meridian

ASSET MANAGEMENT (C.I.) LIMITED

Investment Memorandum

Equities and high quality international bonds have experienced a modest improvement over the last quarter and volatility has remained low. Political events such as those in Iraq and the Ukraine have scarcely registered with investors. In the currency markets, the Canadian dollar and sterling have been the strongest currencies so sterling based investors have generally faced headwinds with their foreign investments, hence only a very modest rise in the sterling adjusted FTSE World Index. In the commodity markets, the troubles in Iraq have raised the price of oil, although not significantly.

The tables below detail relevant movements in markets :

International Equities 31.03.14 - 30.06.14

Total Return Performances (%)				
Country	**Local Currency**	**£**	**US$**	**€**
Australia	+1.0	+0.3	+2.9	+3.6
Finland	+5.3	+2.0	+4.6	+5.3
France	+2.8	-0.4	+2.1	+2.8
Germany	+2.9	-0.3	+2.2	+2.9
Hong Kong, China	+6.0	+3.4	+6.1	+6.8
Italy	+1.5	-1.7	+0.8	+1.5
Japan	+5.2	+4.3	+7.0	+7.7
Netherlands	+2.1	-1.1	+1.4	+2.1
Spain	+8.2	+4.8	+7.5	+8.2
Switzerland	+2.8	-0.2	+2.4	+3.1
UK	+3.2	+3.2	+5.8	+6.5
USA	+5.2	+2.6	+5.2	+5.9
Europe ex UK	+3.5	+0.1	+2.7	+3.3
Asia Pacific ex Japan	+3.4	+2.9	+5.5	+6.2
Asia Pacific	+4.3	+3.6	+6.2	+6.9
Latin America	+5.2	+4.4	+7.0	+7.7
All World All Emerging	+7.1	+5.0	+7.7	+8.4
The World	+4.6	+2.6	+5.2	+5.9

Source FTSE World Indices

FT Government Securities Index All Stocks (total return) : +1.1%

International Bonds - Benchmark Ten Year Government Bond Yields (%)

Currency	31.03.14	30.06.14
Sterling	2.76	2.67
US Dollar	2.75	2.53
Yen	0.65	0.57
Germany (Euro)	1.58	1.25

Sterling's performance during the quarter ending 30.06.14 (%)

Currency	Quarter Ending 30.06.14
US Dollar	+2.5
Canadian Dollar	-0.9
Yen	+0.8
Euro	+3.1
Swiss Franc	+2.9
Australian dollar	+0.9

Other currency movements during the quarter ending 30.06.14 (%)

Currency	Quarter Ending 30.06.14
US Dollar/Canadian Dollar	-3.4
US Dollar/Yen	-1.7
US Dollar/Euro	+0.6
Swiss Franc/Euro	+0.3
Euro/Yen	-2.3

Significant Commodities (US dollar terms) 31.03.14 - 30.06.14 (%)

Currency	Quarter Ending 30.06.14
Oil	+4.3
Gold	+1.6

MARKETS

International equity markets have crept higher over the last quarter. In total return terms, the FTSE World Index has returned 4.6% in local currency terms, 2.6% in sterling terms, 5.2% in US dollar terms and 5.9% in euro terms. There have not been any really significant deviations from the average in the various markets. In local currency terms, the most significant difference came in emerging markets where the FTSE All World All Emerging Markets Index returned 7.1%. On the negative side, the most modest return in our table was in Australia where the FTSE Australia Index returned just 1.0%. Whilst all the markets in our table showed positive returns in local currency terms, the general strength of sterling meant that there were some negative performances in individual European markets and the FTSE Europe ex UK Index was barely in positive territory, returning just 0.1%. Although sterling adjusted returns from Latin America and emerging markets were lower than the local currency returns, the returns from the respective FTSE indices of 4.4% and 5.0% were comfortably above those of the sterling adjusted FTSE World index. The Japanese market, as measured by the FTSE Japanese Index, also performed relatively well in sterling terms, even though the yen was slightly weaker, returning 4.8%.

