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Conference Report

IN ASSOCIATION WITH

Cazenove Capital

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Look forward

2020 vision

The Scotsman Investment Conference 2019 anticipates a challenging year ahead for global markets

Picture: Scott Louden

The Scotsman Investment Conference 2019 – Looking out to 2020 was held at the Principal in central Edinburgh on Tuesday. Three representatives from partner organisations of the event summarise their presentations given to delegates

Ensuring investments meet expectations for retirement

MARK WHITEHEAD

Mark Whitehead delivering his speech at the event

Living longer is forcing a dramatic change to how we financially plan for later life. If you are wondering how to fund a comfortable retirement there are three questions for you to consider – but also some simple solutions.

Firstly, can you afford to stop working? Research shows that not having enough money to retire is a common worry. One survey found that only 6 per cent of respondents definitely expect to have enough money in their final pension pot.

This is scarcely surprising. People are living far longer and this is putting significant pressure on retirement funds. According to a World Economic Forum report, the global savings gap between what people want to save and the final amount could rise to US$400 trillion by 2050.

The second question to be addressed is when can you take retirement? It is no longer black and white – either through necessity or choice, people are working past their retirement age.

There is now evidence of a "Grey Zone", a period between a person's early 60s and early 70s when they are still working. This group have some access to savings, but are not fully drawing down their assets – and, in fact, could still be adding to their pension. As a result, retirement income has to work differently. The simple two-stage process of accumulation and spend is no more.

The third question is where to look for income growth? Many of the traditional methods of accumulating wealth have also begun to lose their effectiveness.

Since the global financial crisis of 2008, the range of assets which provide the desired combination of attractive, sustainable and growing income has shrunk. In particular, the bond market was once the staple of retirement planning, but the falling yields – marginally above recent record-low levels – available from fixed-income asset classes have limited their use.

Nevertheless, there are answers out there. There remain higher-yielding, high-quality equities which can still deliver the necessary returns investors require as they approach retirement and when they finally leave work.

Over the longer term, equities have tended to outperform fixed-interest portfolios and a collection of investments built around quality, growing companies has the potential to provide an attractive, sustainable and growing income, as well as an element of capital growth.

At Securities Trust of Scotland, our objective is to deliver rising income and capital growth and there are a few core rules for stocks included.

> *"We look for companies that can provide durable dividend growth and subject any stocks to extensive scrutiny"*

Importantly, the stocks must be global. Political issues like Brexit remind us of the dangers of restricting ourselves to a single market, such as the UK or US.

As fund managers, a global remit allows us to "go anywhere" to find the world's leading companies. Although investing in foreign markets does bring a measure of currency or political risk, it can be managed through effective portfolio diversification.

The stocks must also have quality. The companies should have certain characteristics, such as high returns on invested capital, which is a good measure of profitability and potential for value creation.

Lastly, the stocks should be sustainable. We look for companies that can provide durable dividend growth and subject any stocks included in a portfolio to extensive scrutiny to gain a greater understanding of their liquidity and capital structuring.

We stress-testing the dividend, modelling how it stands up to more challenging economic environments and examining how the company approaches environmental, social and governance factors, to ensure they are good stewards of capital.

There is no doubting the challenges for investors as they think about their retirement plans, but we believe there is a solution and quality equity income propositions, such as Securities Trust of Scotland, may be worth further investigation.

Mark Whitehead is Portfolio Manger of Securities Trust of Scotland

Positive start raises hopes of stability

Caspar Rock outlines his views on the global situation for stocks and bonds

CASPAR ROCK

Stocks and bonds have rebounded after a difficult 2018, which was a highly unusual year in investment. For only the third time since 1900, both equities and bonds delivered a return lower than cash.

Normally, when shares have a bad year, government bonds offer some respite. This was not the case last year. Concerns about US interest rates rising too far too fast meant investors sold both shares and bonds.

After such an unusual year, what can we expect for 2019? The good news is that both stock and bond markets have started the year on a much more positive note.

Both asset classes were buoyed by the Federal Reserve's soothing words on interest rates.

Major equity markets have enjoyed the best start to the year in decades. Global equities, as measured by the MSCI World Index, rose approximately 8 per cent in sterling terms in the first two months of 2019.

The Fed has, for now, allayed concerns about the pace of interest rate hikes and the immediate political dangers that have weighed on markets may be easing.

