

Economic & Political Roundup

A collation of recent insights on markets and economies taken from the comments made by chairmen and investment managers of investment companies – have a read and make your own minds up. Please remember that nothing in this note is designed to encourage you to buy or sell any of the companies mentioned.

Roundup

Once again, the worst performing of the MSCI Indices in the chart on the right was that of the UK. The election result and start of Brexit negotiations have knocked confidence. Bond yields are higher as policymakers have started to talk about an end to accommodative monetary policy. The slide in oil prices has continued into July.

Global

There seems to be a growing consensus that markets are valued quite highly but some are more pessimistic than others.

Sebastian Lyon, manager of Personal Assets, says valuations are more stretched than ever and points out that the US market's cyclically adjusted price earnings ("CAPE") ratio is at levels last seen before the 1929 crash and the implosion of the tech bubble. The managers of Capital Gearing make the same point and say short duration assets are the key to avoid giving back the returns of the last three and a half decades. Graham Meek, chairman of that fund, says that, for the twelve months ahead it may be that merely preserving the gains of previous years will be viewed as success.

Rachel Beagles, chairman of Securities trust of Scotland, thinks valuations in the US are discounting much of the good news but sees better value elsewhere, particularly... (continued on next page)

Exchange Rate	30/06/17	Chg. on month %
GBP / USD	1.3025	+1.0
USD / EUR	0.8752	-1.6
USD / JPY	112.39	+1.5
USD / CHF	0.9579	-1.0
USD / CNY	6.7809	-0.5

Source: Bloomberg, Marten & Co

MSCI Indices rebased to 100

Time period 30/06/16 to 30/06/17



Source: Bloomberg, Marten & Co

	30/06/17	Chg. on month %
Oil (Brent)	47.92	-4.8
Gold	1241.61	-2.2
US Tsy 10 yr yield	2.3037	+4.6
UK Gilt 10 yr yield	1.257	+20.2
Bund 10 yr yield	0.465	+54.0

Source: Bloomberg, Marten & Co

Global (continued)

...in Europe. The manager of that fund agrees but is cautious about the potential impact of Brexit on European economies. The managers of Seneca Global Income & Growth feel that it is now time to start thinking about the next global economic contraction. Harry Wells, in his capacity as chairman of Establishment Trust, believes that the sheer quantity of global government debt acts as a deflator and thinks that the economic recovery in the USA still appears some way short of 'escape velocity'. Nick Greenwood, manager of Miton Global Opportunities, talking about Brexit negotiations, says investors seem complacent about the continental reality that the political imperative for a united Europe outweighs economic and financial concerns. James Will, chairman of Scottish Investment Trust, thinks the process is likely to drag on for longer than expected as neither side seems to have a clear vision of what they want. The managers of Aberdeen Diversified Income & Growth warn that investment markets are likely to deliver lower returns than they have historically and anyone extrapolating from the past is likely to be disappointed.

Brexit negotiations and their impact on sterling dominate comments

United Kingdom

Roger Cuming, chairman of Montanaro UK Smaller Companies, focuses on Brexit negotiations which he hopes will be conducted in a reasonable and constructive manner. He also cautions on the dramatic growth of passive investment saying that, over many years of investing, he has found that the most popular trends have a habit of disappointing. Norman Yarrow, chairman of Dunedin Smaller Companies, thinks that equity valuations are pricing in a favourable but not unrealistic expectation for profits growth. Peter Jones, chairman of Henderson Opportunities, believes the election outcome has improved the prospects of a 'soft Brexit'. Ciaran Mallon, manager of Invesco Income Growth, sees recovery potential in the Brexit-hit stocks. Eric Sanderson, chairman of Schroder UK Mid Cap, thinks that mid cap shares have become untypically sensitive to movements in the exchange rate. The managers of that fund see the prospect of a continued pick-up in UK mid cap M&A activity.

Attention is being paid to Chinese debt levels but some commentators think China is addressing these.

Asia

David Shearer, chairman of Aberdeen New Dawn, says that the possibility that economic momentum is gaining pace in China is proving a source of comfort. The managers of that fund are some of a number of commentators that draw attention to elevated debt levels in China. The managers of Schroder AsiaPacific acknowledge this as a problem but think that on a medium-term time horizon China should be a broadly supportive influence on global and regional activity. Ian Hargreaves, manager of Invesco Asia, says tightening credit conditions in China will likely lead to a moderate slowing in Chinese economic growth in coming months. He goes on to highlight the attractions of India.

Earnings are growing and valuations are not demanding

Europe

The managers of JPMorgan European Smaller Companies are seeing earnings growth in Europe accelerating for the first time in a number of years. The chairman of

Montanaro European Smaller Companies says that , compared to other developed stock markets, such as the US, stocks in Europe appear to offer relatively good value.

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Japan

Ongoing reforms are seen a positive for the Japanese economy and stock market

Alan Clifton, chairman of JPMorgan Japan Smaller Companies, hails the introduction of 'work-style reforms' which will limit excessive overtime, provide for equal pay for equal work, encourage work beyond normal retirement age and so on. The managers of JPMorgan Japanese say corporate governance reforms are slowly but steadily taking hold. Harry Wells, in his capacity as chairman of CC Japan Income & Growth, highlights recent changes to the Japanese Corporate Tax Code which raise the possibility of increased corporate activity.

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Emerging markets

Emerging markets are changing and there are reasons for optimism

Carlos Hardenberg, manager of Templeton Emerging Markets, notes the high weighting to information technology within emerging market indices and sees this as a sign that the general landscape of emerging market corporations has undergone a significant transformation. John Rennocks, chairman of Utilico Emerging Markets, notes the rise in populist politics and geopolitical tensions, and the impacts of QE and negative interest rates. However, he says GDP growth, low inflation and policy reform in many emerging markets is encouraging. The managers of Aberdeen Emerging Markets take comfort from currencies stabilising, global growth and trade strengthening, corporate earnings revisions improving and flows from foreign investors recovering.

UK Property

Markets will be driven by rental growth from here

David Hunter, chairman of Custodian REIT, points out that, while the occupational market has strengthened through the year and rental growth has taken hold across large parts of regional economies, the investment market has been more volatile. The manager of that fund thinks capital growth has been driven by the prospect of rental growth and not by underlying yield compression. He highlights high cash levels in open-ended funds which may act as a drag on their returns. James Agar, manager of Ground Rents Income, gives an insight into a market which has been controversial of late.

Other

In addition, we have comment on North America from Gabelli Value Plus+; China from Fidelity China Special Situations; India from Aberdeen New India; Biotech and healthcare – where Worldwide Healthcare's manager walks us through the various sub-sectors; Environmental from Jupiter Green; Private equity from both Aberdeen Private Equity and, soon to be stablemate, Standard Life Private Equity; and Renewable Energy from John Laing Environmental and NextEnergy Solar.

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Securities Trust
of Scotland



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Global

(compare Global funds [here](#))

Sebastian Lyon, manager of Personal Assets: In the past year, much has changed from a political standpoint (such as Britain's decision to leave the EU and the election of Donald Trump) but little has changed from an economic standpoint and nothing has changed regarding our main concern—the valuations of asset classes. These are more stretched than ever, particularly after the 'Brexit boom' in UK share prices, and it all feels very 'late cycle'. While at 96 months the US stock market has enjoyed the second longest bull market since 1945 (according to Fortune), it doesn't 'feel' like a bubble. Today's mood music is elevator music rather than heavy metal. Most investors we talk to are not thinking bullishly, but are acting bullishly. The disappearance of income from traditional safe-haven assets such as cash and government bonds has led income-conscious investors to chase yield in the manner of a relay race, when, after each lap, savers and investors have to change to the outside lane and reach out further across the risk asset class spectrum. Traditional measures of valuation insist that equities, led by US indices, are expensive by historical standards. The US market's cyclically adjusted price earnings ("CAPE") ratio is currently 29.2x compared to its long term average of 16.8x, a level only 'bettered' by the levels at the end of the 'Roaring Twenties' and on the eve of the 2000 implosion of technology stocks.

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Graham Meek, chairman, Capital Gearing: During 2016, the decline in the trade-weighted value of sterling came to the rescue of many U.K. portfolios. It is hard to see from what quarter help will ride this year. Inflationary pressures are slowly emerging and whilst the bottom of the interest rate cycle may now be past it is hard to see rapid increases in nominal short rates anytime soon. Meanwhile, the policies of the central banks seem likely to become rather less accommodating in supporting asset prices than recent years. Geopolitical risks intuitively remain high in many regions, with new, untested, administrations facing new challenges. Yet market risk measures remain at or near historic lows. For the twelve months ahead it may be that merely preserving the gains of previous years will be viewed as success.