High quality international bonds performed well. Taking ten year government bonds as a benchmark, the gross redemption yield on the UK government bond fell by 9 basis points to 2.67%, on the US Treasury bond by 22 basis points to 2.53%, on the Japanese government bond by 8 basis points to 0.57% and on the German Bund by 33 basis points to 1.25%.

In the currency markets, sterling continued to strengthen against most currencies. The exception was the Canadian dollar, against which it weakened by 0.9%. Against the euro, sterling strengthened by 3.1%, against the Swiss Franc by 2.9%, against the US dollar by 2.5%, against the Australian dollar by 0.9% and against the yen by 0.8%.

In the commodity markets, oil, as measured by Brent crude and reflecting the situation in Iraq, rose by 4.3% and gold rose modestly by 1.6%.

ECONOMICS

There have been no real economic surprises over the last quarter. All of the problems which have existed for some time remain, as do some of the more encouraging signs of economic recovery. The negative political events have been the insurgency in Iraq as well as the continuing crisis in the Ukraine but, so far at least, investors have been untroubled by these events despite the oil price creeping higher.

As the tables at the beginning of this review show, both equities and bonds have been firm this quarter. This is quite a strange phenomenon. A rise in share prices would suggest that investors are feeling confident about the economic outlook whilst a rise in bond prices and, therefore, a fall in yields, suggests the opposite. For prices of these two asset classes to move together is unusual. They cannot both be right. Furthermore, market volatility has been very low which suggests that investors are relaxed. For those looking at the glass as half empty this is a sign of worrying complacency which presages a fall in the market. Those who regard the glass as half full see the market reflecting an absence of new problems and looking forward to acceleration in economic growth which will be reflected in corporate earnings. We are in the glass half full category, although we certainly do not see the equity market storming upwards; rather we see it as a steady grind upwards, interspersed with bouts of weakness. After last year, though, a modest upward trend in equity markets would be a good result. If it seems unusual that both bonds and equities have risen over the quarter, and we feel that those supporting equities have got it right, it follows that we think that bonds are incorrectly priced for an outlook which sees modest economic growth internationally.

That we have arrived at a stage where we have this unusual state of affairs in bond and equity markets is a function of the extreme monetary policies being followed internationally to deal with the aftermath of the financial crisis. So, a combination of extraordinarily low interest rates at the central bank administered short end of the market and a depression of yields further out along the yield curve, caused by the effects of bond buying as part of the quantitative easing programme, has resulted in a level of yields which, until the financial crisis, would have been unthinkable. The very low level of yields right along the yield curve has created additional interest in other assets like equities and property as investors search for yield. If we look at the ten year government bond yields quoted in the table at the beginning of this review and theoretically asked oneself if one would be happy with the gross redemption yield of 2.67% on a ten year bond if it was held to maturity, you would imagine that most people would answer in the negative. For anyone to answer positively, they would either have to be very negative about alternative investment possibilities or think that the world would enter a deflationary environment so that the low nominal gross redemption yield would be higher in real terms. For someone to think that alternative investment possibilities were unattractive, they would have to believe that other assets such as equities and property were seriously overvalued now, either on price grounds or because they foresaw an economic recession or depression perhaps accompanied by deflation, and that, in these circumstances, high quality bonds would be the safest investment.

