



MPL: IMPLEMENTING STRATEGY BY UNDERSTANDING NEEDS

In order to achieve optimum results from your wealth management strategy, expert independent consultation is essential. **Simon Weighell**, Senior Investment Manager, MPL, discusses market drivers, and how MPL can help every step of the way...

▶ Too often there can be very little teamwork between the investment manager, financial adviser and client which can result in different uncoordinated objectives. MPL Pension Director Jim Spicer agrees, and highlights how MPL seeks to avoid this disparity: “MPL Wealth Management’s in-house team works together to meet investment objectives which are closely aligned with client needs. These include income and capital requirements, whether from pension funds or investment portfolios.”

“All clients receive individually tailored portfolios which are aligned to their risk profiles so that the portfolio can perform within the client’s expectation. In the uncertain markets we are experiencing, it is important to identify areas of value with due regard to the potential risk for client portfolios.”

Investment Director Mark Kitson adds: “Major benefits result from the teamwork between the investment manager, financial adviser and clients at MPL. The majority of financial planning and investment advice can be offered efficiently to our existing and prospective clients in one meeting with all parties present. Hence this enables our clients to make better informed choices regarding their wealth on the basis of the specialised advice they are being given. The information gathered in the planning process enables our team to construct suitable portfolios diversified across different asset classes. As part of this process, we take guidance from historical expectations of the overall risk and return that could be anticipated from combinations of various assets, alongside our wide research into the prospects developing

for them as situations evolve.”

Commodities – demand growth is a double-edged sword

In constructing investment portfolios to meet clients’ needs and objectives, we are able to utilise various different asset classes such as commodities (for medium to higher risk clients), emerging market debt, index-linked gilts, global equities, global property and infrastructure. Our back-testing has proven that this can diversify portfolios and reduce risks associated with the construction of portfolios. In terms of market drivers for the world economy, commodities tell investors two stories, one positive and one negative. We can easily accept that China with its 1.34 billion aspiring consumers is driving demand growth for commodities required for indus-

trial development. The world's second largest economy grows at 9.7 per cent per annum and is lifting many citizens out of poverty; Beijing needs to maintain growth to extend prosperity to more of its citizens. This story is repeated across many other emerging markets and is undoubtedly positive for those uplifted, for the world generally and for swathes of the investment markets. Yet this unprecedented demand growth (no industrialisation in history has involved anything approaching the population numbers involved) suggests a negative.

If the "China-effect" has already stretched supply capacity, as price movements suggest, and as the bulk of the emerging world populace does not yet experience the raised living and consumption standards that they both desire and increasingly expect, then further demand growth must follow, and it is likely that this will prove to be inflationary. As inflation is the enemy of investors, the emergence of this new world order needs to be approached carefully.

Oil remains a key concern – the tripling in the price of Brent crude since 2008 appears at odds with a developed world economy either in or flirting with recession over that period. Global energy demand advanced 5.6 per cent in 2010, the year that also witnessed China's demand rising 11.2 per cent and surpassing the U.S. as the world's largest energy consumer. While recent oil and gas finds off Brazil and north western Australia suggest we are awash with resources, we should observe that these new resources, while undoubtedly large, are remote and expensive to access – full production is years away and marginal production costs of many future resources will exceed \$100 a barrel. Brent sustained above \$100 a barrel is not telling us that supply is plentiful. The International Energy Agency (IEA) stated in its 2007 World Energy Outlook that oil resources would be sufficient to meet projected demand growth through 2030, yet in June of this year the agency called on OPEC and particularly Saudi Arabia to increase production by up to 1.5 million barrels per day (mbpd). This call for increased production, despite weak western demand, is not misplaced. Chinese consumption will rise from 9 to 15 mbpd by

2016, with India moving from 4 to 7 mbpd. Non-OPEC nations account for around 60 per cent of global output, but are widely seen as having little capacity to raise output. The IEA's change in attitude since 2007 appears distinctly supply-related and results from unrealistic former assessments as to decline rates at major producing fields.

Until 2008, the IEA assumed a global production decline rate of 3.7 per cent pa, but after analysing over 800 active fields, revised this upwards to a decline rate of 6.7 per cent pa. This needs to be seen in the context of conservative demand forecast increases of 1.3 per cent per annum, conservative as the IEA assumes OECD demand as flat or in gradual decline to 2030. The IEA's call on members to release 60 million barrels from the Strategic Petroleum Reserve is indicative of high energy costs weighing on OECD recovery. A basic function of the market is to raise prices to a point where new marginal resources become viable, and this is what the market is doing.

Copper supply is similarly constrained; the metal is vital to construction and infrastructure, increasingly high demand areas in the emerging economies, yet globally some of the richest ore deposits are already depleted. In certain instances pits were abandoned when commodity prices languished in the 1980s – the Berkeley Pit in Montana (see picture) is now a tourist attraction rather than a mine.

Consistent demand increase coupled with supply constraints is inevitably inflationary. This poses a threat of inflation becoming longer term and structural. Gold provides the classic hedge, but is itself a notably supply constrained case. South Africa, the major gold producer for over a century, has since 2007 slipped to fifth place as 100-year old mines are 95 per cent depleted. Gold has risen almost 600 per cent in nominal price terms since the 2001 lows, yet supply barely increased over that period. Few large future gold finds are likely and new discovery rates already run below extraction rates. Jewellery and investment demand, dollar weakness and renewed central bank buying provide strong support and suggest future price strength. End-users of certain commodities are thus potentially

caught in a pincer of increased demand and uncertain, possibly dwindling, supply.

MPL's role

MPL specialises in advising clients how best to respond to market conditions therefore ensuring that their strategy is informed and suitably cautious. Investors can participate in commodity strength, but need to be selective as to which to target, and over what term. Higher structural prices, particularly in energy, will act as a consumption tax on already indebted developed nations, extending their sub-par recoveries. Areas of the emerging world, particularly commodity producers as opposed to consumers, are attractive but involve risk. Bond holdings could offset that increased risk but given world debt ratios coupled with inflation prospects, sovereign debt risk and currency concerns, investors should also tread warily where bonds are concerned. More than ever, the case is made for careful construction of portfolios to access key global growth areas while accommodating elevated risk levels evidenced by current macroeconomics. This uncertain investing environment requires especially careful evaluation of clients' risk profiles and longer term requirements. These interesting times are set to continue.

In conclusion, MPL is not attempting to outperform a specific market benchmark. Through teamwork the company aims to meet and exceed client needs and expectations which have been raised during the financial planning process, utilising various asset classes as tools to meet these objectives. ■

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CONTACT DETAILS

Mark Kitson: mark@mplltd.co.uk
 Simon Weighell: sweighell@mplltd.co.uk
 Jim Spicer: jim@mplltd.co.uk
www.mplwealthmanagement.co.uk
 45 Doughty Street, London WC1N 2LR
 T: +44 (0) 20 7831 4711 F: 7831 3137
 Regulated by the FSA (firm number 180309)

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