However, while still positive, the economic backdrop is less supportive than it was and there are still significant political risks.

Schroders recently trimmed its global growth forecast for 2019 to 2.8 per cent, while making a small upward adjustment to its forecast for 2020 to 2.7 per cent. This reflects a recent slowdown in activity, with global trade volumes falling sharply at the end of last year.

We may see further disappointing data as firms run down inventories built up in anticipation of increased US tariffs on China.

However, we at Cazenove do not expect this slowdown to lead to a recession. We see a number of reasons why growth should stabilize this year and heading into 2020.

There have been encouraging signs of progress in the US-China trade talks and increasing hope that the US president and his Chinese counterpart will announce an agreement when they meet later this month. A deal will help support US growth in 2020 as the boost from higher fiscal spending dissipates.

However, even if a trade deal does materialize, the US and China are still at loggerheads over technology and we may yet see a "trade war" morph into a "tech war".

Meanwhile, any Chinese agreement to buy more US products could lead to political tensions with trading parties squeezed out by the new arrangement.

It's a similar story in the UK. It looks increasingly likely that we will manage to avoid a no-deal Brexit. Assuming this is the case, we envisage a modest rebound in UK business and consumer spending later in the year.

Yet it is unlikely that uncertainty over the UK's relationship with the rest of Europe will be resolved any time soon and we expect this to weigh on Britain's prospects.

Globally, the sharp fall in oil prices late last year should help support growth. Lower oil prices mean higher real incomes, particularly in the US where taxation on gasoline is low.

In addition to subsequent higher consumer consumption, rising real wages should help ease the political tensions that have been so apparent over the last few years.

The prospect of higher borrowing costs were a real concern last year. However, in January, the Fed said it would be "patient" about making changes to interest rates this year. We at Cazenove still expect one more increase in US interest rates in the current cycle. We have also pushed back our forecast for rate rises in the Eurozone and UK.

> *"We do not expect this slowdown to lead to a recession. We see a number of reasons why growth should stabilize this year"*

Cazenove portfolios have benefited from the rebound in global stock markets. However, equity valuations no longer look especially compelling. Having started 2019 at a discount to their 15-year average valuation on a price-to-earnings basis, global equities are now trading slightly above this level.

This doesn't mean that equities can't continue to rally. However, given we believe we are in the later stages of the business cycle, we think it makes sense to take advantage of improved valuations to reduce risk.

This will involve moving into less risky parts of the equity market and potentially reducing our exposure to corporate credit in favour of safer government bonds.

Cazenove is also increasing holdings of assets that have historically maintained their value during adverse market conditions, such as gold and cash.

Importantly, we will ensure that our portfolios remain well diversified. This is the best way to ensure that whatever the rest of the year brings, Cazenove portfolios should be able to deliver an attractive return without being fully exposed to any renewed volatility.

Caspar Rock is Chief Investment Officer at Cazenove Capital

David Coombs on the podium at the Principal, Edinburgh

Recovery prospect is sterling stuff

DAVID COOMBS

I don't know about you, but over the past year or so I got into the habit of buying travel money extremely far in advance of holidays.

Soon after the referendum result in June 2016 – when sterling fell like an elephant with a ball and chain on its leg – there was a period when I'd hold off because I thought the exchange rate could possibly, maybe, should be, better next week.

That time of timid hope bled away when the pound slipped below €1.15 and camped out there for more than a year.

But recently, as I look forward to my Santorini sojourn in June, I've started to rethink my approach.

Sterling ticked up to €1.16 last week, pushing against a level that it has struggled to break through for years. Against the dollar, it got to $1.33, its highest point since June last year.

As radicals on both sides of the Brexit divide simultaneously fold in on themselves, investors sniff a compromise in Westminster.

About time too – spring's approaching and another year of paying 20 per cent over the odds for everything Continental is too devastating to contemplate.

So as we barrel toward the Article 50 deadline of 31 March, it could be time for the long-undervalued pound to have a bit of a comeback.

The appetite for a no-deal crash-out in the House of Commons seems very low indeed. The tone in Westminster seems to have subtly changed in the last few weeks. And it's reverberating through sterling.

A plan and a pathway for Brexit would give businesses the assurances they need to go ahead with UK projects, so they would buy sterling to build warehouses and employ more staff and that buying would send the pound higher.