One most likely cause of a recession or depression, on the one hand, and deflation on the other, if one or both are to occur, would be the eurozone, in our view and, theoretically, they could both come together. We will talk about the eurozone in more detail later but, with the latest eurozone inflation rate at 0.5%, deflation is on some people's minds. How might this come about in the eurozone? After all, most people alive today have lived more in the fear or reality of inflation than deflation. Traditionally, inflation might have come about because of a recession with lower demand forcing prices lower to try to stimulate demand. Lower final demand would affect the price of imports like commodities, making it less painful for manufacturers to lower prices. On the present evidence, internationally, a recession looks highly unlikely. However, the problems of the eurozone, directly attributable to the euro, make it a special case and account for the current very low level of inflation in the area with several countries already in deflation, for example Greece. The reason why the currency union could cause deflation in some eurozone countries, and perhaps for the eurozone as a whole, is the way it is constructed and the disciplines it imposes to try to make it work. As we have often said before, it is our view that the euro is a flawed concept. Trying to keep it together, given that it is not an optimal currency zone, implies measures likely to cause recession, even depression, and deflation in the most badly affected countries. Bailouts entail outside supervision of the economy in question, for instance Greece. The fiscal compact defines eurozone countries' borrowing and debt level targets. Given that the public finances of a number of eurozone countries are in a serious condition, these debt and deficit reduction policies will drive austerity. Austerity is and will continue to dampen demand and keep unemployment high or cause it to rise further. All this is keeping prices depressed as firms fight for business and could cause falls in absolute price levels. If this persists then, prima facie, very low nominal interest rates or bond yields, should become more attractive because the real rates rise. For strong credits, like that of Germany, the low bond yields become more credible. However, in such an environment, as just described, corporate issuers or more challenged eurozone sovereigns could face difficulties as their liabilities would increase in real terms and the credit risk of holding their bonds would rise accordingly. Inflation, the traditional enemy of conventional bond investors because it erodes the real value of their investment and, therefore, the saviour of some debt issuers because it erodes the real value of their liabilities, is no longer an option for parts of the eurozone and this is why the ECB announced measures in June to try to stimulate the eurozone economy through various monetary methods. If things go on as they are, quite a number of the eurozone countries, and not just the smaller members, could fall into a nasty debt trap with low inflation or deflation and low growth, causing the outstanding level of public debt as a percentage of GDP to rise. That is why when one looks at the bond yields of some of the eurozone' sovereigns, they seem to take little or no account of credit risk.

Whilst very important to the world economy, the eurozone is declining in relative importance and, to some extent, can be isolated from the rest of the world in investment terms. So, if we go back to the original conundrum as to why both equities and bonds have been rising in price, we can side with the equity markets in believing that the international economic outlook overall is good enough to justify current share price levels. Those who believe that the bond markets have got it right and that the international economic outlook is pointing to another recession can justifiably point to the eurozone as a risk. However, our view is that its poor economic prospects are not enough to stop modest international economic growth occurring and rendering high quality international government bond yields (and lower grade ones) anomalously low.

Reverting to the low level of market volatility, which gives comfort to some and unsettles others, the visibility on interest rates remains unusually good. Because investors feel that they are unlikely to receive any shocks on this front, their confidence can contribute to low levels of market volatility. Broadly speaking, we know that short term interest rate levels are going to remain very low for the foreseeable future. That does not mean that interest rates in the UK, which will probably be the first country to raise them, and the USA, which might follow soon after, will maintain them at this level, but they are not likely to rise to anywhere near traditional levels in the foreseeable future. We also know that, in the absence of anything totally unexpected, the USA will wind down its quantitative easing programme in the next three or four months. We can also be as sure as it is possible to be that the ECB will keep its exceptionally loose monetary policy and may make it even looser if it embarks on formal quantitative easing. We also know that Japan will maintain very loose monetary policy as one of its three policy arrows. We can be reasonably, although not absolutely, certain about the course of the USA and UK economy, respectively moderate to quite good economic growth. We know that the eurozone economy is not going to do very well this year, although it should be an improvement on last year's recession. Perhaps the biggest uncertainties surround the Japanese and Chinese economies. In the case of Japan, it is too early to judge what will be the effect of 1st April's rise in the consumption tax. It will distort or has distorted the first two quarters' economic growth data and may well continue through to the third quarter. It is a question of whether the monetary and fiscal stimulus will outweigh the countervailing part of the fiscal offset, the consumption tax increase. We will know later this year. China is problematic in that, although the economy will grow very quickly by developed world standards, the transition of the economy away from fixed asset investment and exports towards consumption is difficult for the authorities to foresee, although their system of government means that they can act more quickly to effect policy changes.

