Market outlook.

Brought to you by the Investment Management team at my wealth WEALTH at work

The UK Economy

Falling unemployment and improving wages, combined with falling inflation, is a positive environment for many consumers. Add to that an increase in corporate productivity and we believe you have the ideal recipe for a sustainable recovery of the UK Economy and one which looks well placed to accelerate. Many corporates remain awash with cash and as a pickup in confidence comes through, it may entice companies to be acquisitive in order to further accelerate growth. One sign of improving corporate confidence is new companies coming to the market, and there has been a marked pickup in activity lately, some of the more familiar names listing includes Pets at Home, Pound Land, Just Eat and boohoo.

With unemployment levels beating expectation and the economy strengthening, there is inevitable concern over when the Bank of England (BofE) will raise interest rates. Whilst it is difficult to predict the timing of an interest rate hike, history suggests that governments try to avoid 'rocking the boat' in the run up to an election year. So, with the potential for an increase in rates to increase the cost of borrowing and thus decrease demand in the economy, the question has to be whether the BofE will look to increase rates prior to the 2015 elections?

The Japanese Economy

The Japanese Prime-minister Shinzo Abe, in conjunction with the head of the Japanese central bank Haruhiko Kuroda, last year introduced a 3 stage approach to pulling the Japanese economy out of its 2 decade recession. Firstly Japan introduced a bond buying program (Quantitative Easing), in order to pump money into the economy, devalue the Yen, and ultimately make Japanese companies more competitive globally. The second step saw the government put new fiscal policy measures in place, effectively introducing tax increases and tax reliefs in different areas in order to help stimulate growth. The third and final arrow, yet to be completed, is the introduction of structural reforms, which involves the introduction of measures to help stimulate the domestic economy in order to improve productivity, increase wage levels and increase the number of individuals that participate in the job market (primarily targeting females).

In April Prime-minister Abe increased the sales tax in Japan by 3% which stemmed growth levels over the past month. However, as Japan has come so far and has all but shed its 'recession' stereotype it is unlikely that the government or central bank will let the economy revert. So, whilst the first 2 stages of the plan have been relatively successful, it will be key for Japan to successfully roll out the third stage over the coming months in order to help with wage growth. As, it is important to remember that as a result of the new policies, Japan has gone from an environment of deflation to one of inflation, and wage inflation is important to ensure Japanese businesses and the public can survive in this 'new world'.

The Emerging Markets & Asia Economy

In years gone by investments in Asia and indeed the Emerging Markets (EM) have typically been strongly correlated with that of the Western World i.e. if the West increased in value Asia and EM would increase at a greater rate, and if the West were to decrease in value then Asia and EM would decrease at a greater rate. This was typically because Asia and EM was dependent on the West for demand, but last year we saw a clear breakdown in this correlation as the West progressed whilst EM and Asia struggled.

As consequence of investor confidence slowly returning to the Asian and EM regions, the concern of the impact of foreign policies subdued (such as U.S. tapering and Japanese Quantitative Easing), and the introduction of multiple reforms in countries such as Mexico and China is that Asia and EM have been some of the strongest performing asset classes over the past 3 months. Valuations that lagged the Western World last year look very attractive to investors compared to many other regions, and it is this returning capital that is helping the reform measures bolster the stock markets in the region.

Whilst economically there are many growth areas, such as Mexico's energy and trade links with the U.S., India's new 'investor friendly' government, and indeed the potential for overall domestic demand in the Asian and EM regions (demand from a population of billions), there are still political uncertainties that can introduce some short term unknowns. With Russia and Ukraine tensions still high and their frictions over Crimea yet to be resolved, global markets (not just Asia and EM) are currently tentative.