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Peter Spiller, Alastair Laing and Christopher Clothier, managers, Capital Gearing: In financial terms we live in truly extraordinary times. It is worth reminding ourselves of this fact regularly, if not we all risk becoming, like the apocryphal frog in the pan of heated water, so inured to our present circumstances that we go from being alive to being an hors d'oeuvre without noticing. US equities, by pretty much any measure we might use, are incredibly expensive. The cyclically adjusted price earnings ratio ("CAPE") has only been more expensive twice (in 1929 and 1999/2000), EV/EBITDA and Price to Sales have not been higher since 2000. Sadly the bond market does not offer an obvious refuge. Despite approaching full employment and market inflation expectations exceeding policy mandates across all durations, the Bank of England has the most accommodative monetary policy in its history.

The decisive financial development in western markets over the last 35 years has been the collapse of interest rates. Both nominal and real interest rates have seen falls that are unparalleled in modern, or indeed ancient, financial history. In consequence, bonds have enjoyed a bull market that has been astonishing both in extent and duration. Real rates for 10 year government bonds in the UK have fallen

from 4.5% to minus 2% on a 10 year index-linked bond. The effect is not limited to bond markets, the risk-free discount rate is fundamental to the valuation of all financial assets, including equities and property. That is why CAPE assessments of equities are trading at such rich levels and prime properties at such high multiples of rental yields.

The reasons for falling interest rates revolve principally around disinflation and the policy stance of central banks. Both look to be at or close to a turning point. Certainly the prospects for inflation have broken the long term trend, which bottomed in the second half of 2016, when fears of deflation in the US and Europe were widespread. Given the policy background, such deflationary fears always looked overplayed. Even now forward inflation swaps suggest that market participants believe inflation in the US and the UK will be lower than target levels in five years' time. That still seems to underestimate the outlook; as we have seen, if slow growth were to depress inflation, a dovish response by central banks is all but assured. Both countries enjoy essentially full employment; conditions for wage growth are at last supportive.

Debt levels are such that financial repression (inflation levels greater than interest rates) can be assumed. Furthermore, economies have adapted over this prolonged period of negligible interest rates to an extent that prohibits rapid or substantial increases in nominal short rates. Nevertheless with inflation rising and the unwinding of central banks' balance sheets, a steeper yield curve can be expected in both the US and the UK. Europe may lag as political imperatives to shore up the weakest members of the Eurozone, notably Italy, overwhelm any fears of inflation.

This raises an important question, if long bond yields and by extension discount rates are likely to rise how should asset allocation react? For conventional bonds, the conclusion is clear; duration should be short. Historically equity valuations have also been very weak in the face of rising bond yields, most notably in the 1970's. Of course, corporate profits could thrive in more inflationary conditions, but the increase in the valuation of those earnings is what has driven markets up over the last 10 years and the reversal of that process should overwhelm the growth of corporate profits. Much the same process applies to property.

Among the broad asset classes, only US inflation protected bonds ("TIPS") offer the prospect of protection against inflation and real capital gain if inflation rises above long term interest rates. Furthermore these gains are likely to be achieved at a time that all other asset values will be falling.

Overall the conclusion is clear. If the discount rate used to value all financial assets is unprecedentedly low, then the key to asset allocation is to lock that rate in for as short a time as possible. As the prolonged bull market in interest rates comes to an end, and is reversed, short duration is the key to avoid giving back the wonderful returns of the last three and a half decades.

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Rachel Beagles, chairman, Securities of Trust of Scotland: After a disappointing 2016, the world economy is gaining momentum and there are expectations of stronger demand and increased inflationary pressures. This improved economic outlook has been driven by a partial recovery in commodity prices, the benefits of policy support in China, and improved consumer and business confidence in the US. There are potential risks to this more optimistic outlook from a number of fronts, including a faster-than-expected pace of interest rate hikes in the US, lack of progress in some of President Trump's more business friendly policies, fall out from mounting vulnerabilities in China's financial system, and a number of political threats, including the Brexit negotiations and elections in Germany and now the UK.

Valuations in the US look to be discounting much of the good news, leaving downside surprises if the risks emerge. But there is better value to be found elsewhere, particularly in Europe.

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Mark Whitehead, manager, Securities Trust Scotland: US equity markets are likely discounting more than the improving economic backdrop. Recent strength is unlikely to be repeated this year, particularly as much of the exuberance has been driven by President Trump's intended fiscal stimulus plan, which (with the Obamacare repeal hitting a wall of dissenting voices) now perhaps looks as if it was too hopeful. Corporate tax rate reform is also likely to be hotly debated, but politicians will be eager to understand how it will be funded as the country continues to be burdened with record (and growing) levels of indebtedness. The Fed will also have to tread a careful path to ensure it does not tighten policy and choke off demand too quickly.

In Europe, economic indicators have also recovered, with economic confidence near a six-year high. The European Central Bank is now talking about the future path of policy, which could see a tapering of current quantitative easing and the first steps to normalising interest rates. This view seems, in part, to be predicated on building inflationary pressure; while currently on the upswing, this may well roll over later in the year as the effects of the recent oil price and commodities rally pass through.

In the absence of any further political shocks or hard Brexit scenario, the key to how equity markets act now may be as simple as whether or not this late-cycle surge in economic activity is about to stall. It is difficult to know whether or not the upswing has been a result of temporary stimulus, with inventory building but not final demand growth. This has certainly been the case in China where huge fiscal stimulus initiated in 2014 is now being reversed through tighter monetary policy and lower liquidity provision, through a higher reserve ratio for banks. This could have implications for the hugely indebted property market and the recent explosive performance of commodity prices and related equities.

What is certain is that, on a variety of measures, US equities look more expensive than European. One such measure is enterprise value (EV)/sales ratio (ex-financials), where the US market's ratio is currently 60% higher than its European equivalent. Some of this has been due to stronger earnings, particularly from the technology sector and the 'FANG' (Facebook, Amazon, Netflix and Google) stocks. But such a lofty valuation could be overstating US companies' capability to grow sales, margins and profits further compared with their European peers. As a result, we are finding the European equity market attractive in terms of valuation. Should earnings improve and in the absence of a political shock, it could outperform other equity markets this year.

However, we are watching this space carefully. Now that the UK has formally begun negotiations to leave the European Union, we can expect a period of uncertainty for UK and Europe's economies. It is too early to tell whether companies have materially withheld UK investment since the referendum vote last year, but we suspect that this is the case and the UK economy will experience some future weakness. We are therefore inherently more cautious currently on those sectors that have greater economic sensitivity.

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Seneca Investment Managers, managers, Seneca Global Income & Growth: The global economy has been strengthening in recent months, which means that we are now further into the current business cycle that began in 2009. Indeed, the current cycle has already been longer than average, though to a great extent this is a function of the severity of the contraction that preceded it - the worse the 'accident', the longer

the recovery. We thus feel that it is now time to start thinking about the next global economic contraction, which we anticipate will occur in or around 2020. This prediction is based on an extrapolation of current employment and inflation trends, as well as taking account of other factors such as structural slack in labour markets. If our timing is correct, the chances of which are slim, the current cycle will have lasted 11 years, much longer than a typical cycle.

As for asset allocation, we are at the point in the cycle when equity returns should start to fall, albeit remain positive.

It is hard to say how severe the next downturn will be. There are some who argue that it will be mild, because this time monetary authorities have the tools to prevent economic weakness causing stress in financial markets. Others argue that it will be more severe, because debt levels are now higher and central banks will have less scope to lower interest rates or expand already bloated balance sheets.

Frankly, we do not know which is more likely, but are fairly confident that the next economic downturn, however severe, will see declines in equity markets.

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Harry Wells, chairman, Establishment: After eight years of unparalleled money creation by the world's central banks through Quantitative Easing (QE) programmes, there appears to be some germination of recovery in the world economy. Global trade has been picking up. Markets have rallied strongly since Trump's election in November 2016 on US reflationary expectations although China probably remains a more important engine of global growth. We saw growing confidence in a resurgence in the Chinese economy during 2016 reflecting the success of government policy in clamping down on corruption, implementing supply side reforms, containing acute credit problems, stabilising the currency and providing continuing support for infrastructure and investment. The outlook for corporate earnings has improved dramatically not only in China but also across Asia. India promises strong structural growth on the back of government reform while infrastructure spending plans throughout ASEAN countries are an augury of underlying consumption trends. Regional valuations are hardly stretched at a large discount to developed markets. It is perhaps not surprising that, after a long period of relative underperformance, Asian equities are at last rebounding.

Less rosy is the elevation of geopolitical uncertainties with Trump taking a much more robust stance on US foreign policy than his predecessor leading to new tensions with Moscow and Beijing. In North Korea, Mr Kim's brinkmanship is a dangerous game. Fears of trade protectionism are perhaps less pronounced than during Trump's election campaign as he wrestles with Congress to implement domestic policies and tax reforms. Protectionism simmers elsewhere as result of populism in Europe and the possibility of an acrimonious Brexit deal for Britain.