But, overall, we would say that investors have more degree of visibility than usual about economic trends and that, in our opinion, is the main reason for the market's low volatility levels.

However, no one should be complacent because of the market's low volatility, nor think that we are going to experience an extended period of low interest rates which will keep propelling markets upwards. Although ultra low interest rates have been effective in restoring confidence to asset markets, they carry with them economic risks associated with bubbles. With the UK and US economies performing quite strongly, it will be necessary and desirable for interest rates to start rising. If we take the UK, for example, there is increasing concern about the rise in property prices, particularly in London. A price bubble ultimately threatens a crash with losses, bankruptcies and increasing bad debts for lenders with the resulting economic fall out. So, in the UK, so called macroprudential tools are being readied. Low interest rates can also stimulate consumption and unbalance the economy. For example, in the UK, whilst the economy is probably the fastest growing in the G7 countries, it is unbalanced, and the quality of growth would be improved by a better business investment performance (although this is happening) and increasing exports at the expense of consumption and housing. With the UK economy growing quite rapidly, it may soon come up against its productive capacity, at which point inflation could be expected to become a problem. The issue for investors is how a slow return towards the normalisation of interest rates will affect the stock market. In the eurozone and Japan, a rise in interest rates is not in prospect for some time.

We turn now to look at economic developments around the world, starting with the USA where, as this is written, Wall Street is scaling new high ground. The further sharp downward revision to first quarter growth showing an annualised contraction over the previous quarter of 2.9% has been largely ignored by investors because it was attributable to very poor weather in January and February in the USA. Of more interest, and accounting for the stock market's strength, is evidence of growth in the US economy. The latest US jobless number showing a fall in the unemployment rate from 6.3% to 6.1% pleasantly surprised markets. 288,000 jobs were added in June and the trend is improving. The three monthly moving average is now 272,000 and the six month moving average is 231,000. Individual months' figures can be unrealiable as a guide but these three month and six month moving average figures tell a strong story about an improving economy. The closely watched Purchasing Managers Indices remain quite solidly in positive territory at 55.3 for manufacturing and 56.0 for non manufacturing. These June figures are marginally lower than those for May but still point to an economy expanding at a steady rate. Industrial production, after falling in April by 0.6%, recovered by 0.6% in May to give a year on year increase of 4.3%. Retail sales growth was a little less than expected in May, rising 0.3% over the previous month. On the other hand, the housing market still appears to be moving ahead steadily. In May, sales of new homes reached a seasonally adjusted annual rate of 504,000, up 18.6% from April to the highest rate since May 2008. Of course, the weather related setback in the first quarter will have a knock on effect for the rest of the year and, in this context, the IMF, in June, reduced its economic growth forecast for the USA. It now forecasts growth of 2.0% this year, down from its earlier forecast of 2.8%. The IMF said that a "meaningful rebound" was under way and it forecast growth of 3.0% in 2015. On a negative note, the IMF reduced its forecast for the long term potential growth rate of the US economy to 2.0%, which is below the historic average of 3.0%. Overall, from the evidence we have, the US economy is moving forward quite steadily. If the economy continues to report strong numbers and, particularly, if unemployment, which is already lower than the Federal Reserve expected, continues to fall, speculation about a rise in interest rates is bound to increase. We can be almost certain that tapering will continue to nothing from the latest level of US$35 billion per month. If the Federal Reserve senses that wage pressures are increasing, one sign that the output gap is closing, or has been eliminated, then the first rise in interest rates, expected in the middle of 2015, could be brought forward. If that is a sign of the start of the road to normality for monetary policy, we would say that this is a welcome development. That is not to say that the market will see it that way but, economically, it would be good news because it would be a sign that the economy was performing better and it would give the distortions caused by extreme monetary policy the chance to start to unwind.

