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Points of View

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A lacklustre month – Is political uncertainty to blame?

May was a lacklustre month for equity markets with the FTSE World index rising by just 0.87%. Buoyed by some positive economic figures, the US stock market was the best performing asset class (up 3.7%) followed interestingly by UK gilts which rose by 2.4%, perhaps seen as a safe haven investment in the run up to the EU referendum. Emerging markets fell in the month (approx.2%) but remain year-to-date one of the best performing asset classes with a rise 5.8%, just behind that of the US stock market which has risen by nearly 6%. Other major markets recorded sub 1% rises in the month.

There now appears to be a divergence of monetary policy amongst economies, with the US contemplating a rise in interest rates whilst the Eurozone, Japan and Switzerland actually have negative rates. The UK may be described as sitting in the "middle" with a small positive interest rate but no signs of a rise yet.

UK

June could be a fascinating month for the UK markets. The forthcoming EU referendum is likely to dominate the headlines over the next few weeks and the result may have profound effects not only for the UK, but also for the rest of Europe. The polls indicate that the two camps are now much closer than previously. Watch the value of sterling over the month as this may gyrate a lot in expectation of the result, and that has implications for inflation and perhaps the future course of interest rates.

"the result of the forthcoming EU referendum may have profound effects not only for the UK, but also for the rest of Europe."

The uncertainty around the aforementioned EU referendum is blamed for the lacklustre growth in the first quarter of 2016 (GDP up only 0.4%), as business investment fell as companies chose not to invest until the Brexit vote is determined. Looking into the components of GDP growth the economy remained dependent upon the services sector and consumer spending whilst manufacturing output fell.

US

There is a rising expectation this month of a hike in interest rates. The US economic recovery appears to be progressing with both consumer spending and inflation up. Although during the past year there has been talk of a rate rise only for it not to happen, on this occasion the Federal Reserve has dropped heavy hints that a rise this month is on the cards. Consumer spending is increasing (more than two thirds of economic activity), supported by stronger employment markets and rising house prices.

"the Federal Reserve has dropped heavy hints that an interest rise this month is on the cards."

US politics has also become more interesting with the strong likelihood that Donald Trump will become the next Republican presidential candidate. This was not expected even a couple of months ago and so expect much commentary on what a Trump presidency might look like. Protectionism, increased defence spending, who knows? Markets hate uncertainty and at the moment politics is providing plenty of it.

Europe

Although out of the news for some time, Greece came to an agreement with its creditors and received another tranche of loans, with repayments due to commence in July (Greece still owes its creditors 180% of its GDP). The good news is that Greece may have longer to repay the loans and the interest rate paid may be capped. Elsewhere, the bigger problem for the Eurozone remains the threat of deflation (falling prices), not helped earlier in the year by the fall in oil prices. The European Central Bank (ECB) has an inflation target of 2%, however the lack of any pricing pressures reflects the weakness in demand across the region largely due to the lack of progress in reducing the high level of unemployment observed across many parts of the EU, for example Greece and Spain have rates upwards of 20%, which contrasts meaningfully with Germany at less than 5%.

Elsewhere a less commented danger is that of Italian banks. Nearly 20% of all lending by the banks are non-performing i.e. borrowers have fallen behind on their repayments. Watch this space.

Japan

Doubts remain about the effectiveness of "Abenomics" (low interest rates, government spending and market reforms), as retail sales have now fallen for two months in a row and inflation remains moribund. This has led to a postponement of a rise in sales tax until 2017 for fear this may hinder consumer spending, though the reality continues that the average Japanese household remains more inclined to save than consume, which the authorities are finding hard to break. Nonetheless from a sustainability perspective tax does need to rise in Japan as the country has a high debt level and its ageing population will cost more to look after in the future.

"the rise in sales tax until 2017 has been postponed for fear this may hinder consumer spending, though the reality continues that the average Japanese household remains more inclined to save than consume."

In this respect some good news was provided by the economy growing in the first quarter of the year after a contraction in the final quarter of 2015. This meant that Japan technically did not fall into recession (defined as two continuous quarters of decline) and that tax receipts should have been buoyed as a result. Meanwhile the introduction of negative interest rates earlier in the year will hopefully encourage spending by consumers and companies alike rather than make no money on their cash.

Emerging markets

With an expected rise in US interest rates and thus the possibility of a stronger dollar, emerging markets have struggled of late after a good start to the year as value reappeared in various emerging-market stock markets. A US rate rise would be expected to attract monies to the US in search of a higher yield and raise the prospect of outflows from some emerging-market countries, especially those which rely upon overseas monies for finance.

Similarly with the rise in the US dollar, overseas debt issued by emerging-market companies is likely to encounter rising repayment costs, which are likely to be felt most acutely amongst those countries facing budget and trade deficits. Therefore for emerging markets to resume their positive ascendancy the US dollar is likely to need to avoid rising too much, commodity prices stabilise and Chinese growth maintain relative stability, with the latter of particular importance given the contribution of trade to GDP amongst many countries within the emerging-market asset class.

