Investment views and themes for 2011

The following sets out the opinions and forecasts of Philip Saunders and Max King of Investec Asset Management's Global Multi-Asset Team as at December 2010.

It also sets out their suggested investment implications resulting from views.

Philip Saunders

Max King

General observations for 2011

1. We expect a continuing pick-up in growth in 2011

We believe the pressure on governments to cut fiscal deficits will continue to increase and the appetite for credit and mortgage debt in the Anglo Saxon economies will remain muted. However, trade and capital spending should continue to expand while emerging market growth is expected to continue. The Federal Reserve and Bank of England are likely to respond by raising rates from distressed to more normal levels in the second half of the year.

Suggested investment implication: positive for equities, negative for government bonds

2. The euro crisis is unstoppable

While the German economy is almost booming, peripheral Europe is locked into indefinite recession by its structural loss of competitiveness relative to northern Europe in the last 10 years. This makes it near impossible for most countries to reduce fiscal deficits and thereby improve confidence in their creditworthiness. We think a rolling break-up of the euro zone is a matter of when, not if. We think bail-outs can only postpone the inevitable and make it worse.

Suggested investment implication: consider avoiding the bonds of stressed European governments and the equity of vulnerable banks

3. A rolling break-up of the euro zone would be bullish

Nearly all precedents from Argentina in 2001 to Asia in the late 1990s, the UK in 1992 and 1967, back to the demise of the gold standard in the 1930s have shown that the break-up of unsustainable currency unions is bullish for the economies and equity markets of the countries concerned. We believe a break-up of the euro would be no different, providing a welcome stimulus to the global economy and markets. We anticipate the only issue will be the need of governments to recapitalise their banks in response to the heavy losses that rolling devaluations will inflict, but this will be a lot cheaper than bailing out countries.

Suggested investment implication: chaos and crisis should provide an opportunity to add to equity exposure and to return to affected countries and the financial sector

4. Equity markets will advance strongly in 2011

In late 2009, many strategists were sceptical of consensus forecasts of 30% earnings growth in 2010. Earnings in the past year, however, have been consistently better than forecast and we think an out-turn of 44% looks likely. We therefore think that consensus forecasts of 16-17% growth for 2011 look far too low. Société Générale put the global market on a prospective price earnings ratio of below 12.5, well below 'fair' value and below the level of a year ago. Investors remain nervous and their equity weightings are low but the average US return between the day of US mid-term elections and the end of the following year in the last 50 years has been 21%.

Suggested investment implication: good for equities but do not wait for a better buying opportunity as it probably won't come

5. The real yield on developed market government bonds will continue to rise

Bond prices remained elevated for much of 2010 but fell sharply in the last two months. This was due to investors discounting better economic growth, fretting about the persistent failure of the US or Japan to show any interest in cutting their huge (and growing) fiscal deficits, and concern about sovereign risk spreading from Europe to the US and Japan. With fund flows into bonds reversing, we think this trend is likely to continue, resulting in negative returns. The good news is that higher real yields should force governments to cut deficits, to the benefit of economic stability and trend rates of growth, and prevent governments inflating away their debts.

Suggested investment implication: consider avoiding government bonds in developed markets

6. Rising real yields are a headwind for precious metals

Near zero interest rates, quantitative easing and fiscally irresponsible governments have undermined faith in monetary assets to the benefit of gold in the last 10 years. This looks set to continue into 2011 but higher interest rates and real yields would eventually choke off investor demand. Be prepared to exit during the year. This should be positive for global equities as there has been an inverse correlation over the long term between the gold price and equity markets.

Suggested investment implication: be prepared to sell physical gold into significant further strength if real yields are rising

7. Commodities: the best opportunities are in the equities

Higher real bond yields are likely to reduce the attractions of physical commodities but we think the resource equity sectors remain attractive. Economic growth is likely to sustain the growth in demand for base metals, energy and agricultural commodities, keeping prices high.

Suggested investment implication: high prices and firm equity markets suggest another good year but beware of an increasingly frothy market in the junior mining companies

8. Currencies: don't miss the wood for the trees

Shorn of the weaker member countries, the euro would appreciate. The long term trend of the yen appears firmly upwards. Meanwhile, the US authorities seem indifferent to dollar weakness and so pursue policies that encourage it. We believe that trades against these trends are for the short term only.