Aggregate global government debt acts as a powerful deflator, implying a benign outlook for inflation and a positive climate for equities. Despite the Federal Reserve Open Markets Committee (FOMC) forecasting three interest rate increases this year (it was four last year), the economic recovery in the USA still appears some way short of "escape velocity" and the more dovish recent tone from Governor Yellen implies little prospect of a move towards normalisation of US interest rates in the near term. US interest rates and the performance of the US dollar still remain important barometers for emerging markets and Asia, where, irrespective of US monetary policy, there are no shortage of investment opportunities.

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Anthony Townsend, chairman, F&C Global Smaller Companies: After such a strong year, it is reasonable to expect a period of consolidation in the near term. Many stocks are trading at record valuation levels, raising question marks over the potential for further upside, particularly at a time when US interest rates are forecast to continue to rise. The markets will be watching to see if tax reforms are deliverable by the Trump administration, together with how the debate over trade policy evolves. The implications of the general election result in relation to the Brexit process are as yet unclear, but heightened political uncertainty is unwelcome for markets.

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Charles Plowden, Spencer Adair and Malcolm MacColl, managers, Monks: We are less confident that aggregate stockmarket indices will make continued progress given the number of large companies and industries which look to us to be ripe for disruption and long-term decline.

Politics across the developed world does seem to be becoming less predictable, in part because of competition from fast developing economies and in part because of the impact of new technologies on societies.

Three broad themes: continued confidence in American growth; a revival in Emerging Markets; and cautious optimism that we are past the worst in Japan and Europe. While the progress of the Trump administration's reforms are uncertain, we believe the direction of tax and industrial policy is broadly positive and should support the economy, with incentives to increase investment and research particularly important for the longer term. A number of Emerging Markets are benefiting from a cyclical recovery after a difficult few years, supported by competitive currencies and praiseworthy efforts to improve governance and reduce corruption; in several such countries politics is actually becoming a cause for optimism. [In] Europe and Japan, the passage of time and increased pressure for change and reform suggests growing scope for positive news.

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Nick Greenwood, manager, Miton Global Opportunities: Looking forward there is a sense of déjà vu. Markets enjoyed a rally in the aftermath of the US election however more recently the Trump administration has struggled to deliver on its election promises. Bond yields have fallen as investors have lost belief in the Trump trade. Therefore we have returned to an environment which has existed since the global financial crisis. We should expect that very low interest rates will continue to squeeze asset prices higher through a lack of alternatives. Nevertheless, the closed-ended industry faces some challenges which will provide opportunities for the portfolio. A reduction in the capital committed to making markets in investment trusts is likely to increase volatility at times of stress. Further into the future any normalisation of interest rates will undermine the demand structure for alternative income funds which currently command substantial premiums to stated asset value. More imminently the negotiations over Brexit may bring some unexpected surprises. Investors seem complacent about the continental reality that the political imperative for a united Europe outweighs economic and financial concerns.

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James Will, chairman, Scottish Investment Trust: Markets were electrified by the election of the new US President, Donald Trump, as investors reasoned that his campaign pledges would translate into investor-friendly policies. However, more recently, a concern has developed that President Trump's unorthodox style, which was crucial to his victory, may prove a barrier to garnering the necessary political support to enact change.

The recent UK election result, the election of President Trump and the earlier Brexit vote all embody a growing mood to reject the political status quo driven by a perceived decline in living standards. That said, the rejection of anti-EU candidates in elections in the Netherlands and France reassured markets about the political stability of the Eurozone.

Mainstream politicians have reacted to this change in mood and have shown a tendency to adopt some of the popular policies of their more maverick opponents, which is a trend that is likely to continue. Much has been written elsewhere about the Brexit negotiations and, by way of further observation, I only add that the process is likely to drag on for longer than expected as neither side seems to have a clear vision of what they want from the process.

The US Federal Reserve, which unofficially sets the cost of money for much of the world, took advantage of the improved mood engendered by rising markets and increased interest rates. Interest rates remain very low, but breaking an addiction to cheap money may prove traumatic. An important component in the outlook for markets is the perceived timetable and extent to which the Federal Reserve will tighten monetary policy. However, markets have taken some comfort from a view that politicians and officials remain keen to preserve investor confidence.

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Mike Brooks and Tony Foster, managers, Aberdeen Diversified Income & Growth: Looking ahead, our strategic view is that the tailwinds which have boosted economic growth and the performance of investment markets since the early 1980s - improving demographics, increasing global trade and rising debt levels - have now turned into headwinds. Working age populations are now declining in most major economies; 'populist' policies are seen as a threat to global trade and the debt burdens which triggered the global financial crisis have not yet been fully addressed. These deflationary forces point to an era of sluggish growth in personal incomes in many developed markets. With government bond yields in most developed markets close to historically low levels, investment markets are likely to deliver lower returns than they have historically and anyone extrapolating from the past is likely to be disappointed.

In the shorter-term our base case economic view is generally supportive for equities and other risk assets. There has been an improving growth trend, most notably in the US which has the potential to be boosted by President Trump's plans for corporate tax reduction and fiscal stimulus. Central banks remain supportive in Europe and Japan. In China, we believe that government policies will continue to prioritise growth.

As ever, there are a number of clouds on the horizon which temper this broadly positive base case. In the US, the Trump-led administration failed to secure its first policy reform, in healthcare, which calls into question its ability to enact fiscal policy stimulus. In Europe, uncertainty comes largely from Brexit and rising populist political pressures, as Prime Minister Theresa May can clearly affirm. In China, it is unclear how levels of credit growth, which seem to be unsustainable, might be normalised. In investment markets, equity indices are, in most cases, at all-time highs and valuations look stretched.

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United Kingdom

(compare UK funds [here](#))

Roger Cuming, chairman, Montanaro UK Smaller Companies: It is currently almost obligatory to make cautionary remarks about the impact of the UK's planned withdrawal from the European Union ('BREXIT'). The two-year period for discussions about withdrawal is currently scheduled to end on 29 March 2019.

The 2015 Office for National Statistics ('ONS') 'Pink Book' figures show that the UK exported GBP134bn worth of goods to the remaining 27 countries of the EU and imported GBP223bn. It is therefore in everybody's interest that negotiations are conducted in a reasonable and constructive manner. From the UK's perspective, it is essential that we show a united approach, free from any form of schadenfreude. This is particularly relevant following the recent General Election which resulted in a hung parliament. A minority Conservative government relying on the Democratic Unionist Party ("DUP") for support is far from ideal.

Although BREXIT worries may increase volatility in UK and European stock markets, it is debatable whether it will cause anything other than a 'blip' to long-term returns. The enormous debt levels incurred by governments, companies and individuals as a result of unconventional monetary policies (such as Quantitative Easing), together with the risk of protectionist trade measures, are of far greater concern. However, the exponential technological progress aiding new discoveries in medicine, energy, robotics and other areas bodes well for the future, especially in SmallCap.

The unusual investment environment since 2007/08 and the impact of fees in a low growth decade has boosted the trend away from active towards passive management. The dramatic growth of passive management, dominated by indices on autopilot, could pose future systemic risk. Over many years of investing, I have found that the most popular trends have a habit of disappointing.

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Norman Yarrow, chairman, Dunedin Smaller Companies: Brexit is at the forefront of many investors' minds. A great deal of uncertainty remains as to what form our future relationship with the European Union will take, and this is only exacerbated by the outcome of the recent General Election.

There are of course other unknown factors as well. It is currently unclear how President Trump's policies will impact on US and ultimately global growth. In Europe, the French Presidential elections have passed without issue but the potential for populism to disrupt the region's recovery remains. Equity valuations [are] pricing in a favourable but not unrealistic expectation for profits growth.

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Peter Jones, chairman, Henderson Opportunities: The outcome of the General Election on 8th June was not the one expected when the campaign began but, from a portfolio perspective, it should not necessarily be seen negatively. The prospects for a 'soft Brexit' have almost certainly improved and if, as seems likely, there is now an imperative to retain an open border in Ireland, this could arguably require that the UK remains part of the single market. Although inevitable political uncertainty will discourage some investment, the obverse may well be increased public spending and continuing sterling weakness, both of which might be viewed positively by many UK businesses.

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Jonathan Cartwright, chairman, BlackRock Income & Growth: Improving economic data in Europe and the US are positive signs for the global outlook and the US Federal Reserve increased interest rates in March and June of this year following strong US economic data. Any rise in the Bank of England's base rate is expected to be gradual and well flagged. The rate of inflation is also expected to rise, in part as a result of the depreciation of Sterling and a corresponding rise in import costs, which may negatively impact the domestic economy as UK consumers react to rising prices.

There are still a number of significant risks and headwinds present for the global economy.