The US Economy

At the beginning of the year we saw a change in the head of the Federal Reserve (Fed), the US central bank. Janet Yellen took power, replacing Ben Bernanke to become the first ever female Fed chairman. Ben Bernanke's reign saw him introduce large scale bond purchasing, known as Quantitative Easing, in order to aid pulling the U.S. economy out of recession by pumping money into the economy, decreasing the value of the dollar, thus making the U.S. more competitive. With the Fed chairman introducing a slow reduction of the country's bond buying (known as tapering) at the beginning of the year, it gave a clear indication that the U.S. is now in the midst of an economic recovery. The US has now reduced its bond purchasing from $85 billion a month to $55 billion a month, with Janet Yellen announcing last month that unless there is a market shock, the intention of the Fed is to continue tapering at a rate of $10 billion a month until bond buying is at zero.

In addition to Janet Yellen stating that the completion of tapering will likely be in the next 6 months, she also stated that it is highly unlikely that the U.S. would look to increase interest rates from the current low levels until at the very least tapering is complete. She went on to suggest that once tapering is complete it would require a combination of economic factors such as stability in unemployment numbers, inflation and indeed the currency (amidst other factors) before the base interest rate would be increased. As, an increase in the interest rates is an effective increase in the 'cost' of money, and if the cost of lending increases, then the demand in the economy would fall, stifling the recovery. This being the case, with the U.S. being the world's largest economy, it is likely that the Fed will be extremely cautious before increasing the interest rates. With all of the above in mind, the U.S. employment data, manufacturing data and Gross Domestic Product (GDP) has continued to beat expectations, making the U.S. economic recovery one of the strongest of the Western World economies.

The European Economy

In the few years running up to the end of the third quarter of 2013, despite the obvious concerns in the European periphery such as Greece and Portugal, on the whole good quality companies based in stable economies were strong and steadily performing investments. Countries such as Germany, Switzerland and those belonging to the Scandinavian block had stable and consistent unemployment, manufacturing and GDP data, making the relative risk of investing lower than present day.

Whilst the European stock markets have not yet seen a significant fall, their outperformance has decreased relative to many other regions year to date. This is primarily because of high valuations of shares going into 2014, accompanied by increasingly inconsistent/weak economic data coming out of a number of countries in the region (such as German, Italy, France). The President of the European Central Bank (ECB) Mario Draghi has expressed concerns over the past few months that the recent strong performance in European equity markets is unfounded, and whilst he stated that there is a slight risk of deflation, he was more concerned with the potential for a prolonged period of low inflation, high unemployment and a strengthening currency (Euro). It is true to say that if these scenarios do indeed continue the way they have been, the region will become increasingly uncompetitive and may slump further back into recession. It is however likely that the ECB will look to introduce further policy measures, like decreasing the base interest rate or introduce a bond buying program (Quantitative Easing), in order to stimulate growth and avoid a slide back into recession.

2014 looks set to be an uncertain time for the European markets, with the ECB skeptical over the economic strength of the region, share valuations high, political instability in many countries, and of course the worry of the highly tense Russia/Ukraine situation on the door step (yet another political headwind that has exposed the differing views of the many countries that form Europe).

Fixed Interest

Typically fixed interest (bonds) has been seen as a safer investment than shares when global investment markets have been falling. However, it is true to say that in recent years with all of the economic and political frustrations experienced by many countries, fixed interest assets have not performed how they typically have historically. Over the past few years many of the larger economies such as the U.S., Europe and U.K. have decreased their base interest rates in order to stimulate growth. As a result, this has aided in strongly decreasing the level of return you get from many fixed interest investments.

The current economic environment sees the risk of many government bonds, for example Greek bonds, as greater than that of many larger companies. However, an investor in Greek bonds is not being rewarded for that extra risk they are taking. As a result, with global investment markets performing well, but concerns of political and policy risks still present, the fixed interest market continues to offer low returns, but slightly higher risk levels than that which has been typical of them in the past. Until we see a significant increase in the base interest rates of some of the larger economies (U.S., U.K., Europe), it is unlikely that we will see a significant increase in the income levels received from bonds.

At this stage it is worth considering that recent comments from Janet Yellen the U.S. central bank chairman, and Mario Draghi the head of the European central bank, amongst others, suggest that increases in the respective U.S. and European interest rates are not likely to happen soon. This suggests that the fixed interest investments, both government bonds and corporate bonds, have some time to go before an element of normality returns.

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