Asset Allocation Debrief

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Growth Prospects Persist

- A multitude of factors contributed to a return of market volatility in July, while central bank policy remains the overriding influence.
- Geopolitics, sanctions placed on Russia and instability in the Portuguese banking system tested investor nerves.
- Ultra-loose monetary policy had dampened market volatility, explaining why markets were unresponsive to the increase in geopolitical tensions earlier in July.
- The committee opted to pull back on weightings to the UK and Japan to fund an increase in allocation to Emerging Markets and Cash.

Economic Growth	2013	2014	2015
US	1.9	1.7	3.0
UK	1.8	3.0	2.5
Eurozone	-0.4	1.0	1.5
Japan	1.7	1.5	1.2
Asia	6.3	6.4	6.3
China	7.7	7.4	7.2
India	5.0	4.7	5.4
Latin America	2.4	1.8	2.7
Brazil	2.2	1.3	1.7
EMEA	1.9	1.8	2.5
Russia	1.3	0.5	1.5

Inflation	2013	2014	2015
US	1.5	1.9	2.2
UK	2.6	1.7	1.9
Eurozone	1.3	0.7	1.2
Japan	0.4	2.7	1.8
Asia	3.8	2.7	3.7
China	2.6	2.4	3.0
India	10.9	9.5	8.0
Latin America	7.6	10.4	9.3
Brazil	6.2	6.4	6.2
EMEA	5.3	5.5	4.8
Russia	6.8	7.0	5.6

Central Bank Rate	2013	2014
US	0.3	0.3
UK	0.5	0.6
Eurozone	0.3	0.1
Japan	0.1	0.1
BRICs		
Brazil	6.0	6.0
Russia	6.9	8.0
India	8.2	7.3
China	10.0	11.0

Source: Datastream/Brewin Dolphin
All figures represent year on year change in percentage terms

The UK economy clearly remains on an expansionary path. A raft of recent economic data is, on the whole, supportive of the growth story and yet the recovery has still posed something of a puzzle to the UK policymakers. It is difficult to argue against those that have contributed to the rally in sterling in expectation of an imminent interest rate rise. With consumer prices close to target, the economy accelerating and employment rising, a November rate rise looks entirely plausible. We are in good company in believing (like the IMF) that sterling is overvalued, but while this perseveres it seems sensible to slightly reduce the overweight position we currently hold in the UK. The high international exposure of UK listed companies has hurt translated earnings and has become a regular feature of company results announcements. This was why we lifted our commercial property weighting in June's meeting as it gave a pure play on the UK economic recovery.

We recognise that the geopolitical environment does not lend itself particularly well to a risk-on approach. News of a build-up of Russian troops on the Ukrainian border is unsettling, with the Polish Prime Minister saying this week that the threat of a direct intervention by Russia's military in Ukraine has risen in recent days. EU sanctions that started off as token asset freezes for Vladimir Putin's cronies, have begun to ramp up into more meaningful and potentially provocative moves. The mutualistic relationship over Russian gas supply to Europe was discussed at length and cited as a reason why the current stand-off may be limited to an escalation in political rhetoric, which ultimately recedes before any real economic impact is felt by either side. To take a little risk off the table, we have added to our cash allocation with the proceeds from our UK reduction.

Emerging Market reform

The committee looked for reasons to be overly positive on the emerging market story after missing out on the gains made there in recent months. Country-specific structural impairments are plain to see here, but we do concede that there are enough reasons to remain excited about them for some time. The scope for a new era of reforms is there to give corporate sectors a lease of life and macroeconomic decision making, on the whole, looks to be improving. Beijing has committed to exchange rate liberalisation, which (in the long term) can only be positive news, a newly independent Reserve Bank of India looks to have a credible strategy to restrain inflation and a general emergence of more political accountability are recent, and wholly positive examples. With this in mind, the committee has opted to increase the allocation to Emerging Markets from a zero weighting to 1% to maintain a less extreme Underweight position.