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Hugh Twiss, chairman, Invesco Income Growth: I think that I must accept that I am like a vinyl record where the needle is stuck in a groove because I continue to caution that positive returns are likely to prove harder to generate for a while, particularly in light of the increased uncertainty following the recent indecisive UK election result and the possible impact on the Brexit negotiations that have now started, let alone the reality of Trump. Not that I am upset being like a vinyl record, which for many is still considered the best way to listen to good music and so too, I believe, that investment trusts are the best structure to invest in for the long term and to successfully weather any challenges ahead.

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Ciaran Mallon, manager, Invesco Income Growth: Following a brief period of volatility, the UK's upward trajectory of the last seven years has accelerated over the past year. Meanwhile there remain headwinds to withstand, including the as yet unknown impact of Brexit implementation, with economic growth likely to remain subdued. In the US, there remains uncertainty over the Trump effect, with the risk that the enhanced expectations of economic growth will not be met while, in China, there is a risk of a slowdown in the capital investment cycle later this year. Additionally, sterling could strengthen from current depressed levels, creating uncertainty for UK equities. Finally, the recent UK election result has led to heightened uncertainty over political direction.

Market valuations in terms of historic dividend yields and price earnings ratios are now above long term average levels, but, excluding the one-off impact of weak sterling on companies with overseas revenues, earnings growth for many companies and sectors remains elusive or even negative. There is, however, recovery potential in the Brexit-hit stocks.

Dividend growth in the market in 2017 is likely to prove lower than overall earnings growth, as companies seek to re-build dividend cover from historically low levels. Additionally at current stock market levels, it can prove difficult to find quality companies able to deliver growth in both income and capital.

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Eric Sanderson, chairman, Schroder UK Mid Cap: Since the period end, there has been a general election in the UK which has resulted in a hung parliament. This will give rise to greater economic uncertainty and its impact is as yet unknown. While the final outcome will provide an answer to one of the uncertainties facing UK equity investors at the moment, there are plenty of others to come. To take just two examples from the last 12 months, mid cap shares have become untypically sensitive

to movements in the exchange rate, and investors now face a long period before the implications of the negotiations for the UK to leave the EU become clear.

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Schroder UK Mid Cap: UK mid caps have performed strongly so far this year as investors appreciated the level of earnings and dividend growth coming through. To a degree there has also been an element of catch up following the strong currency induced performance from FTSE 100 companies last year.

We are continuing to see companies using a low interest rate environment to make acquisitions to supplement organic growth. This is being well received by the market and is a trend we would expect to persist. We also expect a continued pick-up in inbound UK mid cap M&A activity, particularly in light of the recent weakness of sterling.

We think UK mid cap dividend growth could continue to outstrip that of large cap counterparts. This is partially because, as we have said before, we believe that many mid caps have better growth prospects than some FTSE 100 companies, and partially because mid cap dividends are far better underpinned by dividend cover.

In the UK, economic growth has continued to surpass the expectations of most forecasters who expected a significant slowdown. Consumer spending has remained robust even if the traditional bricks and mortar retailers face never-ending margin pressure from their cost-light internet competitors. The weakness of sterling has started to see higher costs being passed onto the consumer and we are keeping a close eye on whether companies will be able to make those increases stick or will have to reverse them due to falling demand.

Other headwinds for companies such as the living wage, business rates and the apprentice levy are all going to have an impact on companies and their ability to grow profitability.

Finally, this month's general election has added to short-term uncertainty instead of the other way around. This may affect decision-making for both consumers and companies.

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Asia

(compare Asian funds [here](#))

David Shearer, chairman, Aberdeen New Dawn: In the near term, there are grounds for cautious optimism about the Asia Pacific region. Although the so-called 'Trump trade' that has supported global equities for the past few months now seems to be on shakier ground as doubts have grown about the US President's ability to push through promised reforms, Asian markets have taken the bouts of volatility in their stride. Improving corporate earnings, healthier exports and favourable policy-making have been equally instrumental in lifting investor sentiment. The possibility that economic momentum is gaining pace in China has proven a source of comfort, given its fortunes are so crucial to the wider region.

The long term investment case for Asia Pacific remains attractive, underpinned by good demographics, rising wealth and political reform.

Aberdeen Asset Management Asia Limited, managers, Aberdeen New Dawn:

Prospects for the global economy appear generally upbeat, supported by economic growth in Europe and the US. The outlook for the Asia Pacific region is also improving, especially the reform-fuelled growth in India. China appears relatively stable, although elevated debt levels are a cause for concern. From a stock market perspective, valuations in the region are undemanding.

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Schroder AsiaPacific Fund: Recent weeks have seen a distinct moderation in the optimism about economic growth that dominated the second half of 2016. Bond yields have retraced much of their rise, commodity prices have softened, and defensive sectors have recovered some of the ground lost in 2016. However, the global economy looks in reasonable shape. Excessive hopes for US growth may be disappointed (partly because the scope to stimulate an economy near full capacity is by its nature limited), but there is no reason to expect a sharp downturn, while other developed economies such as Japan and Europe appear to be on a broad recovery tack.

Less investor focus in general has been given to the importance of China in stabilising global growth. The influence is clear in the strong export numbers in the Asian region (Taiwan: +13% year-on-year in March; Korea: +14%) and in the buoyancy (until very recently) of commodity prices. For all the talk of fiscal packages and monetary measures in the developed world, the net new stimulus has been almost wholly from China over the last 18 months. In engineering a strong recovery, China has done it by the text book: lower interest rates, real estate stimulus, public investment and continued supply of credit (with credit continuing to grow over twice nominal GDP) leading to an impressive recovery in the secondary industry and a swing in producer prices from -6% year-on-year at the end of 2015, to +7.6% in March.

Recently the Chinese authorities have signalled a less pro-growth stance (marginal tweaks up in policy interest rates, cooling measures for large cities' real estate markets), but the priority will be to maintain a satisfactory level of growth - not too hot, not too cold, to use a cliché.

The long-term resolution of China's addiction to credit (lower growth, debt work-outs etc) has still to be faced, but on a medium-term time horizon China should be a broadly supportive influence to global and regional activity.

Trade protectionism remains a salient risk for the Asian markets, although this comes at a time when more cyclical supports are healthy, including a slow repair from the crisis conditions of 2015 for a number of emerging markets (Russia, South Africa, Latin America, Middle East) and steady recovery in Europe, which is at least as important a destination for exports as the United States. External balances in terms of current accounts, trade balances and foreign exchange reserves remain healthy, and provide some cushion should there be tighter global monetary conditions or a stronger dollar than we currently envisage. Domestic demand drivers (outside China) remain muted, however. It probably awaits a more concerted push on infrastructure spending in places like India and emerging ASEAN for this to change. Most governments have more fiscal room to manoeuvre than they did, so it is political will that forms the main impediment.

Geo-political risk is somewhat elevated for other reasons, most notably the increasingly disruptive actions of the Democratic People's Republic of Korea in pursuit of a credible nuclear deterrent. With the possible return of a more interventionist US foreign policy, tensions are high as at the time of writing. Much hangs on the personal relationship between presidents Xi and Trump given that it is

China that has the power to influence the North Korean regime should it choose to exert it.

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Ian Hargreaves, manager, Invesco Asia: With Asian markets having recovered strongly since the lows in February 2016, valuations are now less attractive than before. In particular equal-weighted average valuations in Asia ex Japan are now close to 17x 2017 earnings. This is towards the upper end of the range since the global financial crisis. In our view, this means that further sustainable market performance will be more reliant on an improvement in earnings momentum. Since late 2016, consensus 2017 earnings for Asia ex Japan have been revised up by 7%. To date, the earnings improvement has been mainly concentrated in the materials, energy and technology sectors and to a lesser extent financials. With the exception of technology, where insufficient supply of memory chips is the cause, the re-acceleration of the Chinese economy has been the dominant driving force. This, in turn, has resulted from an easing in monetary policy and rapid credit growth. Since the end of 2016, however, the Chinese government has expressed increased concern about overheating in areas of the property market and high leverage in parts of the non-bank financial sector. An important factor is credit impulse relative to GDP and the authorities have already tightened credit conditions. This will likely lead to a moderate slowing in Chinese economic growth in coming months and a peak in earnings momentum for the sectors that rely heavily on Chinese growth. The strength in a number of Asian currencies versus the US Dollar since the beginning of 2017 will be an additional drag on future earnings growth.

In our opinion, India is differentiated in two ways from other Asian economies. Firstly, it is one of the only economies at the trough of its credit cycle. It has seen a negligible increase in leverage over the last 10 years, a period during which most other Asian economies have seen large increases in debt levels. It currently has the lowest credit growth for 30 years as the banks deal with bad debts resulting from the infrastructure lending boom of the last decade. This is leading to relatively subdued economic activity, weak private investment and low earnings momentum. However, India's position in the credit cycle suggests there are fewer constraints to growth in the longer term as compared to other Asian economies. Secondly, under the stewardship of Prime Minister Modi, India has the best reform momentum amongst the countries we invest in. There are headline grabbing reforms such as the introduction of a unified goods and service tax, demonetisation, the use of technology to distribute subsidies and reforms in the real estate sector. However, there is also evidence of better execution in the day to day operation of the bureaucracy and a gradual assault on the small scale corruption that acts as a friction to economic activity. We continue to like the private banks in India. Representing only 30% of lending in India, these banks still have great potential to gain market share from the government banks which struggle to compete on customer service, efficiency and credit appraisal.