For the eurozone, life remains a struggle and even Germany is showing a few signs of exhaustion. First quarter GDP figures for the eurozone were very disappointing with growth over the previous quarter of just 0.2% and an annualised rate of 0.7%. Year on year growth was 0.9%. This overall growth rate is nowhere near sufficient to deal with the debt problem. It is insufficient to stop the overall debt burden rising. It was against this background that the ECB authorised a further loosening of monetary policy in June. It took three measures to try to stimulate the eurozone economy. It reduced its benchmark interest rate by 0.15%, instituted a negative rate of interest of 0.1%% on banks' balances with the ECB and offered up to €400 billion of cheap long term loans to banks to stimulate lending to small businesses. No doubt these measures will help at the margin but the austerity measures implicit in the eurozone's fiscal compact exercise a dead weight on the eurozone's economies. At the same time, without major structural reforms to increase the long term potential growth rate of the eurozone economy, these measures can only have limited effect. Companies will not borrow money if structural rigidities in the economy make expansion difficult. In this respect, it is worth noting that in the eurozone's economic powerhouse, Germany, the coalition agreement went backwards in certain areas, introducing some rigidities into the German economy which were not there before. Making necessary structural changes in Europe is very difficult because of powerful vested interests. Tragically, in the labour market, too many companies will find it too risky to take on staff and, therefore, the ability to borrow money more easily, which is one of the objectives of the latest ECB actions, might not count for much.

The latest Purchasing Managers Indices for the eurozone were slightly disappointing. The composite index for June declined from 53.9 in May to 52.8 in June. Within this index, there were declines in all three components, manufacturing, services and construction. The manufacturing PMI fell from 52.5 to 51.9, that for services from 53.5 to 52.8 and that for construction from 53.9 to 52.8. The German PMIs were one of a number of indicators for that country that growth may be faltering. The composite PMI for June stood at 54.0 against 55.6 in May. Of course, that still implies expansion but at a modest level. Breaking down the component parts, the manufacturing PMI stood at 52.0 (53.3), the services PMI stood at 54.6 (56.0) and that for construction at 45.5 (48.1). The Italian and Spanish composite PMIs were quite respectable at 54.2 (52.7) and 55.2 (55.6) respectively although both countries have significant economic problems. The real concern is the eurozone's number two economy, France. June's composite PMI was a very disappointing 48.1 (49.3) implying an economy in contraction. There was no growth in the French economy in the first quarter and the year on year rate of growth at the end of the first quarter of 2014 was a meagre 0.8%. Within the French Purchasing Managers Indices, the reading for manufacturing was 48.2 (49.6), for services 48.2 (49.1) and for construction a desperately low 38.0 (36.3). The reasons for the economic malaise in France are well known by independent observers, namely an oversized public sector, onerous taxation and over regulation. There seems, at least, some realisation in government that things have to change. After raising taxes in the first two years of his Presidency as the main way to try to address the budget deficit problems (the overall tax take has risen from 44% of GDP to 47.6%, a U turn was executed at the beginning of the year and now the plan is to cut business costs and address the level of public spending, a much more promising course of action. The new French Prime Minister, Mr. Manuel Valls, is more of a reformist than his predecessor and it is to be hoped that he and the President can drive through their change of policy. However, there is a great deal of opposition to reform within the governing party and, as the recent rail, air traffic control and culture sector strikes show, strong opposition to the reforms which France so badly needs.

It seems that France and Italy, the latter in the form of the new reformist Prime Minister, Mr. Renzi, are pushing for a relaxation of the austerity policy implicit in the eurozone's fiscal compact although this will meet strong opposition from Germany. Reductions in budget deficits, which are required in certain eurozone economies, are not compatible with economic growth, hence the calls to soften the budget deficit reduction requirements. One could argue that the discipline of the euro would force recalcitrant economies to make themselves more efficient and competitive in so many ways so that these economies competed with, say Germany. This is theoretically true and an argument in favour of monetary union but, in practice, it is just not going to happen. The recent elections for the European parliament show the strength of anti EU feeling and, if austerity continues, then the economic disciplines built round the Growth and Stability Pact might well crumble. Even though the euro and all that goes with it is the fundamental reason for the eurozone's economic problems in our view, no one in authority in the EU is willing to recognise the problem. The absence of flexible exchange rates for countries which form part of the eurozone is really being felt at present. It is difficult to see the eurozone being anything but a drag on international economic growth for the foreseeable future. The latest IMF and OECD forecasts for the eurozone are for economic growth this year of 1.2% and next year for 1.5% (IMF) and 1.7% (OECD). For this year, at least, this may be a little optimistic.

