Global Investment Outlook

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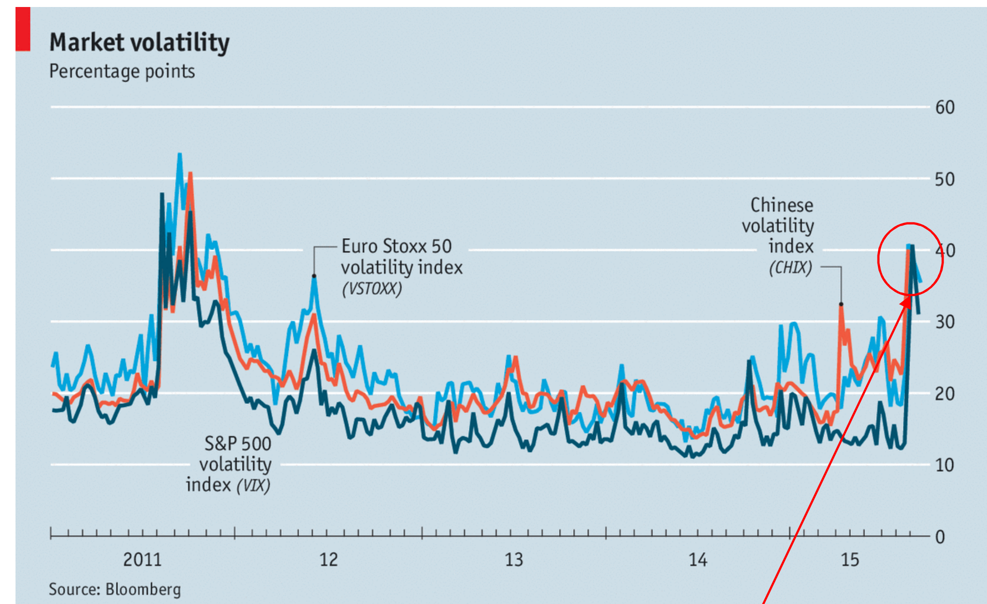
Market volatility is making investors wary