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Europe

(compare European funds [here](#))

Francesco Conte and Edward Greaves, managers, JPMorgan European Smaller Companies: Fears of an impending populist uprising in Continental Europe have so far proven unfounded as the Dutch and French voted overwhelmingly for centrist

parties. Moreover, more recent opinion polls in Germany now expect Chancellor Merkel to win a fourth term. Mr Renzi, the newly elected Secretary of the centrist Italian Democratic Party, is also leading in the polls after several months of trailing the populist Five Star Movement party.

The synchronised global economic recovery is gaining traction, central banks remain supportive and we are seeing earnings growth in Europe accelerating for the first time in a number of years.

While we are fundamentally positive for the rest of the year, short term our enthusiasm is tempered by the more than 20% rise in markets since the November lows, with barely a pause for breath.

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AR Irvine, chairman Montanaro European Smaller Companies: Last year, we noted that the outlook - supported by low interest rates, an improving employment situation and benign inflation - was encouraging. This remains the case today. Valuations are not categorically cheap but nor are they extreme. Indeed, compared to other developed stock markets, such as the US, stocks in Europe appear to offer relatively good value. It is likely that next year will bring further political surprises.

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Japan

(compare Japanese funds [here](#))

Alan Clifton, chairman, JPMorgan Japan Smaller Companies: Growth in Japan's economy is picking up amid strong evidence of improving conditions in the United States and Europe, and better trading too in most of those emerging economies which are important to Japanese companies. There are longstanding constraints on the pace of growth in Japan - including ageing demographics and relatively weak standards of corporate governance - but these are well known and are being successfully addressed by reform initiatives and thoughtful legislation. A set of 'work-style reforms', for example, will come into force soon which will limit excessive overtime, provide for equal pay for equal work, encourage work beyond normal retirement age and so on. Further, recent corporate governance reforms are already resulting in better capital management and shareholder returns.

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Shoichi Mizusawa, Nicholas Weindling and Eiji Saito, managers, JPMorgan Japanese: Japan's economy continues to expand at a reasonable pace, although the growth rate remains constrained by the demographics. We believe that the global economic growth will accelerate as fiscal policies turn from a headwind to at least neutral, and possibly to a tailwind. The strong growth is broadening beyond the US to Europe and the emerging economies. Encouragingly, earnings expectations have been improving across regions and sectors after several years of earnings recession in Europe and emerging markets. Our base case is that corporate earnings in aggregate will grow strongly in 2017. Corporate governance reforms in terms of better capital management and shareholder returns, combined with unwinding of cross shareholdings, are slowly but steadily taking hold. Listed companies generally have healthy balance sheets and can afford much higher payout ratios. The valuations are not at all demanding in our opinion. The TOPIX trades on around 14x prospective

earnings and 1.2x book value, and is cheap relative to its own history and relative to the rest of the world.

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Harry Wells, chairman, CC Japan Income & Growth: In today's challenging low interest rate environment, we consider that the income potential from Japanese companies is still widely underrated despite strong evidence to the contrary. Shareholder returns have improved radically since the depths of the financial crisis. A recent review of the 2016 fiscal year ending in March 2017 by Nomura Securities estimates that year-on-year aggregate dividends for listed Japanese companies rose almost 10% and total shareholder returns, as measured by the combination of these dividends and company share buybacks, increased by 3.1%. This was a record for the fourth consecutive year. Although the total value of shares repurchased fell year-on-year, the number of companies implementing buyback programmes rose to a new high. This reflects the broader commitment amongst corporate managements to improve shareholder returns with dividends as a key component of sustainable distribution to investors.

The attention of international investors is often drawn to the headline grabbing shenanigans at companies such as Sharp, Toshiba or Takata. The attractions of companies in Japan with competitive business models, strong finances and clearly communicated shareholder return policies are regularly ignored.

Recent changes to the Japanese Corporate Tax Code have introduced a potentially significant incentive for companies seeking to restructure their operations. Under certain conditions independent business units or subsidiaries will be permitted to be spun off without incurring capital gains tax. This raises the possibility of increased corporate activity as a route to realise the value that exists within many inefficiently managed group companies.

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North America

(compare North American funds [here](#))

Andrew Bell, chairman, Gabelli Value Plus+: Since the middle of 2016, there has been increased evidence of an improving and broadening recovery in the global economy. The period of falling corporate earnings, centred on the natural resources sectors, also ended during 2016. Much of the rally in global equity markets over the past year can be ascribed to these two factors.

In addition, investors have responded positively to the hope that a Trump Presidency would be associated with a reduction in regulations and cuts in corporate and possibly personal taxation. Although some of the post-election enthusiasm has been tempered by the realisation that achieving consensus on reforms will be difficult, within the constraints of the budget setting process, there remains a belief that the U.S. economic recovery, which has been more resilient than growth in many other developed economies, will achieve some impetus from fiscal policy in 2017-2018.

Offsetting this is the reality that the U.S. Federal Reserve has started to raise short term interest rates and will likely raise them further. Whilst this process seems likely to be gradual, aimed at controlling the speed of the economic cycle rather than bringing

it to an end, it does represent a headwind for the U.S. stock market as a whole, which is widely viewed as highly valued by historical standards.

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Gabelli Value Plus+: While the last fiscal year was marred by continued unrest in the Middle East and terror incidents around the world, the U.S. election dominated the national consciousness to such an extent that it impacted American football ratings and retail spending. A conclusion to this quadrennial process (some might say ordeal) and greater political certainty would likely have sparked a market rally no matter who was elected, but the 10% rise in the S&P 500 since 8 November 2016 has the potential to rank as the largest post election market move for a new U.S. President since the 1961 inauguration of John Fitzgerald Kennedy. The so-called Trump rally has been fueled by the potential for increased fiscal stimulus, lower corporate and individual taxes, and deregulation. Taken together, these elements could drive U.S. GDP growth well above 2%, deferring the inevitable end to the current ninety plus month old expansion in the United States.

Corporate tax reform has been on the Washington agenda for many years, but with the Executive and Legislative branches in the hands of one party, it could finally become a reality. With many details to be reconciled, a reduction in corporate tax rates from 35% to 25% or even lower, combined with a change to the current global system that taxes profits wherever they are earned, should lead to higher earnings. Similarly, a reduction in individual tax brackets and rates has the potential to stoke consumption and increase the incentive for work. Both of these reforms will have to be accompanied by offsetting limits to deductions, including the potential elimination of the deductibility of corporate interest expense, which could have broad consequences and somewhat limit the impact of lower rates. Increased fiscal stimulus in the form of increased infrastructure and defense spending should also boost GDP growth, but may also be limited by Republican concerns about the size of the deficit and the practical scarcity of shovel-ready projects. Finally, a rollback in the regulatory creep of the Obama years seems most assured. A redesign of the healthcare system, a loosening of rules governing the banking system, a lighter touch toward Internet regulation, a different approach to domestic energy production and transportation, and a more accommodative vision for anti-trust enforcement appear to have awakened the animal spirits of the business community.

Trump will make mistakes, as all Presidents do. For better or worse, the U.S. Constitutional system, with the checks and balances of Congress and the Courts and power dispersed through the states, modulates change by design. As we witness the evolution of Candidate Trump into President Trump, he has gathered some controversial but well seasoned advisors, and seems humbled by the majesty of the office. Three areas bear continued watching. Protectionism is bad for consumers and businesses alike, but "free" trade is not always "fair" trade, and it does not mean that the President should not attempt to negotiate better deals with America's trading partners. Second, a geopolitical flashpoint is a near certainty over the next four years - how will Trump balance a desire to project a strong America with a distaste for foreign entanglements? Lastly, it is worth noting that candidates who are populists are usually not unwaveringly pro-business; CEOs in all sectors should be alert for Twitter bombs, the modern form of jawboning, such as those lobbed by the current President at the pharmaceutical industry and several defense contractors.