For Japan, the big question is whether the rise in consumption tax in April from 5% to 8% will stall economic growth once the short term effects have worn off. Obviously, a lot of spending was brought forward to the first quarter from the second quarter and the question is how long lasting the effects would be beyond the second quarter. First quarter economic growth was faster than expected as consumption was brought forward and capital spending was stronger than economists had forecast. First quarter growth was 1.5% above that for the previous quarter to give an annualised quarter on quarter growth rate of 5.9%. First quarter year on year growth stood at 3.0%. The second quarter is clearly going to be weak and the IMF forecast for 2014 as a whole is 1.4%, which appears to be a consensus forecast at present. The OECD's forecast is little different. The latest Purchasing Managers Index for Japan for June stands at 50.0 (49.2 in May), exactly on the line between expansion and contraction. Manufacturing is a little stronger 51.5 (51.1) and services a little weaker at 49.0 (49.3). The latest Tankan survey is a little disappointing at 7(12). So, the jury is out. In the medium and long term, a lot depends on how Mr Abe's third arrow, structural reform, will work out, and his fiscal and monetary initiatives will count for very little if the potential growth rate of the Japanese economy cannot be raised. One positive development for shareholders is his initiatives on corporate governance. Foreigners now account for about 30% of the ownership of the Japanese stock market and their ideas of corporate governance are more advanced and shareholder friendly. In this respect, the push towards companies having independent directors will help. Companies might be expected to be more shareholder friendly, for example by paying out more by way of dividends. By international standards, Japanese corporation tax is fairly high at 35% and Mr Abe has promised to lower it first to 29% and then to go lower.

As we have said before, the Japanese economic experiment is risky. The country's outstanding level of public debt is around 240% of GDP, by far and away the largest level of any developed country and nearly twice the level of Italy where the debt level at around 134% of GDP is considered a major concern. The budget deficit is forecast to be around 8% of GDP this year. The vast majority of its public debt is held internally thus reducing, but not eliminating, the risk of a mass exit from the debt market caused by a lack of confidence. Because of the fall out from the nuclear disaster following the 2011 tsunami and earthquake, Japan has had to import considerably more to meet its energy requirements and its famous current account surplus is diminishing rapidly so that the expectation for 2014 is only for a small current account surplus. Whilst a weaker yen was one of the government's and central bank's objectives, if there were to be a loss of confidence in the currency, the inflation target of 2% could be exceeded with consequences for interest rates and debt servicing levels. So, in our view, Japan remains one of the higher risk/higher reward markets.

China remains in the forefront of investors' minds with heightened interest in the UK following the Prime Minister's visit to the UK in June. The investment story remains much the same with investors focused on how successful the efforts to transform the economy from fixed asset investment and exports to consumption will be. The Prime Minister has warned local government and provincial Communist party chiefs about the need and urgency of reform. As the second largest and, in time, the largest economy, progress and developments in China are of paramount importance to investors. A slowdown in economic growth from double digit levels, the case some years ago, to a more sedate level, is inevitable and, in so far as the quality of growth improves, that will be a good thing. Over investment in fixed assets threatens banks as they prove to have been poor investments, and the banking system's health is a significant concern in China. One of the most closely watched surveys in China, as elsewhere, is the Purchasing Managers Indices. The latest ones for June remain, just, in positive territory overall. That for manufacturing rose marginally to 51.0 (50.8) whilst that for services, whilst quite well into positive territory, was marginally weaker than in May (55.0 against 55.5). The consensus view is that China will grow at a slightly lower rate than in 2013 at around 7.3%. First quarter growth showed an increase of 1.4% over the previous quarter reflecting an annualised growth rate of 5.7% and a year on year increase of 7.4%. Whilst the growth rate in China is slowing down slightly, these are rates of growth that will still provide an important support for the world economy where the USA is advancing modestly and the eurozone only limping along. So, investors will continue to monitor the economic news from China very closely.