Suggested investment implication: look for tactical opportunities but major trends may prove elusive

Investment themes for 2011

1. Corporate credit: spreads should narrow further

Higher yields on government bonds would be a significant headwind for corporate bonds but rising corporate profits and balance sheets should lead to credit upgrades. This is likely to provide reasonable opportunities in medium and high yield while there is a strong rationale for spreads on high quality multi-nationals turning negative.

Suggested investment consideration: Investec GSF Global Strategic Income Fund, a flexible, actively managed strategic fixed income fund should, in our view, still give reasonable returns. Also the Investec GSF High Income Bond Fund will provide high yield exposure

2. Emerging market currencies and debt are still attractive

Local currency emerging markets debt has been discovered as an asset class and suffered a recent short-term setback alongside developed market bonds. Most emerging currencies however still appear undervalued and spreads over developed market bonds are high relative to the risks. We think it is too early to take profits.

Suggested investment consideration: Investec GSF Emerging Markets Local Currency Debt Fund and the newly launched Investec GSF Emerging Markets Blended Debt Fund, which invests in both local and hard currency EM debt. The Investec GSF Global Strategic Income Fund should also give reasonable returns, whilst the Investec GSF Emerging Markets Currency Alpha Fund provides a leveraged pure EM currency play

3. Quality growth and cyclicals will continue to outperform

There continues to be a consensus, especially in the UK, in favour of cheaply valued, high yielding mega-cap stocks. These will outperform again one day but not in 2011 in our view. The best stocks to buy may be the ones you wished you had bought a year ago.

Suggested investment consideration: Investec's 4Factor investment process should, in our view, generate added value, to the benefit of the Investec GSF Global Equity and the Global Dynamic Funds and also to the regional funds (including Investec GSF UK Equity Fund and Investec GSF Continental European Equity Fund)

4. Modest outperformance from emerging market equities to continue

There was a popular view a year ago, which we did not share, that emerging markets would lag in 2010. The bears are now warning of a bubble, but valuations are still below those of developed markets while we think the outlook for earnings in the short to medium term remains excellent and the long term macroeconomic outlook is as compelling as ever. Frontier markets have lagged emerging and look especially attractive in our view.

Suggested investment consideration: Investec GSF Asian Equity, Latin American Equity, Africa & Middle East, Middle East & North Africa Funds and Africa Opportunities Funds, which we believe will continue to do well

5. Energy should have a better year

Despite a firm oil price, the energy sector performed disappointingly in 2010 as gas prices remained weak and the oil majors also performed poorly. The overhang of excess oil stocks has disappeared, promising higher prices, while gas prices are also likely to rise. Better performance from the integrated major energy companies and those focused on gas combined with continuing opportunities in service and exploration and production companies promises a better year in 2011.

Suggested investment consideration: A better year for the Investec GSF Global Energy Fund and Investec GSF Enhanced Global Energy Fund

6. Japan

Our advice last year to not underweight Japan was rewarded with a return to outperformance in the final quarter. We expect this to continue in 2011, driven by attractive valuations, strong earnings growth, improving focus by management on shareholder returns and increasing investor interest. 2010 showed that Japan can prosper despite a strong yen, helped by high exposure to the rest of Asia. This should become better appreciated in 2011.

Suggested investment consideration: Investec Asset Management does not offer a Fund which is exclusively focused on Japan. Other alternatives should be considered

7. Smaller companies

Smaller companies are no longer significantly undervalued relative to larger companies, except in Japan, but we think still offer abundant opportunities for adding value through stock selection. Good smaller company funds will continue to outperform the broad indices by wide margins.

Suggested investment consideration: Investec Asset Management does not offer Funds specifically focused on smaller companies. Other alternatives should be considered

Investec offer a risk profiled range of global multi-asset funds which are flexible and actively managed. For international investors these comprise the Investec GSF Global Strategic Managed Fund, and Investec GSF Multi-Asset Protector Fund (USD).

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