WHERE SHOULD I INVEST NOW?

Standard Life Investments

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HEAD OF GLOBAL STRATEGY, STANDARD LIFE

Andrew is responsible for global economic and market analysis at Standard Life Investments where he has operated for 12 years. He has 26 years investment experience including employment with HM Treasury and other Economic Advisory roles. Currently, Andrew believes inflation is the biggest risk to investors' wealth over the long term.

LINDSELL TRAIN

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CO-MANAGER, LINDSELL TRAIN GLOBAL EQUITY FUND

Michael started as an investment manager in 1982 and has spent much of his career managing investments in Japan, where he has amassed three decades experience. In 2000 he co-founded Lindsell Train Investment Management with Nick Train and in 2011 the duo launched the Lindsell Train Global Equity Fund, a member of our Wealth 150. Lindsell Train's central philosophy is to run their clients' money as they would run their own, and to take a long-term investment approach.

HARGREAVES LANSDOWN

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Mark joined Hargreaves Lansdown in 1998 as Head of Research and is one of the most quoted figures in the national media, making regular appearances on TV and radio. He contributes to The Times and The Telegraph and writes a weekly column for the Independent on Saturday.

Today we are going to try and answer a question at the forefront of every investor's mind, "Where Should I invest now?" In other words, where do the best opportunities lie for investors over the next few years?

Given the events of the last year this question is particularly pertinent. Global stock markets have risen and there are signs the US economy is on the road to recovery. Meanwhile, the Japanese stock market, which has been neglected by investors for over two decades, has rallied strongly since November after newly elected Prime Minister Shinzo Abe announced unprecedented stimulus measures designed to tackle the country's long running deflationary problems.

We asked Andrew Milligan, Head of Global Strategy at Standard Life, Michael Lindsell, co-founder of Lindsell Train Investment Management and co-manager of the Lindsell Train Global Equity Fund, and our Head of Research, Mark Dampier, for their views.

Mark, we know markets can go down as well as up but over the last year global stock markets have risen strongly. It has been termed the 'impossible rally' given the stuttering economic recovery in the United States, a flat-lining UK economy, and on-going problems in Europe, with France going back into recession. Where does this leave investors now?

Mark Dampier: First of all I wouldn't say it is the last 18 months; the market has doubled since 2009. I don't

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Important Information - The value of investments can go down as well as up, so you could get back less than you invest. It is therefore important that you understand the risks and commitments. So you can make informed decisions for yourself we aim to provide you with the best information, best service and best prices. The views expressed are those of the speaker and do not necessarily reflect the views of Hargreaves Lansdown.

think many people realise that the market has done so well against an economic background which has been really difficult and has put so many people off investing in the first place.

So in terms of the immediate outlook are things looking good? There must be something to back up this rally?

Mark Dampier: One contributor is a lot of the economic risks have diminished somewhat. I wouldn't say the euro problems have been solved, in fact I don't think they have been solved at all, but they have at least temporarily abated.

Another theme has been that interest rates, particularly in the UK, have been sliding down. I am not talking about base rates; but deposit rates to savers. Even compared to last year, where you could get around 3% on your easy access account, you are now down to about 1.5% gross. Suddenly you are looking at another dynamic and people are realising interest rates aren't going to go up any time soon. Therefore, many people are moving out of cash and into the stock market.

Andrew, given the current economic situation, where do you believe the best investment opportunities lie over the next few years?

Andrew Milligan: I agree with what Mark said about the economic environment, which is relatively good for corporate earnings, and I absolutely agree with his views on interest rates which are going to remain low for some time to come. However, there is another factor which is particularly important given what has happened, and what may happen, which is quantitative easing (QE).

Central banks have injected vast amounts of liquidity and the rally in Japan is a very clear example of that. Central banks are deliberately trying to inflate asset prices around the world and this includes not only equities but other assets such as real estate as well. Their hope is the wealth effect from this, and the benefits that the improvement in the financial system is going to create, will engender further economic growth and a positive feedback loop. That is still quite uncertain but some of the early signs are good. Recession does look a little less likely with everything central banks are doing. With interest rates this low people are encouraged to buy equity income, real estate or high yield debt. These investments have a good chance of beating returns on cash over the long-term. However we also need to be careful about quantitative easing. Consideration needs to be made as to whether we are going to see a lot more QE in Japan, and potentially even Europe, or whether it begins to be withdrawn, as America is threatening to do. The speed with which those factors all come together will determine how long you stay in any of the asset classes. The simple answer to your question in this current environment is that equity income, high yielding corporate bonds, and real estate look to be the most attractive asset classes.

Michael, where are you looking for investment opportunities at the moment?

Michael Lindsell: We are looking at a very narrow range of truly excellent businesses. One of the characteristics we look for in our portfolios, which many other investors fail to focus on, is simply the longevity of the companies we are investing in. The average company in our portfolio has been around for 106 years and I think that says a lot about the ability of these companies to continue to compete and maintain their competitive advantage in the future.

Is there a general theme running across your portfolio and are there any particular companies you wish to highlight?

Michael Lindsell: We have two big themes running through our portfolios. The first is we like identifying consumer franchises that can take local brands, export them and establish them overseas. If they can do that we think these companies can build a really big competitive edge and the obvious example of this over many years is Coke.

Another company we are investing in is Heineken and this is an example of a company we think should be able to claim the title of global beer brand of the future. At the moment Heineken has a 20% market share and that is double the nearest competitor. Over many years, we think Heineken's business could claim that stature.

The other main theme we are looking at is the way companies can use technology to enhance and expand their business. We are focusing on owners of valuable content and it is no surprise to us for instance that the Premier League football rights went up 70% in value for domestic TV in the last offering. Those are probably the most valuable TV rights out there and we think this trend is set to continue.