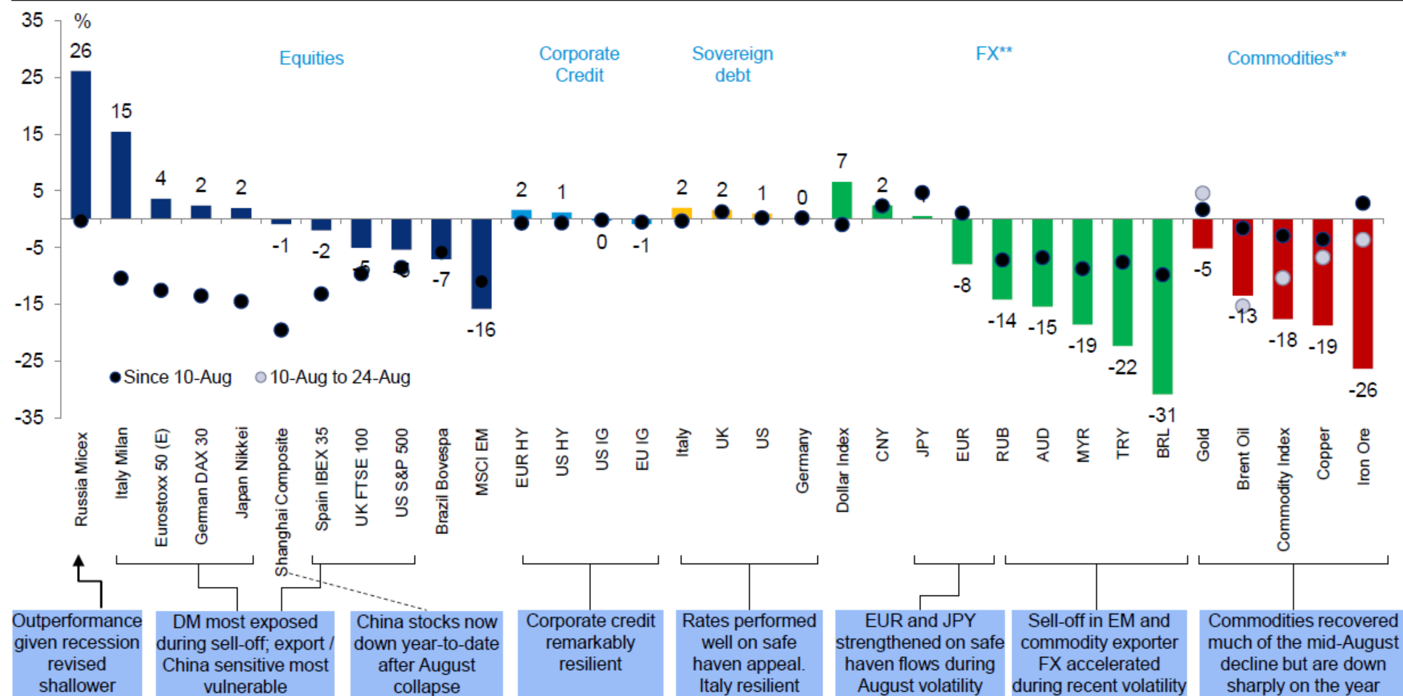
- Recent devaluation of Chinese currency rattled financial markets globally, raising concerns about a significant slowdown in China's growth together with fears as to implications of this on the rest of the world
- Emerging markets have been affected by a slowing in world trade growth (particularly Asian exports) and falling commodity prices (particularly China)
- Emerging market currencies suffered a sharp drop in light of investors' fears over China's decelerating growth
- Deterioration and concern around Euro area financial stability, particularly in light of events in Greece, Spain, Portugal and Italy
- US growth momentum fades while global markets await Fed's decision on interest rates (*17 September 2015*)
- Geopolitical risk is still high (e.g. migrant crisis, instability in Middle East, oil prices, etc.)



Summer 2015 volatility last seen in 2011 amidst Eurozone debt crisis

Sources: *The Economist, Bloomberg, Financial Times*

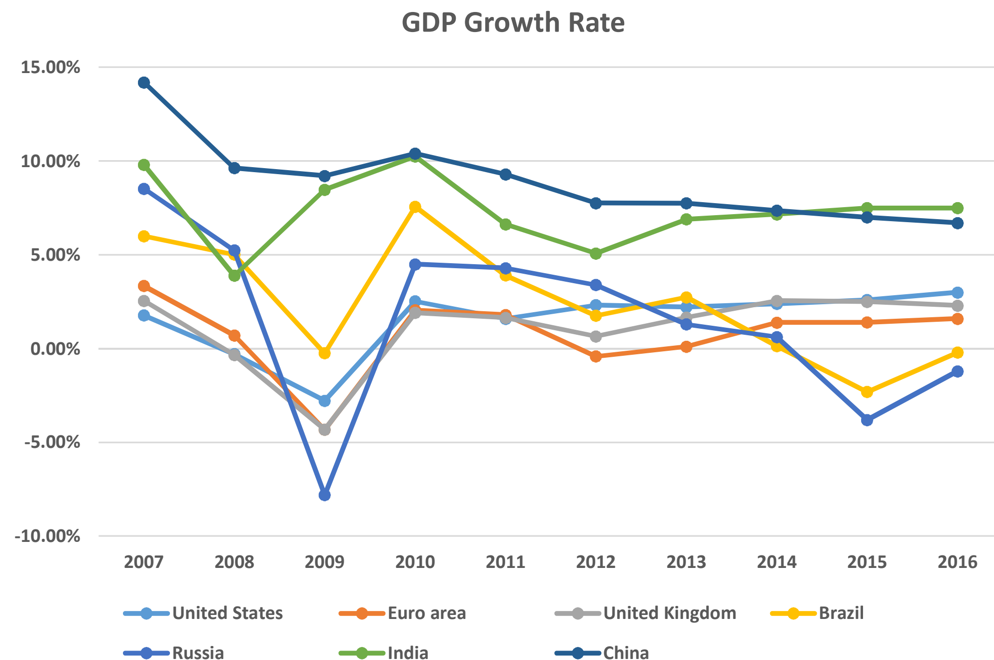
There have been few, if any, safe havens in 2015