President Trump has inherited several interrelated macroeconomic shifts that were already in motion before the election and accentuated by its aftermath: higher interest rates, a stronger dollar, and increased inflation expectations. The ten year U.S. Treasury note rose from a low of 1.4% in July to 2.2% (at this writing) while the dollar has strengthened against its trade weighted basket. The Federal Reserve ("Fed") has

signaled a willingness to raise rates multiple times in 2017. A divergence in monetary policy from still dovish central banks in Europe and Japan, not to mention a potential fraying of the European Union, will continue to propel the dollar and reduce the competitiveness of U.S. exports, an outcome neither Chair Janet Yellen nor the new administration will relish. A tightening labor market and the promised fiscal stimulus may, however, force the hand of the Fed. With all else equal, higher interest rates and accelerating inflation are bad for all asset classes, including equities. But all else is never equal. The question is whether GDP, and consequently earnings growth, will accelerate enough to overcome the natural governors of higher rates (felt in the form of higher borrowing costs) and inflation (felt in the form of reduced purchasing power). Put simply, earnings estimates for the S&P 500 Index may be revised upward, but may not overcome the pressure of a reduction in the market multiple which at over 17x is already above historical norms.

Although the 2016 U.S. Presidential election has left prognosticators abashed, 2017 promises to be another eventful year, with key votes among several European Union members and the unfolding of policies at home. Those who bemoan the election of Donald J. Trump should take solace, and those who cheer his election should take pause - the President's authority extends only so far. Neither the economic cycle nor the curse of demographics can be repealed, and factors such as interest rates, debt levels, and productivity respond only marginally to the party in power. America remains great, but could always be better.

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Emerging markets

(compare global emerging markets funds [here](#))

Carlos Hardenberg, manager, Templeton Emerging Markets: The general landscape of emerging market corporations has undergone a significant transformation from the often plain vanilla business models of the past (tending to focus on infrastructure, telecommunications, classic banking or commodities) to a new generation of innovative companies that are moving into technology and higher value added goods and services. The information technology ("IT") sector represents over 24% of the MSCI Emerging Markets Index: in fact, the top four constituents by weight are IT companies (as of March 2017). Further, this is a larger weighting than information technology's proportion of the United States index. In comparison, in 2008, IT companies represented about 7% of the MSCI Emerging Markets index. Furthermore, we are starting to see the establishment of globally represented brands originating from emerging market countries.

China's economy remains on a fast growth trajectory and is expected to grow by 6.5% in 2017. [In India] growth is still expected to be 7.2% in 2017 and accelerate to 7.7% in 2018, making India one of the fastest growing major economies in the world. The country also recorded better than expected fourth quarter 2016 GDP growth of 7.0%. We continue to favour companies that we feel are well placed to benefit from higher per capita income and growing demand for goods and services, which, in turn, should support the earnings growth outlook for those stocks.

The Russian economy is expected to return to growth in 2017, after two consecutive years of contraction, supported by a rebound in oil prices coupled with recoveries in mining, manufacturing and agriculture. Energy, financials and IT companies continue

to look attractive due to their appealing valuations. Higher oil prices and technological developments could further support the earnings recovery of these sectors.

We believe the recent improvement in emerging market fundamentals should be helpful for continued strength in emerging market equities, and we also believe valuations in these markets appear attractive relative to developed markets. Nonetheless, we are mindful of potential volatility and remain alert to risks, some of which include the potential of further increases in US interest rates, uncertainty about the new US administration's policies, and potential currency moves.

Strengthening macroeconomic data including acceleration in domestic consumption, a revival of private investment, a recovery in export demand and easing concerns about trade friction with the US bode well for Chinese equities. After the tightening of capital outflows by the People's Bank, the Chinese renminbi has also seen some stability against the US dollar. The earnings outlook for corporates also appears positive as many companies could benefit from reflation in the industrials sector and recovery of capital expenditure. However, we remain mindful of the fact that China is still in the process of making adjustments in its policy framework. The growth of shadow banking, the presence of high leverage in the system and regulatory objectives on ensuring stability in the system, mean that we may see strong policy response from China which could impact growth and have implications on various sectors including commodities and real estate.

The Company maintains a positive view on technology hardware and semiconductor stocks in South Korea and Taiwan. Although we are cautious of the share price advances in some shares, we continue to see pockets of value in the sector. The information technology sector has been growing in importance in emerging markets, and is becoming more integral and competitive. In addition to internet companies, which stand to benefit from a movement toward more online transactions, we see potential for attractive long-term investment opportunities in the following areas: shopping, gaming and other services, hardware companies providing application processors and memory chips for smartphones, graphic processing units for data centres and artificial intelligence applications, as well as connectivity and processor integrated circuits for autonomous cars and devices related to the "Internet of Things."

We also think opportunities still exist across the energy sector. Overall, we believe oil companies with upstream operations are best positioned to benefit from higher oil prices, and we remain positive on a number of companies in China, Russia, Thailand, Pakistan and India. Over the longer-term, higher oil prices could result in a potential increase in supply from a number of areas such as more shale producers, increased drilling activity around the world, and/or a production increase by low-cost producers to support fiscal revenues.

In Brazil, strong momentum on reform in both macroeconomic issues (government debt, pension deficits, labour reform) and across economic sectors focused on improving the business environment provides reasons for optimism. Additionally, the economy is recovering from two years of GDP contraction. Therefore the base of growth is very low, allowing strong operational advantage with even a small upturn. Taking that into consideration, we believe Brazil is likely to continue to cut interest rates this year, allowing strong financial leverage to consumers and companies.

Emerging markets are generally in a recovery mode. Low borrowing, improved current accounts, robust exports, progress in corporate earnings, and stabilising industrial production and exchange rates are reasons to be confident. Overall, we believe that emerging markets are on course to continue their recovery based on robust and improved economic fundamentals. Valuations have not been this low,

relative to developed markets, in many years and we are seeing attractive opportunities for investors.

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John Rennocks, chairman, Utilico Emerging Markets: We have made the point for some time that markets in general remain outside normal historic parameters. From a monetary policy perspective, we remain in an environment where unconventional tools are deployed, such as negative interest rates in a number of countries and Quantitative Easing ("QE") is still being implemented in both Europe and Japan.

From a political perspective, we continue to witness a rise in populist politics with a move away from established parties and candidates as voters seek change. We are also witnessing an increase in geopolitical tensions in places such as North Korea and Turkey.

All of these factors individually and collectively create uncertainty and ultimately could lead to negative implications for markets. As such these issues are a concern from an investment perspective.

However, despite this uncertain backdrop, it is encouraging to see that most economies, including those in emerging markets, are still delivering positive GDP growth with low inflation which should be positive for markets. Furthermore, we continue to see positive reform policies being implemented in many emerging markets, including India, Argentina and Brazil.

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Aberdeen Asset Managers, managers, Aberdeen Emerging Markets: With the emerging markets index having rallied some 60% from its low point in January 2016 it is worth pausing to take stock of the prospects for further gains. It should be highlighted that returns were flattered to some extent by the sharp depreciation of Sterling post 2016's Brexit referendum, which boosted returns from all assets denominated in foreign currencies. It should also be noted that the strong recent performance came after a lengthy period of consolidation during which emerging market equities traded sideways for much of the earlier part of this decade.

As for the fundamental outlook, we take comfort from the fact that many of the issues that had proved to be headwinds for emerging markets in the earlier years of this decade have abated, with currencies stabilising, global growth and trade strengthening, corporate earnings revisions improving and flows from foreign investors recovering. While valuation metrics have risen, they remain in line with long term averages and, more importantly, stand at significant discounts to those of developed markets. While remaining conscious of the political and economic risks in both a global and domestic context we believe that the investment case for the asset class remains attractive.

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China

(compare Asian single country funds [here](#))

Dale Nicholls, manager, Fidelity China Special Situations: On the whole, China has showed signs of economic improvement reflected in a clear acceleration in nominal GDP growth. The biggest overhangs to sentiment towards China have been

falling economic growth, oversupply in 'old China' industries like steel and coal and the rapid acceleration of credit growth. The government has embarked on a supply-side reform programme that has had meaningful impact. For example, coal mines and steel mills have cut output, which has helped trim some of the oversupply in these sectors, a factor supporting the move of the Producer Price Index ("PPI") into positive territory for the first time in over four years. This has played a role in economic stabilisation as demonstrated in the reported GDP growth of 6.9% in Q1 2017.

The growth in credit remains my greatest concern and so I am encouraged by increased efforts by regulators and The People's Bank of China ("PBOC") to address this, particularly in the shadow banking areas. Growth in corporate debt has clearly slowed. On the issue of reform in general I am hopeful of a renewed focus following the major political transition taking place towards the end of this year. With the majority of the Standing Committee members of the Politburo changing, I believe we will see improved prospects for more reform-minded leadership.

Looking ahead, I remain positive on the investment opportunities that I see in the market in China. Challenges remain but it continues to be a dynamic economy and market, with huge variation in trends between the winners and losers. While the market has moved up, valuations on the whole remain compelling in a global context. One wonders if what has become a relatively stable and predictable policy environment compared to much of the West might also start to get reflected in valuations. The gap between China's share of the global economy and its share of global stock markets remains significant, and I remain confident this will close over time. It is a matter of time before A-shares move into global indices. The prospects for an acceleration in the reform process are also improving.