First published on 3rd June by Simon Brett of Parmenion Investment Management.

How to correct a shortfall in your pension before you reach retirement

Many people do not engage with their pension savings in the same way that they manage their bank account or look after their other investments.

Those who don't use a financial planner may have a firm grasp on their current or saving account balances, but even though they are making regular payments into a pension pot every month, they may not know how much retirement savings they have in total. Most importantly, they do not know how much income this will produce when they retire. It can come as an unwelcomed surprise that their pension savings may not produce the income needed or expected. There are steps however that can be taken to correct this.

How to correct a shortfall in your workplace or personal pension

There are two main options you can take to correct a shortfall in your personal or workplace pension scheme. Firstly, you can top up your pension pot by adding to an existing scheme, or start an additional one if that is a better option for you. If you can't afford to do this, or don't have enough time left before retirement age to be able to build up additional pension contributions, then the second option is to delay the date on which you will start to take the benefits from your pension savings. Some people choose a combination of these two methods.

There are tax incentives to saving into a pension scheme over other savings accounts, such as an ISA. Maximising your pension contributions in the years before retirement brings an immediate boost in the form of tax relief, based on the rate of income tax you pay. For example if a basic or higher-rate taxpayer contributes £800 into their pension, the government adds £200 in the form of tax relief, so £1,000 is contributed into the pension scheme. In addition to this, a higher-rate taxpayer can also claim a further £200 of higher-rate relief through their tax return, effectively reducing the overall cost to them of the £1000 gross contribution to just £600. There is a limit on the contributions you can pay into your pensions each year that qualify for tax relief, and you should check these limits before making large contributions.

Delaying when you start taking your retirement income helps in a number of ways. It allows more time for you to contribute to your pension pot and more time for it to potentially grow – so you may have accumulated more savings by the time you retire.

If you plan to buy a lifetime annuity, which provides a guaranteed income for life, then it could be that you receive a higher income when you do eventually retire. This is because annuity rates increase as you grow older, so delaying may mean you will receive a higher income, subject to overall annuity rates not falling. Your pension provider may apply charges for changing your retirement date, so it is important you check this before changing your plans.

What you should not consider doing is to increase the level of investment risk you take with your current pension savings if you are less than five to ten years away from your chosen retirement age. In fact it is usual at this stage to start to reduce the amount of risk, in order to reduce the impact of any stock market falls. Whilst the potential to make higher gains might be tempting, if the investments fall in value, which they easily could, then there may not be time for them to recover before you retire.

How to correct a shortfall in your state pension

You need to have completed at least 35 qualifying years of National Insurance contributions to get the full basic new State Pension (currently £155.65 per week, the current State Pension is £119.30 a week). These contributions can be a mix of those you have paid and others you are treated as having paid, for example, during periods when you were bringing up young children or unable to work because of health problems. If you have fewer qualifying years, then your pension entitlement will be proportionately lower, however you can make some top up payments to bridge this gap. The cost for each 'missing year' will depend on your circumstances.

Planning for retirement is an important step for everyone and early planning can reap rewards that may be more difficult to achieve the closer you get to your retirement.

First published on 3rd June 2016 by Sanlam UK.

Should a shift in pricing shift your view on property?

It seems as though fund houses move in unison; where one goes, the others follow. Certainly in the case of property, anyway.

Threadneedle, Henderson, M&G and Standard Life have all now taken the decision to alter the pricing basis for each of their most prominent property funds. While, for the more pessimistic investor, this may bring back memories of the actions taken by property managers in the wake of the Financial Crisis, the more bullish amongst the ranks may be looking firmly the other way at the potential buying opportunities ahead.

The principle reason for changing the pricing basis of a fund is to ensure the costs associated with selling property to raise cash for redemptions is borne by those exiting rather than those who stay in the fund. By moving from the offer to bid (or mid) price, the value of the underlying investors' holdings will effectively drop by the difference in price – generally circa 5% – reducing the incentive to take money out. This should subsequently reduce the level of outflows and protect the interests of long term investors.

So, has sentiment turned? Are investors voting with their feet? Or is this just a moment of uncertainty, following so many years of positive inflows into property funds? Given the current UK climate is so unfamiliar – markets are filled with a mixture of QE cash injection and BREXIT uncertainty, amongst other things – it can be hard to pinpoint exact reasons.

But looking beyond sentiment, the key point to consider is why property is used in a portfolio to begin with. It behaves differently to equities and fixed interest assets, for example, and so offers a diversifying element to a client's portfolio. There are different characteristics and drivers of return which make the asset class fundamentally different. Rental yields make up a significant proportion of the total return from property with capital values typically more stable when compared with other assets.