Source: *Deutsche Bank Research "The House View: The Final Countdown" dated 8 September 2015*

Overall economic growth projections remain modest

- US, UK and Euro area expected to grow at a modest pace with low inflation
- BRIC markets split
  - ✓ Brazil and Russia to start recovery in 2016
  - ✓ India will slow down, but outperform
  - ✓ China expected to do everything it can to keep its GDP growth at around 7% (i.e. further devaluation likely)



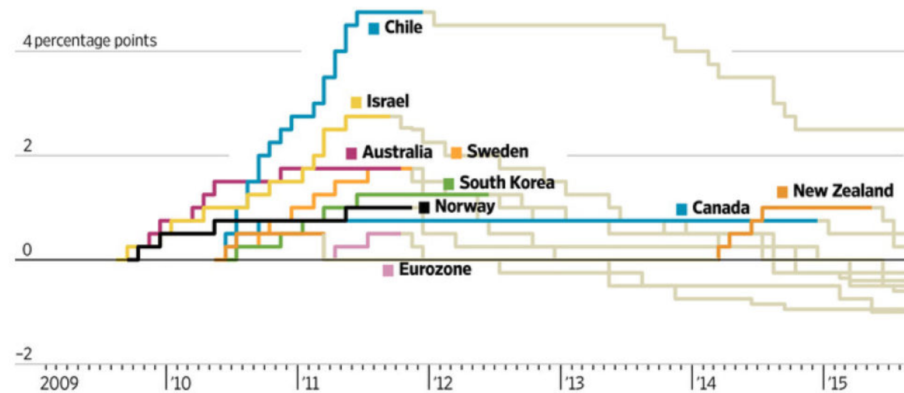
Sources: *Historical data through to 2014 - IMF World Economic Outlook Database, April 2015; Projections starting 2015 – Deutsche Bank Research "Global Economic Perspectives" dated 3 September 2015*

Interest rate policy has distorted asset values

- Traditional policy making around interest rates:
  - ✓ Interest rates are raised when the economy is growing too fast
    - Encouraging people to spend less and save more, while reducing inflationary pressure
  - ✓ Interest rates are reduced when the economy is growing too slowly

- But these policy decisions and their timing do not come without risks!!

- A number of central banks have tried to raise rates, only to reduce them again as their economies stumbled