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India

(compare Asian single country funds [here](#))

Hasan Askari, chairman, Aberdeen New India: India remains a domestically-focused economy, and this insulates it from much of the global volatility that affects other emerging markets. However, it is not completely immune to the shifting patterns of world trade, a revival in US protectionism or changes in commodity prices. In fact, a higher oil price is a key risk for Indian corporates, as it could aggravate costs and put pressure on margins, while visa restrictions could adversely hit outsourcing companies in the IT sector.

At home, from Aadhaar (a nation-wide identity card) to a new bankruptcy code, from GST to the now-institutionalised MPC, the Modi government continues to make good on some of its pledges to liberalise the Indian economy and ease the cost of doing business. Demonetisation has been a significant long-term positive for the country despite the short-term pain. It has created an opportunity to clamp down on corruption, widen the tax net, bringing the informal sector into the fold, and adding momentum to becoming a cashless society. There may be some disruption when GST is first implemented, but most businesses seem optimistic that it will help improve logistics and cut costs in the long term. However, both consumer spending and capital investment remain muted and some structural reforms such as bank recapitalisation have not been addressed as yet. Nevertheless, the overall economic outlook is positive and should present investors with periodic opportunities to add to their current positions.

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Aberdeen Asset Management Asia Limited, managers, Aberdeen New India:

GST is set to be rolled out on 1 July, with scope for cost-savings particularly for cement producers. Aside from lower taxes, they will be able to sell cement freely across state boundaries and reduce their depots significantly, as deliveries will go directly to distributors. Similarly, fast-moving consumer goods companies could also reap savings in logistics and distribution costs.

Next, demonetisation appeared to have caused some initial disruption to earnings, but the worst seems to be over. Admittedly, sluggish demand could continue to weigh on earnings for another quarter or so.

Meanwhile, recent company visits showed an upbeat mood, although they see rising oil prices as a key inflation risk. More broadly, we have yet to see an improvement in revenue growth, while a recovery in private-sector capital expenditure remains elusive, given excess capacity and funding concerns.

Finally, we thought that the 2017 union budget was a sensible one, sticking to fiscal targets and helping rural consumers and small to medium enterprises cushion the short-term impact of demonetisation. A greater commitment to spending on infrastructure and the rural economy should benefit companies in the materials sector. Separately, the cigarette tax hike was lower than expected, while the tax net was cast wider to draw in companies that produced bidi (a local tobacco product).

Globally, we are seeing signs of a recovery in trade and exports, although geopolitical risks remain a key concern for financial markets. On the domestic front, leading indicators paint a rosier economic picture. The impact of demonetisation is fast waning. Manufacturing appears to be turning around, though private investment remains sluggish. Inflation risks mainly revolve around a potentially poor monsoon and the one-off effects from GST, but easing crude prices could alleviate cost pressures. Encouragingly, Prime Minister Modi is making great strides in improving the regulatory framework and facilitating the ease of doing business, backed by a stronger political mandate. Such reform commitment is positive for the long-term growth of the country, albeit there are still structural challenges, particularly resolving stressed assets and weak balance sheets in the banking sector. Against such a backdrop, India remains one of the best places for stock pickers. It offers a diverse range of companies with good fundamentals that can take advantage of the untapped growth potential of a vast market.

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Biotech and healthcare

(compare biotech and healthcare funds [here](#))

Samuel D Islay, manager, Worldwide Healthcare:

Large Capitalisation Pharmaceuticals

Currency effects notwithstanding, global pharmaceutical stocks posted mostly modest gains in the year. Whilst the New York Stock Exchange ARCA Pharmaceutical Index (DRG) returned over 21% sterling terms, the return in local currency was a more subdued 5.6%. The U.S. Presidential election remained both an overhang and a

headwind that significantly diminished the appetite of investors to bet heavily on the sector. Moreover, with the broader markets outpacing the pharmaceutical sector by over 10.0% in the period (in local currency), investors preferred to dine at smorgasbord of financials, technology, materials, industrials, and energy over pharmaceuticals.

Looking ahead to 2017, we expect the group to resume trading on fundamentals instead of macro concerns. This should be a positive for the group as we anticipate a multitude of catalysts going forward. First and foremost is positive earnings momentum as revenue headwinds from patent expirations are currently at an ebb. New product launches over the past three years have been robust and we see important inflection points ahead for many companies in this universe. Additionally, important catalysts should play out in the coming year in oncology, cardiovascular, immunology, rheumatology, and neuroscience, just to name a few. Finally, we expect important legislative news flow about putative tax reform in the United States which could trigger a business development shopping spree for large capitalisation pharmaceutical companies, fattening their pipelines and their valuations.

On the regulatory side, the environment for new drug approvals continues to be favourable. President Trump has said repeatedly that he would like to expedite the approval of new drugs, and his nominee to head the FDA, Scott Gottlieb, is regarded as industry-friendly. Once there is more clarity about President Trump's plans for drug prices, we would expect therapeutic stocks to recover in a more convincing way.

■ Biotechnology

Whilst much of the healthcare sector remained range bound heading into the U.S. Presidential election in November 2016, perhaps none was more affected than biotechnology stocks. Fears over a potential Hillary Clinton victory and her proposed policies to reduce drug prices continued to act as an overhang on the sector.

The surprise election victory of President Donald Trump briefly catalysed a relief rally in biotechnology, sending the Nasdaq Biotechnology Index up 9% (local currency) on the day after the election. Investors perceived the Republican sweep of the presidency and both chambers of Congress as a more favourable outcome for the drug industry than a Democratic victory, as it appeared to lessen the likelihood of any dramatic government action to control drug prices. Indeed, President Trump's platform had largely been based on jobs, trade, taxes, and national security rather than lowering prescription drug prices. Nevertheless, there is some uncertainty about specifically what President Trump intends to do with his healthcare policy going forward, including the "repeal and replace" of Obamacare, or the Affordable Care Act (ACA).

Despite some remaining opaqueness in Washington D.C., the fundamentals of biotechnology companies remain strong. Innovation continues, with companies such as Biogen, launching a new product Spinraza (nusinersen) for spinal muscular atrophy and Amgen, announcing positive results from a cardiovascular outcomes trial of their cholesterol-lowering drug Repatha (evolocumab). Innovation from emerging biotechnology companies also remains strong. For example, we should see new product approvals in the gene therapy space (for blindness) and the anti-cancer therapeutic known as CAR-T.

Valuations of large-capitalisation biotechnology companies remain very reasonable, even though earnings growth has slowed as the revenue bases of the companies have gotten larger. Valuations are seen by many investors as sufficiently compelling that an acquisition of a large-capitalisation biotechnology company by a larger

pharmaceutical company would not be surprising. Additionally, Republican plans to institute a tax repatriation holiday should allow large-capitalisation U.S. biotechnology companies to repatriate overseas cash at a reduced tax rate, increasing the cash balances they have to make acquisitions of smaller biotechnology companies and add assets to their pipelines.

■ Specialty Pharmaceuticals

Branded drug franchise pricing concerns have plagued specialty pharmaceutical stocks over the past year and were a major reason behind the group's lacklustre performance. Although the pricing environment remains challenging, the outlook for specialty pharmaceutical stocks, in general, looks fairly bright with several names poised for recovery. Current valuations largely reflect expectations of reduced pricing power, allowing investors to better appreciate the varied strategies employed by companies in this group. Over time, we believe investors will increasingly reward players with durable franchises and attractive growth profiles. We also anticipate that a greater focus on proprietary pipelines will drive increased interest. In our opinion, proprietary pipelines for certain companies remain significantly undervalued, setting the stage for share price outperformance upon favourable data disclosures. As a result, we view a select group of companies with significant pipeline disclosures over the next 12-15 months as particularly attractive.

In Europe, we have become more constructive on a select group of companies benefiting from improving trends, new launch cycles, and increased M&A activity. We expect M&A to remain a dominant theme, especially with recent sector devaluation, as players continue to pursue creative business combinations driven by potential revenue, operating and tax synergies.

■ Generic Pharmaceuticals

There was a significant correction in generic pharmaceutical stock prices over the year. Uncertain dynamics in the U.S. generic drug market made investors wary of the sector. Significant and sustained pricing erosion, stemming from the consolidation of pharmacy and wholesaler distribution channels, has destabilised large-scale and niche generic players alike, resulting in reported earnings shortfalls, downwardly-revised revenue and earnings forecasts, worsened leverage ratios, and depressed valuations.

In Europe, market conditions for generic companies were somewhat better. Some sizable markets like France, Italy, and Spain demonstrated better growth potential as generic utilisation ramped up from relatively modest levels. In these markets, pricing erosion was more moderate and largely in line with expectations, in stark contrast to the rapidly deteriorating conditions observed in the U.S.. Throughout Asia, economic expansion, favourable demographics, supportive governmental policies, and other contributing factors continue to drive robust generic utilisation throughout the region. In contrast, the Japanese generic market saw decelerating volume growth and extreme pricing concerns.