To service the rise in allocation to Emerging Markets, we have trimmed our Overweight position in Japan. While still positive on the story unfolding there, concern was raised over the relative failure of Shinzo Abe's reforms to kick the economy on from the initial furore in 2013. Though still popular, the Prime Minister's ratings are on the slide, making it increasingly difficult for the much-needed labour market liberalisation to take place. The Bank of Japan has failed to anchor inflation expectations at their desired 2% level and instead is facing what looks like a stagflationary environment, where inflation is present with little improvement in investment. Increasingly, flexibility of labour is a politically unpopular move and would have been more palatable to the electorate if measures had been brought in sooner.

As cited in last month's meeting, the committee is conscious of a slowly improving outlook in Europe on the economic front. At long last, employment is expanding, but a deflationary threat stubbornly remains and it is still too early to measure the success of the ECB's latest subdued policy moves.

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The US rumbles on

Countries	P/E	Yield
US	16.3	2.0
UK	14.0	3.8
Europe ex UK	15.4	3.4
Japan	13.9	2.1
Asia ex Japan	12.7	2.6
Emerging Market:	14.9	3.4
China	9.9	3.3
India	16.7	1.6
Latin America	14.3	3.0
Brazil	11.9	3.9
Eastern Europe	5.8	4.8
Russia	4.5	5.2

Source: Datastream/MSCI

Yield figures are in percentage terms

The US economic outlook continues to improve. Increasing employment levels, similar to the UK, have been the overriding force in this expansion. What has, of course, worried investors has been the winding down of the Fed's monetary stimulus that has squeezed funds from treasuries into higher yielding asset classes. Under Janet Yellen, this process looks to be going as smoothly as one could hope for. Signs of a tightening in the labour market and the ensuing monetary policy response will strengthen the dollar and ought to continue to weigh on emerging markets, where there is a longstanding inversely correlated relationship. We see the extraordinary level of monetary stimulus as entirely appropriate in mitigating the impact of the extended period of deleveraging. If the Federal Reserve can withdraw the stimulus as fast as possible without cutting off demand (and inflation) then the outlook for the US market looks strong. Taking all of this into account, the committee remains Overweight.

In fixed income markets, we have been surprised by the performance of medium/long government bonds which have provided similar returns in the main markets of Europe and North America. Falling yields were accentuated by lowered inflation expectations in Europe, capital flight on geopolitical concerns and the early in the year concern over US growth. While issue two remains present, deflation has just about been staved off in Europe and growth is looking rosier in the US. With this is mind, we maintain that fixed income offers little appeal and are comfortable with the Underweight allocation to the bond market, despite their fillip so far this year.

The committee's viewpoint, whilst taking most of this positive news flow into account on a meeting by meeting basis, was that the outright level of yield available from the gilt market still made it an area which does not provide an adequate level of return for this risks involved; which despite steep curves, still meant the delivery of low real yields and low outright yields tied into an elevated level of risk should the markets take on a more negative slant to interest rates. This remains the view and the committee's more positive view to equity markets has, to a reasonable extent, been "funded" by the under-allocation to this area.

Asset Class	WMA Growth	BD Growth	WMA Balanced	BD Balanced	WMA Income	BD Income
Cash	2.5	2.0	5.0	3.5	5.0	3.0
Bonds	7.5	4.5	17.5	14.0	32.5	27.5
Gilts	7.5	0.0	17.5	9.0	32.5	22.0
Corporate Bonds (O/B)	0.0	4.5	0.0	5.0	0.0	5.5
Equities	82.5	89.0	70.0	76.0	55.0	59.5
UK	45.0	48.5	40.0	42.5	37.5	39.5
Overseas	37.5	40.5	30.0	33.5	17.5	20.0
North America	20.5	24.5	16.4	20.0	9.6	13.0
Dev'd Europe ex UK	6.3	7.0	5.0	6.0	2.9	3.5
Japan	3.2	4.5	2.6	3.5	1.5	2.0
Asia	4.9	3.5	4.0	3.0	2.3	1.0
Adv Emerging	2.0	1.0	1.6	1.0	0.9	0.5
Emerging	0.5	0.0	0.4	0.0	0.2	0.0
Alternatives	7.5	4.5	7.5	6.5	7.5	10.0
Hedge Funds	7.5	0.0	5.0	0.0	5.0	0.0
UK Commercial Property	0.0	1.5	2.5	4.0	2.5	4.5
Other Alternatives (O/B)	0.0	3.0	0.0	2.5	0.0	5.5
Total	100	100	100	100	100	100

All weights as % of total portfolio