That will be double-edged: a stronger pound means Brits' wages will go further, boosting retail spending and in doing so the largest part of the economy. But it will depress the value of foreign earnings and therefore the business of exporters who compete on price.

> *"As radicals on both sides of the Brexit divide fold in on themselves, investors sniff a compromise in Westminster"*

It will also, in the fullness of time, hurt the share prices of FTSE 100 giants who make most of their cash offshore.

But a stronger pound will be good for the economy overall.

It will also be great news for anyone who enjoys a little Continental sunshine.

David Coombs is Multi-Asset Portfolio Funds Manager at Rathbones

Mark Whitehead of Martin Currie, chair Bill Jamieson, David Coombs of Rathbones and *The Scotsman*'s Jane Bradley at Tuesday's event. Picture: Scott Louden

Risks and rewards assessed

Amid concerns over Brexit, the US-China trade war, and data hackers, the investment community has challenges ahead, reports **Stephen Emerson**

Cyber crime is the biggest threat that investors will face over the next decade was one of the key messages delivered at The Scotsman Investment Conference 2019 – Looking out to 2020, held at the Principal in Charlotte Square, Edinburgh, on Tuesday.

The special event, chaired by *The Scotsman*'s Bill Jamieson, saw invited speakers discuss the threats and opportunities that investors will face in the coming years.

David Coombs, head of multi-asset investments at investment managers Rathbones, told delegates that it was a prerequisite for every company his firm invested in nowadays to have a robust strategy for dealing with cyber crime.

He said: "The biggest threat to investments comes from cyber crime. Every company that we invest in now has to take this seriously. We now deal with companies who have their own in-house team of experts who look for weaknesses in their own systems.

"We need to take this very seriously as it is not going to go away. This is the biggest macro threat investors will face over the next ten years.

"There is opportunity in this situation, however, and we should be looking to invest in companies that can provide solutions to the cyber crime problem."

Coombs then pointed to the HSBC hack of US customer accounts in November last year which saw hackers access personal details, including account numbers and balances, statement and transaction histories and payee details, as well as users' names, addresses and dates of birth.

He expanded: "When you look at when HSBC was hacked there was not one pound that was stolen. Someone hacked into a bank and did not steal any money. At one time this would have been considered incredible.

"What they were after was more valuable, however. They stole personal data."

Earlier at the event, Caspar Rock, chief investment officer at Cazenove Capital, outlined the pressures that Brexit and the China-US tensions were having on the investment market.

He said that a sustained downturn was not likely over the next two years, but that the economic climate was definitely less heated.

"We are not going into recession in 2019 or 2020 but it is clearly getting cooler," he added.

"Inflation is not a problem right now, however, we do expect it to pick up in 2019."

Rock added that the outcome of the trade war between the US and China would be of crucial importance to the prospects of investors.

> *"We should be looking to invest in companies that can provide solutions to the cyber crime problem"*

He argued that the trade dispute, which began in January of last year with the US imposing tariffs of up to 30 per cent on Chinese goods, was actually about the protection of intellectual property rights, as far as Donald Trump was concerned, and not about safeguarding American steel jobs, as the US President argued.

Investors were also urged to keep an eye on the beleaguered high street retail sector, following a number of successful innovations in the states.

Faced with fierce competition from Amazon, American retailers are now focusing on their in-store experiences and service as a means of competing against the online retailer.

Coombs said: "Home Depot are now putting more staff into branches and improving their stores so that people can easily find what they are looking for.

"Their digital strategy complements their in-store experience as their app helps people to navigate around their stores.

"They cannot compete on price with the likes of Amazon, but they can compete on service. Companies who cut service see their long-term revenues decline.

"For us, we will look to invest in companies that treat customers as importantly as shareholders."

Mark Whitehead, head of income at Martin Currie, told the conference that it was vital for those looking to retire with a comfortable income to have a sensible investment strategy in place.

He said: "People are living longer and will spend, on average, 19 years in retirement.

"Most people at the moment are saving for only seven years, which means they will have to lower their living standards, live off equity or leave less for their children.

"It is notable that 25 per cent of retirees are now returning to the workforce.

"We all need to save more, and equities income is one of the best ways to achieve this.

"We advise a global and diverse approach that targets high-quality companies."