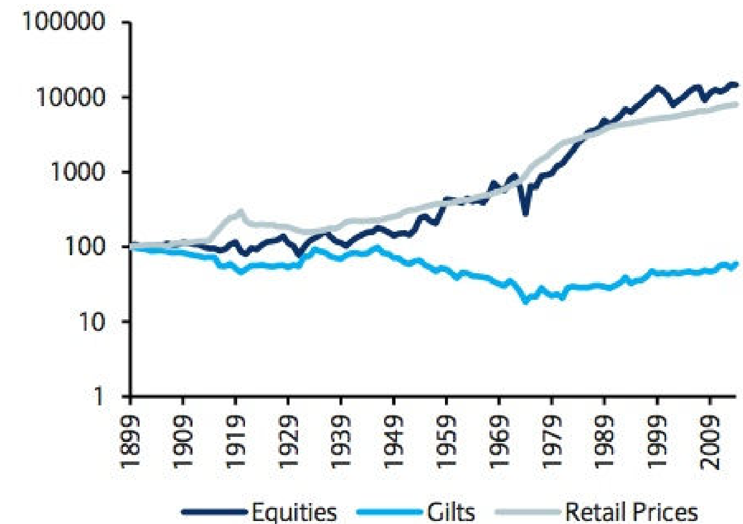


Sources: *Wall Street Journal*

Interest rate policy has distorted asset values - UK

- In February the UK redeemed GBP218m of Britain's oldest and most unusual national debts: the 4% Consolidated Loan
  - ✓ A government bond issued in 1927 by then chancellor Winston Churchill to re-finance national war bonds originating from the first world war
  - ✓ Traces its lineage back to the 18th century (South Sea Bubble financial crisis of 1720)
  - ✓ Perpetual gilts which have no fixed redemption date, giving the government the right to repay them at any time
  - ✓ The Debt Management Office estimates that the nation has paid GBP1.26bn in interest on these bonds since 1927
  - ✓ The government made this move to take advantage of falling borrowing costs on global capital markets by refinancing the debt at a time when long-dated gilt yields are at a 60-year low

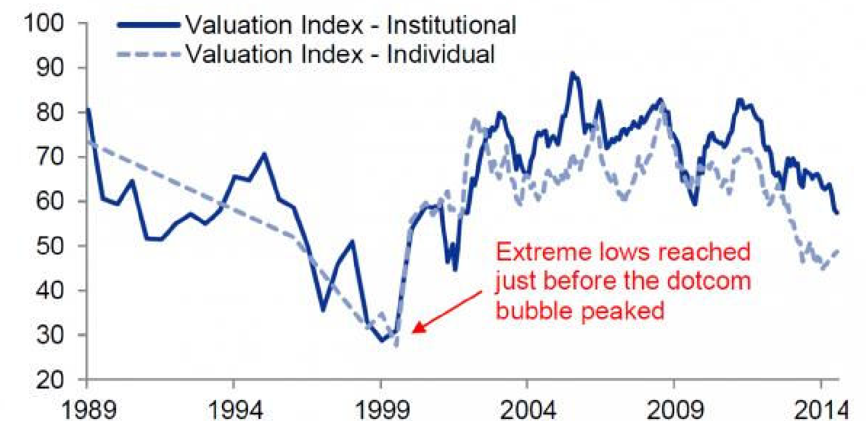
- The Barclays Equity Gilt Study 2015 finds that performance of gilts (UK government bonds) in the last two years has been the opposite of that for UK equities
  - ✓ Since 1899 equities have achieved average annual returns of 5%, compared with just 0.8% for cash
  - ✓ Investment in equities held for a five-year period have beaten cash 75% of the time



Source: *Financial Times, FT Adviser, The Guardian and Barclays Equity Gilt Study 2015*

Interest rate policy has distorted asset values - US

- Nobel economics laureate Robert Shiller interview in Financial Times on 13 September 2015 highlights fears of a US stock market bubble
  - ✓ Shiller's valuation confidence indices, based on investor surveys, showed greater fear that the market was overvalued than at any time since the peak of the dotcom bubble in 2000
  - ✓ "It looks to me like a bubble again with essentially a tripling of stock prices since 2009 in just six years and at the same time people losing confidence in the valuation of the market"
  - ✓ The recent bout in volatility "shows that people are thinking something, worried thoughts"
  - ✓ Shiller has made clear that it remained impossible to time any fall in the market, and cast doubt on whether stocks would drop should the Fed raise rates



Source: *Financial Times and Yale School of Management; chart from Zerohedge.com*

Almost impossible to get two economists to agree…

- Since December 2008, the Fed's benchmark interest rate has been set at between 0% and 0.25%
- Question asked of leading economists in the US: "By keeping interest rates so low for so long, could Fed Chair Janet Yellen and her fellow policymakers have unwittingly set the stage for a crisis of some kind in the future?"
- Answers offer conflicting viewpoints

