upward trajectory, the risk of a bubble

scenario was raised. The IAB flagged the possibility of the Bank of England (BoE) restricting banks' mortgage lending capacity, so as not to have to bluntly push interest rates up to prevent the bubble from inflating further. Keeping interest rates low encourages savers to put their money into real investments, which is a cultural shift the BoE is keen to nurture. The big increase in IT jobs was cited as evidence of a more broad-based UK recovery this time around.

In politics, the Scottish referendum now poses less of a risk to the UK than it did towards the end of 2013, as the momentum around independence seems to have waned. One IAB member in particular believed Alex Salmond had discredited the Yes argument in recent weeks. However, the rising strength of the UK Independence Party (UKIP) and the potential future impact on the UK's relationship with the EU should not be overlooked. **A short sterling versus US dollar currency trade** was briefly discussed.

### Japan

In Japan, the short-term risk of a market correction is countered by long-term opportunities should Abe's structural reforms deliver. The board's view was that exposure selection in Japan remains key, as passive investment strategies do not deliver in the current environment. Hot money has washed into the Nikkei index as a leveraged beta play but **a short JGB position could be interesting**. Very low yields offer limited downside for such a trade.

### Emerging markets

Investors are now fully aware of the slowing growth situation in China – January's manufacturing numbers came in at an eight-month low, while service sector growth dropped to a five-year low. One IAB member warned that we were likely to see a rise in defaults of Chinese corporates in 2014. This would be a relatively new scenario for the country, as the government has historically stepped in to bail out struggling firms. Similarly, demand for the country's industrial outputs is declining, as Chinese state-owned enterprises (SOEs) are not coming forward to bolster demand during buying lulls anymore. But despite the gloomy numbers, the IAB was keen to stress that China is unlikely to be a repeat of Japan, or even the US around 2008. The country has learned lessons from its global peers. The authorities seem in control – the country is avoiding a systemic crash by taking pre-emptive action now. In the meantime the growth slowdown is presenting select buying opportunities in the equity market.

However, trading around the current situation was flagged as challenging, with only a limited number of credible investment tools available to choose from. The issues of

Chinese trust products and a potential blow-up of this market were also discussed, with the IAB supporting the actions of the government in letting the dubious nature of these products come to light sooner rather than later.

Broader emerging markets remain the laggard on the global scene and continue to display a significant gap between fundamentals (which are strong) and asset prices (which remain weak). A fresh wave of geopolitical risk in the form of the Russia / Ukraine situation has not aided any rebalance in this disparity, with the market continuing to trade at credit-crunch lows.

Within the asset class, investors are favouring bonds over equities on the basis of the more favourable risk profile. **Long-dated government bonds in Mexico, Brazil and South Africa were cited in particular**. In equities, the IAB highlighted that pockets of value do still exist, such as in **South Africa and Mexico**, and **capital is best put to work via buying on lows**.

One board member felt that the only question for emerging markets was not a matter of if, but when they would bounce. Other members highlighted that **Western stocks with emerging market exposure, as well as luxury goods companies, provide an attractive play on the asset class** in what could be considered a 'diet' format – where the less concentrated return profile is compensated by better liquidity than pure-play investments.

### Other Investment ideas

Beyond the ideas shown above, the IAB also noted how expensive high yield credit markets had become and suggested **protection on US high yield** would eventually come to fruition.

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