

Equity Market Rally

For the last few months we have continually said we are nervous about the speed and strength of the recent rally in equity markets. However, despite a few blips along the way, this rally just keeps on going!

This is very welcome of course, as most clients have been overweight in equity and therefore valuations are now looking a lot better than they were in March.

Incidentally, some clients have commented that they don't feel they have felt the full extent of this rally. Sometimes this is due to timing of valuations – someone who received a value in mid March and then last week would certainly see a big difference!

Despite the strength of the rally, the further it goes the more nervous we get. There just doesn't seem to be enough reason for such optimism in the markets. Although we think the FTSE 100 could end the year around 5,000, we think it is probable there could be a dip in the autumn.

When I wrote my first draft of this article, the FTSE 100 was hovering around the 4,900 mark (although it's now dipped somewhat). We think now is the time to bank some of the gains seen since March and reduce risk.

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Tactical Changes

Our ideal tactical (short term) position for a typical cautious client since the start of this year has been 30% in equity. We're reducing this to a "neutral" 25%. For a typical balanced client we are reducing from 40% to 35%, and for adventurous we are reducing from 45% to 40%.

Of course, as our service is bespoke the changes we recommend to your individual portfolio may be slightly different. We will discuss this with you at your next review, but please get in touch if you want to reduce equities now.

If you do wish to reduce now, we may suggest moving 5% to cash initially pending a full discussion when we next meet or written recommendation at your next postal review.

We do have the option to reduce equity in our discretionary portfolios but we are not yet using this facility as we are still in the process of migrating clients to the new service. Until all clients are moved to our ideal mix of equity funds we must be very careful how we use this facility as we could potentially move more out of the markets for some clients than we, or you, would like.

This is another reason why we are pushing forward with our wrap migration project, as once completed we think we can enhance our service even further.

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Property Outlook

Having made the decision to reduce equity, where then do we put the extra 5%?

We think that for cautious and balanced clients, now is the time to “dip a toe” back into commercial property.

Whilst we are still anticipating further falls in residential property prices, commercial prices look like they have stabilised. Rental yields are up at around the 8% pa mark, so even if prices were to fall over the next year the rents could compensate for price falls up to a reasonable level.

We are still being cautious about this area which is why we’re only putting 5% into property for now. We have chosen funds which have high cash levels so that they are able to take advantage of market lows and buy properties at attractive levels. High amounts of cash also means they should be able to manage any withdrawals without any issues, lessening the potential for lock-ins.

For adventurous clients, we are generally recommending moving 5% from equity to alternative equity instead of property. Alternative equity is not completely correlated to equities and so could rise even if equities fall.

We feel that with careful entry timing, this area has higher potential returns than property in the short term but it is higher risk.

Investment Dinners

Although we form our own views on each asset class, we of course listen to the experts in various areas before forming opinions.

Some of the experts have remained very defensive throughout the recent equity rally. Neil Woodford of Invesco Perpetual has been particularly cautious and this means that his short term performance looks poor by comparison with his peers.

However, Woodford has been bearish in the past when others have been overly optimistic. He is not afraid of some short term underperformance as he’s willing to back his own judgement, and he has been proved right many times in the past.

We are lucky to have Mitchell Fraser-Jones, from Woodford’s UK Equity Team speaking at our forthcoming investment dinner on 24 September. If you are interested in attending to hear more about their current defensive position and why they remain concerned about the UK economy, please get in touch.

We will also be talking about commercial property at this dinner. The venue is the London Road restaurant in Alderley Edge, and the food and wine is on us! Spaces are very limited and are on a first come first served basis.

Mike Deverell, Investment Manager

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General economic overview

Where previously there has been much discussions about whether inflation or deflation is the biggest threat to the economy, the consensus is now that inflation is less of a risk in the medium term. Inflation could become an issue again in perhaps a year's time.

Optimism that we are in a recovery has risen and we may even technically be out of recession, but it won't seem like it for some time as the effect of redundancies is only just being felt.

Asset Class Views

<p>Equity Markets</p> <p>Equity markets have had another strong month moving from around 4,600 up to around 4,900 at the end of August. The possibility of a setback has increased further and we are now moving from an overweight position in equity back to a more neutral position.</p> <p>We've reduced our equity outlook from a +3 to a +2. We have enough concern to reduce our overweight position, but we still think equities are good value on a medium term view. Our best guess for the rest of the year is that markets will finish higher, after a difficult autumn.</p>	<p>+2</p>
<p>Fixed Interest</p> <p>The rally in corporate bonds continues, whilst gilts have fluctuated up and down. We remain optimistic about investment grade bonds and negative on the outlook for gilts.</p> <p>As the rally has continued we've again reduced our outlook, this time from plus 4 to a plus 3 as we believe the returns we've seen will start to level off. However, we still believe we will see positive returns for the time being.</p>	<p>+3</p>
<p>Commercial Property</p> <p>Commercial property is starting to look good value in some areas and we are now starting to invest in this asset class again.</p> <p>The derivatives market is forecasting a slight capital gain to the end of the year. If this is correct then there could be a reasonable return once rental income is factored in.</p> <p>We are recommending property funds with high cash levels so they can take advantage of distressed sellers and can manage outflows if they occur.</p>	<p>+1</p>
<p>Residential Property</p> <p>House prices rose again last month, by the biggest amount since 2004. However, we do not believe this is sustainable and expect weakness for some time to come.</p> <p>We believe that prices could fall further as the effect of redundancies takes its toll. Access to mortgage lending remains restricted, which in the short term could prevent a recovery.</p>	<p>-1</p>

Key:

+ means we are positive about an asset class

- means we are negative about an asset class

= means we are neutral about an asset class - we expect it to behave normally

+5 is most strongly positive, **-5** is most strongly negative.

These represent Equilibrium's collective views. There are no guarantees, although we hope to be right more often than wrong. We usually recommend holding at least some funds in all asset classes at all times and adjust weightings to reflect the above views. These are not personal recommendations so please do not take action without speaking to your adviser.