"No. A weak recovery is a closer danger than runaway inflation. Current levels of continuing slack in the labour market point to low inflation risk."
David Crowe, Chief Economist,
National Association of Home Builders

"Possibly. The prolonged period of interest rates at the 0 lower-bound limits the Federal Reserve's ability to react to future economic troubles."
Doug Duncan, Chief Economist,
Fannie Mae

"Yes. Investors are chasing yield elsewhere, which translates into greater risk-taking."
John Silvia, Chief Economist,
Wells Fargo

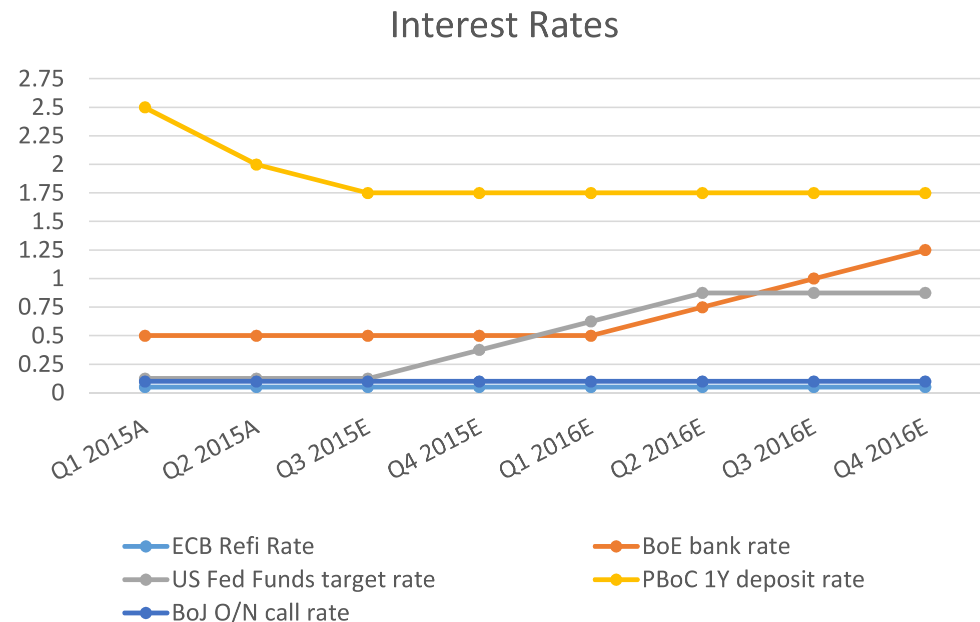
"No. There is a chance that it could, but it doesn't seem to be feeding any really big bubbles, at least at the moment. Clearly, low rates are not causing an economic overheating."
Robert Johnson, Director of Economic Analysis,
Morningstar

"Yes. Artificially low rates can result in investors reaching for yield – taking on too much risk without appropriate levels of return. In the last cycle, the Federal Reserve kept rates too low for too long, and this contributed to the asset bubbles that were a cause of the crisis."
Michael Fratantoni, Chief Economist,
Mortgage Bankers Association

Source: *2015 Bankrate Economic Indicator Survey*

Timing is also uncertain

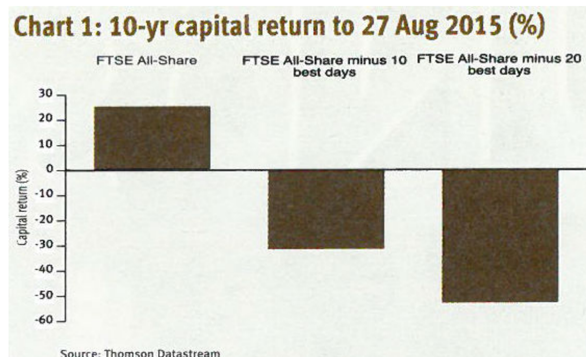
- Two central banks have not raised rates since the crisis – the Fed and the Bank of England – and they have enjoyed stronger recoveries than others
- Their economies may now be strong enough to bear the effects of an increase in rates
- But the question is, who will make the first move?
  - ✓ Stanley Fischer, Vice Chairman of the Fed, said in an interview with CNBC in late August "We haven't made a decision yet, and I don't think we should. ***We've got time to wait and see the incoming data*** and see what exactly is going on now in the economy"
  - ✓ Mark Carney, Governor of the Bank of England, said in July "once normalisation begins, interest rate increases would proceed slowly and rise to a level in the medium term that is perhaps about half as high as historic averages" indicating that the decision will likely come "***around the turn of this year***"

