Investment strategy

December 2013

Mark Burgess
Chief Investment Officer

Economic and market commentary

As 2013 draws to a close, investors' thoughts inevitably turn towards 2014 and the knowledge that risk assets will have to learn to begin to live without the seemingly unending flow of central bank liquidity. This presents some concerns as the earnings growth that many companies had banked on for the second half of this year has failed to materialise. If this trend continues, and the market's focus shifts gradually from liquidity to fundamentals, risk assets may well come under pressure.

Excluding high yield, fixed income markets have had a lacklustre year and we expect to see a similar trend in 2014. The continuing scramble for income has supported the high yield sector, which offers the highest level of income (relatively at least, although yields are low in historical terms) and the shortest duration exposure in the fixed income asset class. We regard corporate credit as a suitable asset class for a low-growth world and it is clear that coupon flows and maturities continue to easily absorb new issuance. Sectorally, financials remain in credit-friendly mode (and we expect them to remain so) but corporates appear to be increasingly equity-friendly, and thus leverage is rising. In core sovereign markets, yields will rise next year, particularly if the Federal Reserve delivers an earlier-than-expected taper (I still anticpate such a development at the end of March). However, we do not expect a rout in core markets and would anticipate 10-year US treasures to yield around 3.5% by end-2014. Sovereign markets such as the US and the UK are offering positive real yields, which will provide some valuation support in what is still a low-growth/income-hungry world.

In terms of our recent activity, we have been taking some risk off the table in our multi-asset portfolios, primarily through reductions in emerging market equity and emerging market debt. The sell-off experienced by these asset classes in the summer, caused by concern over tapering fears, has provided a portent of events next year. Indeed, emerging market assets are likely to face a number of headwinds in 2014, namely rising treasury yields, a stronger dollar and a less benign liquidity environment.

Looking forward to next year, we do not anticipate a re-run of 2013's stellar returns but remain positive on the outlook for risk assets. There are some developing tail risks (European deflation, Chinese/Japanese regional political tensions) that are not part of our core scenario, but which nonetheless provide potential uncertainty for markets should we see a continuing deterioration in the recent trends in these areas. China has thrown another wildcard into the mix with its recent announcements on domestic policy following the Third Plenum, which outlined a shift towards more market-friendly policies. However, as one would expect the timing, detail and implementation of these moves remains suitably vague.