Where Will Investors Find Profit in 2014?

US fund managers are divided as to the future of the stock market. Will domestically focused stocks shine or is it time to reconsider emerging markets?

Emma Wall | 5 December, 2013 | 7:20AM

The US stock market has been the single best performing country indices so far this year. Up 30% and counting since January, the index continues to break through all-time highs.

If you had been savvy enough to call the bottom of the market in January 2009 at 798, your money would have more than doubled - to 1,793 today.

But camps are divided as to whether this run is sustainable. Joanna Shatney, Head of US Large Cap Equities at Schroders says although she is careful not to be complacent, investors are not fully invested into the market and the rally has further to run.

"The consistency of the US market is hard to beat," she said at a conference in New York last week.

"There may be better growth opportunities elsewhere, but it is not a certainty - you would have to accept volatility. Corporates are looking good, we expect 2014 to look like 2013."

Her colleague Jenny Jones, who looks after small and mid cap stocks agrees. She said that valuations were not necessarily a barrier to good performance, and companies were so cash rich that acquisitions should pick up next year, boosting the stock market.

Economist Nancy Lazar from Cornerstone Macro says US stocks have done well because the economy has recovered. She drew comparisons between United Rentals, a domestically focused rental company which has returned more than 70% this year, and machinery company Caterpillar which sells across the globe - and is only up 2%.

"Spending by companies is at a record high - on technology, property, oil rigs. This boosts the economy and the stock market," she said.

One man who is not so sure is Cazenove multi-manager Marcus Brookes. He says that now is the time to take profits -the market rally has been impressive, but it cannot last.

There have been warning signs. The market has become over confident - regardless of the macro picture.

"This year, every bit of good or bad news has pushed the S&P higher," said John Linehan, Head of US Equity for T. Rowe Price.

"Valuations are no longer attractive and it is very rare that a market will go from cheap to fairly valued and then stop. Usually valuations continue upwards and become overvalued. Compared to bonds, equities are still attractive but compared to historic levels, they look less so."

The market could be boosted if corporates choose to start spending some of the excess cash on their books.

"Total debt in the S&P 500 is at a very low level and cash as a total of assets has increased significantly," said Linehan.

"What should corporates do with all that cash? There has been little M&A [merger and acquisitions] activity and capital expenditure is still below average, but it is increasing which is great for the economy. Any dividend payments or share buy-backs will be good for the market - it is a very powerful driver."

But Brookes says that instead of spending this excess cash, companies are hoarding it - with blue chip stocks behaving more like bonds than equities.

"They should be investing in themselves, expanding their businesses, making acquisitions and building properties," he said. "But the stock market seems to have been conditioned not to invest in itself."

Bill Stromberg, Head of Equities for T. Rowe Price says that investors have come to expect too much.

“Investors should not count on high growth in the first place – deleveraging slows growth and that’s what this country must do,” he said. “We must be careful not repeat the mistakes of before, hopefully the tapering of quantitative easing will help prevent another bubble, but we should expect a market correction. The S&P 500 could fall up to 20% next year."

If this is the case, it could present a buying opportunity, but for investors looking to take profit from the US now, China could be a consideration.

A more conducive macroeconomic environment is not reflected evenly across stocks, creating investment opportunities in emerging markets – and in Europe.

Valuations in Europe are cheaper than other regions and government reform has put stabilisers in place to ensure economic growth in the future.

"Thanks to corporate restructuring and consolidation, certain sectors now look very attractive," said Europe manager Dean Tenerelli.

"Before the credit crisis there were 67 banks in Spain, now there are 11. This improved market positioning makes for a great investment opportunity."