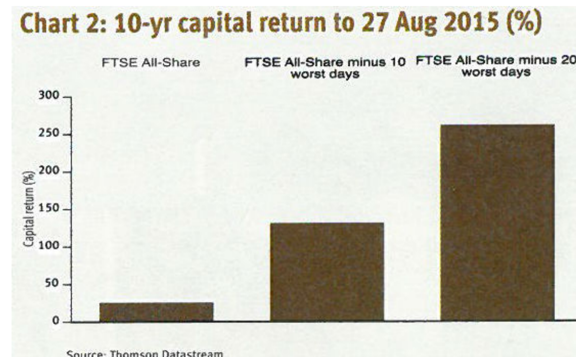


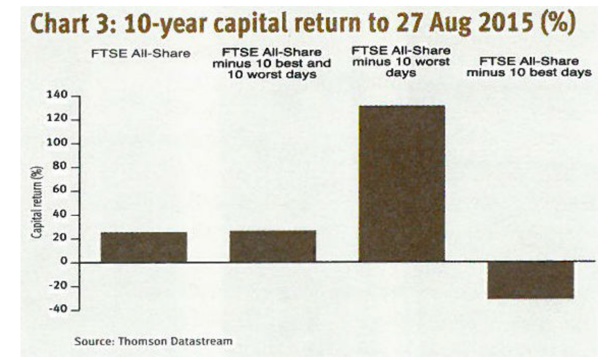
Sources: *Wall Street Journal; NY Times; Deutsche Bank Research "Focus Europe: Migration and its impact" dated 11 September 2015*

Few are good at timing markets

- Being out of the market or underinvested has risks of its own
- Maintaining a sensible commitment to the market and a disciplined asset allocation are probably key







Sources: *Investors Chronicle 4 September – 10 September 2015 edition, "Chronic Investor"*

So, given the uncertain environment, what should investors do?

Asset Class	Barclays Expected 5yr returns	My Views
Cash & Short Maturity Bonds	1.5%	Low expected returns; may be completely eroded by inflation
Developed Government Bonds	1.4%	Very expensive asset class offering low returns
Investment Grade Bonds	2.3%	Very expensive asset class offering low returns
High Yield & Emerging Markets Bonds	5.0%	Expensive and risky asset class
Developed Markets Equities	7.9%	May be overheated (see Shiller), but still considered a stronger bet than emerging markets equities
Emerging Markets Equities	10.6%	Offers attractive prospects but risky considering economic slowdown and currency risks in emerging markets
Commodities	4.8%	Subject to geopolitical and monetary policy risks, and continuing uncertainty in China
Real Estate	8.0%	Attractive long-term investment, however, returns are likely to be eroded by interest rate normalisation
Alternative Trading Strategies	3.5%	Long-term investment; with the right strategy can offer significant returns with much less volatility

Source for Asset Class Allocation and Expected 5yr Returns: *Barclays Wealth and Investment Management "Compass Q3 2015"*

Summary

Volatility is likely to persist

Interest rate normalisation is a given

But, the effect and timing are almost impossible to predict

Few asset classes seem highly attractive on a risk / reward basis

Attractive / non-correlated investment strategies may be the right way to ride out the storm

Thank you

Questions & Answers