Andrew, what are some of the big economic themes we are likely to see unfolding over the next 5 to 10 years?

Andrew Milligan: Two themes have been talked about very ably and these are the emergence of the emerging market middle classes and the importance of technology. I think those two themes are absolutely vital for portfolios. There are two other themes which investors should consider. The first is demographic trends. Ageing in the Western world will provide opportunity and the emerging market economies will also be important.

One of the very big themes for the next 5 to 10 years is inflation. As Mark and I said, interest rates are very low. Central banks are doing everything they can to create economic growth at the moment and this has already begun to feed through to inflation. In the short term slow wage growth is likely to put a lid on inflation but looking further ahead it could become a problem in some of the major economies.

Rather than investing in the whole market place through a passive fund I think much more focused investing is often very helpful to take advantage of some of these long-term themes.

Mark, are there any other investment themes you wish to highlight?

Mark Dampier: The themes Michael and Andrew mentioned are very interesting because what they are talking about is running much more concentrated portfolios with stocks that will see you through these economic times. Economic forecasting is virtually impossible and most people get it wrong so it's vital to pick stocks which aren't going to be so dependent on the economy.

Michael mentioned Heineken and his co-founder Nick Train once told me that beer was not out of fashion a thousand years ago and it is probably not going to be out of fashion in a thousand years' time. In comparison, technology can go out of fashion in a matter of weeks. Investors need

to bear this in mind.

If there is a lesson to be learned from the last few years it is that spending too much time watching the News at Ten and listening to columnists and commentators tell you how awful the economy is doesn't often lead you to better investment decisions.

Michael, you favour UK-listed companies that have international earnings streams. Is this something investors should be focusing on?

Michael Lindsell: Not necessarily. I think it's a coincidence we happen to own some overseas earners and the reason we do is they are fantastic companies. We own Pearson which is the biggest educational company in the world, Unilever, which is one of the biggest consumer goods companies in the world and we own the biggest spirits company in the world as well, Diageo. They all happen to be listed in the UK but we are investing in them for the aforementioned reasons, not because it is necessarily a theme of ours.

Are these companies benefitting from growth in other economies?

Michael Lindsell: Absolutely, all three companies draw a large part of their revenues from growing emerging markets. That is a very important part of what they do.

I'd like us to turn our attention to Japan. Michael, you have been investing in Japan for around three decades now. We have had this massive stimulus package announced by the Japanese government, which includes increased public sector spending, a doubling of the Quantitative Easing programme and structural reform to increase the productivity of the economy. Are these stimulus measures a game changer?

Michael Lindsell: The stimulus measures are designed to shock people into taking risk and to spend and I am sure that will happen to some extent. The market has been given this huge sugar rush and as a result the stock market has risen strongly since October. However, for it to be sustainable the government and corporations need to follow through with some proper rationalisation and deregulation.

The reason we have had deflation in Japan for so long is because there is overcapacity in many industrial sectors, partly as a function of overinvestment, but also as a function of a declining population. Therefore, there needs to be a lot more merger activity. A lot of companies that are overly-reliant on ultra-low interest rates need to close and that will lead to people losing jobs. Politically that is a difficult decision to make and the politicians there have held off on that that type of judgement for the last 20 years. It is not clear they are going to follow through with those restructuring measures and frankly if they don't the rally at some point will probably peter out.

Andrew, what are your thoughts on Japan?

Andrew Milligan: I think Japan is the single most important market at the moment because it is still the world's third largest economy. If they do manage to escape deflation, something that has been holding them, and the rest of the region, back for 25 years, this is an extremely significant step for investors to contemplate and include into their portfolios.

They have shot two of their arrows, the fiscal stimulus and the monetary stimulus, which has been very effective but the third, the structural reform, is key to whether or not Japan does manage to create some sustainable growth going forward.

There are some key figures coming up, including important commission papers in May and June, the upper house election in July and then some larger announcements expected in the autumn. Therefore, I would not be at all surprised if there is a pullback in the equity market in the next few weeks as people wait to see whether or not the government can push through with the third of its arrows (structural reform). If they do convince investors I think a large amount of institutional money will move into Japan. A lot of people are currently on the side-lines.

Mark, on the basis of what Andrew and Michael have just said do you currently think Japan is under, fairly or over-priced?

Mark Dampier: There have been a number of false dawns but about six or seven months ago we put a newsletter out saying we thought Japan may have just enacted a fundamental change. The newsletter said Japan appeared to be on a very cheap rating, much the same as Europe.

Europe and Japan are under-owned by investors, disliked and unfashionable and those are usually pretty good ingredients for a stock market rally. Usually when everyone thinks everything is cosy and lovely that's the time to be selling. In these two regions I find that private investors are not keen to buy and that usually is quite a good sign. As Andrew said, institutions are massively underweight in Japan because of what has effectively been a 20 year bear market. They will be looking at this rally and wondering whether to jump on board. If they start to move in to Japan we could see the market significantly higher.

Putting all of that together, what sort of areas do you think long-term investors should be considering?

Mark Dampier: Well in some respects it never changes. I would still look at a broad spread of assets. We write off the UK as UK investors because we are very close to it and we look at how hopeless the politicians are over here, as they are virtually everywhere else. This means investors are often drawn to more dynamic places in Asia, for example. However the UK has some really top class companies, as Michael suggested. The UK stock market has been doing very well and has been joining in the global stock market rally. I would probably also have Europe and Japan.

The only area I disagree with Andrew on is I am still not a property fan; either residential or commercial. I still can't get excited by that. This is partly due to the difficulty private investors face in getting exposure to the area. Therefore, I am not so keen on that area; I am much more of an equity man.