The star of the show in the developed world is the UK, reflecting a remarkable transformation from the view, only fifteen months ago, that the UK might be facing a triple dip recession. Whilst the Chancellor has been much less tough than many critics like to portray, and whilst he has allowed the economy's automatic stabilisers to work, the growth in the UK economy, unhampered by membership of the euro, has proved that it is possible to make a start in addressing the very serious budget and public debt problems and see an economic recovery. As a result of the recovery (from a very low level) in the UK economy, many forecasters now expect the UK economy's growth rate to begin with a "3" this year, in which case it will almost certainly be the fastest growth rate experienced by any G7 economy this year. The June Purchasing Managers Indices remain very strong with the composite reading at 58.0, slightly down on May's 59.0 but still very positive. The manufacturing PMI was 57.5 (57.0), that for the dominant services sector 57.5 (58.6) and for construction 62.6 (60.0). Nearly every other indicator supports an improving trend in the UK economy. The latest Nationwide house price index shows a rise in our prices of 11.8% year on year, up from 11.1% the previous month. The rise in house prices is beginning to worry some, hence the introduction of one of the macroprudential rules on some loans. The strength of the UK economy has brought forward analysts' views on the timing of the first interest rate increase, and the Governor of the Bank of England's apparent U-turn in a recent speech on this subject suggests an increase in hawkishness of some members of the Monetary Policy Committee whose views he perhaps has to reflect. The rise in sterling, whilst it is helpful in subduing inflation, is not so helpful for manufacturers and exporters, although this has not really been reflected in business surveys. The real issue for the UK stock market is next May's General Election. The two main parties' policies have become increasingly polarised and what is really concerning is the anti business rhetoric which has been gaining currency, with some big businesses particularly vilified. Some of the populist policies being advocated will certainly be unhelpful to the UK economy. As 2014 progresses, this is an issue which is likely to be exercising the minds of investors as far as the UK stock market is concerned and it could be a drag on progress in otherwise what looks to be a promising economic outlook. However, for whoever forms the next government, there is a lot more repair work to be done on the UK's public finances before investors can rest easy and the path of austerity will have to be maintained.

In summary, although 2014 has started off satisfactorily for investors, the questions become harder to answer. There are those who would like the low interest rate punch bowl to be taken away soon before the problems of severely distorted monetary policy become too severe. The central bankers' bank, the Bank for International Settlements, is in this camp, warning that central banks risked raising interest rates "too slowly and too late" to counter emerging asset bubbles. Others think it too risky to start raising interest rates, believing that the output gap is sufficiently large not to risk a rise in inflation. When there is such a divergence of views, discerning likely market trends becomes very difficult for members. If interest rates do start to rise soon in some of the stronger economies, like the USA and UK, will investors take fright, as they did temporarily last year when Ben Bernanke floated the question of tapering, or will they regard it as a reassuring sign that things are slowly normalising? Have equity and bond prices become so addicted to the monetary "sugar rush" that securities prices are completely dependent upon central banks' munificence. What is certain is that, without significant supply side reforms, very loose monetary policy has very little chance of stimulating an acceleration of countries' long term potential growth rates. Obviously, views are subjective. Our firmest belief is that bond markets are significantly overvalued. The yields on offer, depressed by central banks standard and non standard monetary policies, do not significantly allow for credit or interest rate risks as monetary policy is eventually tightened. Shares offer more opportunity for continued modest returns as we expect profits to grow this year and next to validate the recent strong share price rises. However, given the level of valuations, shares will be vulnerable to bad economic and perhaps, political news (although markets seem relatively immune to the latter) so we expect a modest uneven rise from these levels. Cash, which we are building up in portfolios, will be committed to the market on a reasonable setback but, where we have significant equity positions, we feel no pressure to chase prices.