Lower and slower, for longer...

David Stevenson talks about interest rates and returns on cash

David Stevenson is an experienced investment commentator and writer, writing for a number of leading publications including the Financial Times, Investors Chronicle and Investment Week.

I'm delighted to be kicking off my first investment commentary for 'alphaTimes'. The theme of my first article is one that's increasingly central to my thinking, which is that pretty much everything could be set to stay 'lower and slower, for longer'!

I'm referring initially to *interest rates and returns on cash* – but in future issues I'll also come on to *bond yields and the returns on corporate and government bonds* (which to my mind now present more risk of capital loss than many investors have cottoned on to) and the *future returns on equity markets* (which I would suggest might be lower in the foreseeable years ahead than in the recent years now behind us).

While it's not the cheeriest of opening columns from me - although hopefully it's not too gloomy either - the fact is that there are some good opportunities out there. And perhaps the main point is that there are many reasons for savvy investors to be thinking about things carefully and positioning their portfolios judiciously.

So, interest rates? Well, they're low! You don't need me to point that out! We have now had a 0.25% increase in the UK and there's talk of interest rates rising further, most obviously in the US, where hikes are already underway, but also here in the UK. Some folk even talk of (or hope for) so-called 'normalisation' of interest rates, by which they mean rates go back towards their long-term averages, of around 5%. But I'd suggest you need to have an enormous bowl of salt by your side when you next hear this view!

It's hard to argue with the view that US interest rates, as determined by the US Federal Reserve, might increase several times more in the next 18 months. But even if that is the case, the sum of minor upticks might only take rates back to around 2.5% - and it's a fair bet that by then the US economy could be close to stalling, with the obvious response to that being lower interest rates!

And here in the UK, any Bank of England policy-maker looking to jack up interest rates is going to have a hard time doing so. BoE govenor Carney says as much himself. Even if we have a year or two of rising rates I think we'd be 'lucky' to get to 2.5%. But with Brexit looming, which brave central banker would want to embark on a drastic set of increases?

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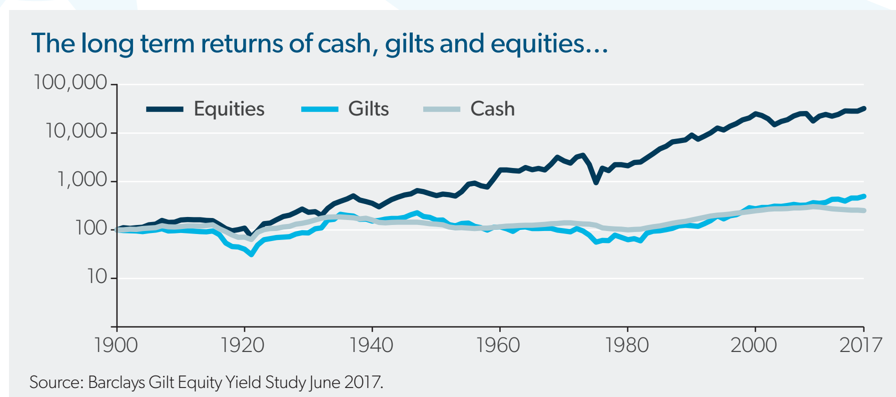
A while ago I spent some time talking to leading banking sector analysts for some global investment banks. NONE of them thought interest rates would get to much above c.2.5% in the next few decades! Phew, that made me draw breath! To be exact, the consensus view was that we wouldn't see rates above 2.5% until 2047. "Too much debt, too little inflation, too dangerous for central banks who've got home owners addicted to low interest rates" was one comment.

In these circumstances, the simple chart below should be a wake-up call for investors. It's taken from the widely read Barclays Equity Gilts Study and shows the relative returns from cash, bonds/Gilts and equities over the last century. A chart can paint a thousand words and this one says 'cash serves many valuable functions… but investment isn't one of them!'

Remember that these numbers were heavily influenced by many decades of interest rates at the long term 'normal', of around 5%. Currently with interest rates up slightly at 0.5% and retail price inflation (RPI) close to 4%, cash is in fact losing you money. It's a destructive asset, wasting away your long-term real returns. And that may be true not just for the next few years but even the next few decades, if we are in a 'new norm' environment of significantly lower interest rates. Even if interest rates in the UK do miraculously rise to 2.5%, you could still be losing money, in real terms, on cash. So it's time to think about alternative sources of income and yield, pronto. It won't be easy, but doing so may help your financial future.

> Cash serves many valuable functions… but investment isn't one of them!

The long term returns of cash, gilts and equities...



Source: Barclays Gilt Equity Yield Study June 2017.

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