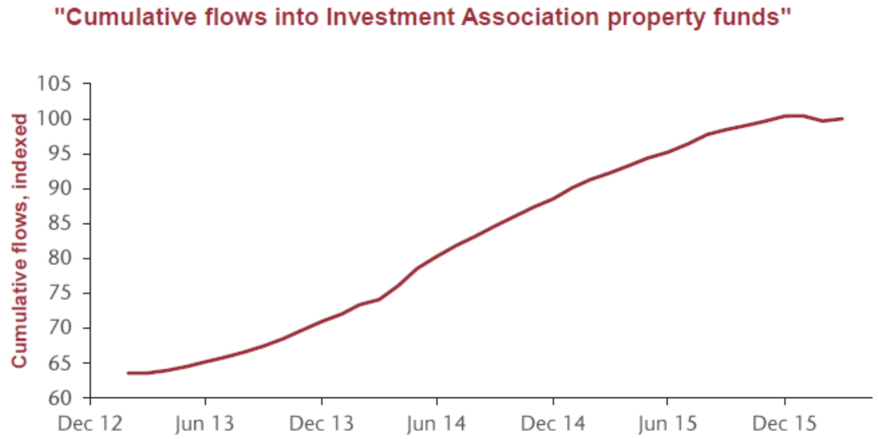

Figure 1: Cumulative net asset flows into property funds.
Source: Investment Association, Brooks Macdonald

For these reasons property still holds an important place in portfolio construction and offers a benefit to clients beyond purely the returns it generates.

Within PIM, we have recently adjusted our tactical allocation to the asset class by moving from a double overweight position to a single overweight one. While the timing of this change has worked well in respect of avoiding the fund pricing changes, this wasn't the primary reason for doing so and our outlook remains positive and thus our allocation to the sector remains overweight. Yields are still attractive within the sector and they are coupled with strong risk and return characteristics.

Whether sentiment for the property sector is shifting or not, the underlying fundamentals of the asset class have not, and nor have the reasons for holding it within a diversified portfolio.

First published on 25th May 2016 by Jasper Thornton-Boelman of Parmenion Investment Management.

The referendum on the UK's future in the EU is suddenly upon us and the British public vote on whether or not they want to stay in the EU next week.

Unsurprisingly, this has seen significant media attention as both sides make claims and counter claims about the benefits of a vote in either direction. It has to be said that the majority of these are politically driven rather than supported by hard facts, with the truth more likely to be somewhere in the middle. As a result, we would expect the impact on the UK economy to be less dramatic than that described in the media, with boosts being seen in some sectors being counterbalanced by negative effects seen in others, regardless of the outcome. Ultimately though, we just don't know what the long term impacts would be of leaving the EU and this uncertainty will likely cause further volatility in risk assets, in the UK and Europe, in the lead up to the referendum.

There are a number of key topics that people mention when discussing the impact of a 'Brexit', and as you would expect, each of them have potential impacts that are both positive and negative.

Border Controls

Perhaps the most talked about in the media is what a Brexit would mean for the UK government in terms of having greater control over Britain's borders. It is arguable that Britain could see an increase in skilled workers entering the country through tighter migration controls; however, whether the UK gains any powers to restrict the flow of unskilled workers from Europe will depend on its future relationship with the European Union and whether it wants to retain access to the single market. Conversely, a reduction in unskilled migration could also cause potential problems for low-wage sectors of the economy that are heavily dependent on migrant labour, such as agriculture.

Trade agreements

A Brexit would give Britain an opportunity to broker its own trade agreements with the rest of the world, something it has not been able to do as part of the EU. Although potentially beneficial, we should also remember that a significant amount of our exports are linked to European Union membership. Thus, a renegotiation of a trade agreement, outside of the single market, would be needed if the UK is to avoid paying trade tariffs. Were a Brexit to occur, it is fair to say that it would be a negative for the EU; Britain has a world-class financial centre that no other major European city is likely to match in the short-term, is a major contributor to the EU budget (10% of the total in 2015) and is a leading voice for free markets. It is, therefore, unlikely that the EU will 'play ball' during negotiations over new trade agreements with the UK in an attempt to discourage other separatist calls that are likely to arise, particularly from the troubled peripheral countries.

These are just two of the many questions facing voters as they try to decide whether the UK would be better in or out of the EU. The property market, foreign investment, the City of London, changes to regulatory and legal landscapes and the state of the country's finances will all be impacted by the outcome of the referendum. Again, the perceived impacts on these areas will be dependent upon the arguments you listen to and the way politicians try to influence voters. The thing to remember is that neither side is coming from a position of certainty, with their predicted outcomes being best estimates.

The value of Sterling

If the country does vote yes to leaving the EU then the biggest impact will be that there is likely to be pressure placed upon the value of sterling. This will benefit those large companies that operate globally and have earnings in currencies other than Sterling, but is likely to make life tougher for those companies focused on the domestic market. This means it is more important than ever to have a well-diversified portfolio, both in terms of sectors within the UK and regions globally. Although client portfolios do have exposure to UK equities this is balanced against a range of overseas equity funds and our asset classes such as fixed income. Exposure to overseas equities is going to be vital in navigating the coming months; the focus of investment portfolios being balanced with exposure in regions outside of the UK will help to limit the impact of any volatility seen in the UK markets.

First published on 15th June 2016 by Sanlam UK.

You can read more about the potential impact of brexit in our blog post **here**.

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