Looking ahead, recent commentary from both a large global generic company and a major wholesaler leads us to believe that U.S. market dynamics could deteriorate further over the next few quarters. Thus, large global generic companies appear best-positioned within this sector. We believe solid performance in key European and Asian markets could offset weaker U.S. performance for the large diversified players. We anticipate further consolidation of the generic industry; however recent

transactions indicate that unfavourable U.S. dynamics have impaired acquisition premiums.

Medical Devices

Entering 2016, our collective view on the Medical Devices sector was notably more positive than at any point in the past several years. That view remains unabated as we look ahead to 2017, with new product innovation in cardiology, orthopaedic extremities, and surgical robotics poised to unleash a new wave of revenue growth for the sector in the 2018-2020 timeframe.

The macro environment is stable, with healthy procedure volume growth providing stability against normal (but importantly not intensifying) pricing pressures. Political headwinds are navigable: the sector is largely insulated from potential healthcare reform given much greater exposure to Medicare covered lives vs. commercial, and tax reform represents a solid tailwind for the majority of companies. M&A remains a key theme for the sector, with further large acquisitions still possible and ample opportunity for portfolio rationalisation, divestments, and smaller tuck-in acquisitions.

Against this backdrop, we continue to favour companies with differentiated growth profiles in durable sectors such as cardiology, where transcatheter heart valve market growth and several other emerging product categories are promising, surgical robotics which is gaining further traction and recognition as a replacement for surgery, and orthopedic extremities implants/biologics which offer uniquely strong revenue growth in the orthopaedic industry.

Healthcare Services

Exposure to Medicaid Health Maintenance Organisations (HMOs) in the U.S. was significantly reduced after the recent Presidential election. These companies were big winners under the ACA, benefiting from accelerating patient enrollment in their plan offering and earnings growth as many U.S. states expanded Medicaid eligibility under the law.

However, those tailwinds are over and going forward we foresee operational headwinds for Medicaid HMOs under the Trump administration, including potential "repeal and replace" of the ACA, including block grants (also known as funding cuts).

We are bullish on commercial and Medicare HMOs, because ACA-related taxes and regulations will be "repealed" and "replace" would further privatise Medicare. There are also macro catalysts for these stocks like corporate tax reform (100% domestic business) and rising interest rates. We remain cautious on the drug supply chain including distributors and pharmacy benefit managers due to deteriorating fundamentals highlighted by decelerating drug price inflation and intensifying competition.

Life Science Tools / Diagnostics

For 2017, we expect the sector to continue to benefit from relative uncertainties and volatility of bio-pharma as drug pricing rhetoric in the U.S. possibly lingers with unclear pathway forward. Kicking off this year, we are seeing early signs of recovery in the cyclical industrial end market, which has been a drag to the overall growth profile of the industry for the past few years. Additionally, new product cycles in genomics continue to grab investors' interests. In particular, new products that can proverbially "move the needle" could drive valuations higher.

That said, forward looking valuations of the sector should, and will, be debated. The current premium versus the broader market and other healthcare sub-sectors remains elevated. We expect this trend to continue. But with stretched balance sheets and rising interest rates environment, expectations of large transformative deals should be muted.

Defensive bids, generated by stability in end markets, should allow current valuations to be sustained in the near term. However, looking at the sub-sector holistically, a dose of caution is necessary given premium valuation. We remain neutral in the sector but select exposure to product cycle names is warranted.

Emerging Markets

Emerging markets continue to offer healthcare companies with superior growth prospects than many companies in the West, driven by aging demographics, rising income levels, and an expected increase in the proportion of GDP spent on healthcare.

In China, in the pharmaceutical space, the Chinese government has been undertaking reforms to increase the quality of drugs sold in China and improve the robustness and efficiency of their drug approval system. To improve the quality of medicines in China, the government is mandating bioequivalence testing for many of the generic drugs currently marketed in China to confirm that they truly have equivalent efficacy to the original brand. The government is also discouraging use of so-called "adjuvant" drugs, which account for the majority of hospital drug use yet have little to no clinical data demonstrating their efficacy. We expect these initiatives to reduce the number of low-quality drugs in the Chinese marketplace, which should reduce pricing pressure in the space. On the regulatory front, the Chinese FDA (CFDA) has been criticised for being slow to approve new drugs (typically taking multiple years rather than the U.S. FDA's target of a year or less). To clear the extensive backlog of drugs pending review at the CFDA, the agency asked all pharmaceutical companies to certify the clinical data integrity of any pending drug applications at the agency. Any drug sponsors found to have applications with deficient clinical data quality would be sanctioned by not having any of their future drug applications accepted or approved by the agency for a period of time. As a result of this stringent self-certification requirement, the vast majority of pending drug applications were actually withdrawn from the CFDA. In addition, the CFDA has instituted a priority review programme which accelerates review of innovative drugs in certain therapeutic areas of unmet medical need. All of these policies should benefit high-quality drug companies developing innovative drugs.

While we expect pricing pressure to persist, we believe volume growth should allow companies to continue to deliver strong earnings growth, especially those companies with innovative products that are less susceptible to competition.

In the private hospital sector, the government has been encouraging more private investment in hospitals. Unlike drug companies, private hospitals do not face the same headwinds stemming from pricing pressure due to drug tenders.

In India, our strategy remains to invest in high quality generic companies with compliant manufacturing and specialty/differentiated products. Over the course of the year, the FDA continued to inspect the manufacturing facilities at many Indian generic manufacturers, resulting in the identification of deficiencies that in some cases led to temporary plant suspensions. While we expect the FDA inspections to continue, we would expect the leaders in the Indian generics industry to remedy any manufacturing deficiencies identified, resulting in a long-term improvement in manufacturing quality

for the Indian generics industry overall. One headwind that has weighed on the Indian pharmaceutical industry is the pricing erosion seen recently in the U.S. generics market, which will affect Indian companies with U.S. exposure. We believe new generic launches can mitigate this impact.

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Environmental

(compare environmental funds [here](#))

Michael Naylor, chairman, Jupiter Green: Last year the world was celebrating what had been achieved in Paris and through much of the year, we watched in wonder as the Paris Accord was ratified far earlier than many had expected. Our fears that the Trump administration would withdraw from the Paris Accord came to realisation in early June. The White House stated America will follow the lengthy exit process outlined in the deal, meaning it will remain in the agreement (at least formally) for another three-and-a-half years - taking us right up to the next presidential election in November 2020. However, it is worth noting that many of the Paris Accord's key stakeholders remain steadfastly committed to seeing it through - not so much for political reasons but for the hard fact that issues like pollution and environmental degradation are already having a profound impact on many communities around the world. It therefore seems likely that demand for environmental solutions will remain strong despite the political backdrop in the US, even if this demand is hindered somewhat in the short term. Additionally, advances in technology are leading to lower costs, which are disrupting markets for mainstream counterparts. Notwithstanding current political uncertainty, this process is likely to remain supportive of the long-term structural changes in the global economy.

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Charlie Thomas, manager, Jupiter Green: There is little doubt these are challenging times when it comes to the political backdrop for environment investing and we will continue to watch the Trump administration's climate policies closely. His pledge to "make America great again" seems to involve an attempt to boost the US coal (and wider fossil fuels) industry. However potential benefits of his policies to the coal sector may prove particularly short-lived given how uneconomic this industry has become in the era of cheap gas and disruptive renewable energy. It is worth highlighting that his federal policies may not be matched at the state level where some 29 states have legal renewable portfolio standards, while a further eight states have voluntary systems in place. So long as the wind power tax credit scheme remains in place, onshore wind power in the US will remain a commercially attractive energy choice, alongside gas.

At the time of writing the implications for the Paris climate accord, which was hastily ratified only a few weeks before the election, were unclear. To pull out now could potentially come at a high economic and political, as well as environmental, costs for the US. The accord's other stakeholders are standing firm in their resolve and the US could be left behind in the technological revolution happening in the areas of renewable energy and energy efficiency. Time will tell whether the economics of this technological revolution will give the President pause for thought when it comes to the Paris Accord. Moreover, in his first 100 days in office, the President has learned a hard lesson about the limitations of his position and there is growing scepticism about other key aspect of his policy agenda, including his spending and tax plans. As

investors, we have to heed this lesson too and be careful not to get carried away with overly optimistic or pessimistic prognoses about Trump's potential economic impact.

Despite the uncertainties presented by the new US administration, we believe the investment case for renewables remains unblemished and the recent operational performance in the US is testament to that. This is one sector that has long been subject to the influence of the prevailing political backdrop and as investors we have had to remain cognisant of the potential for changes in support due to shifting regimes.

Overall, while the political noise coming out of the US may be unfavourable and may create some headwinds, this must be viewed in a global context where we continue to see growing opportunities, most notably in Europe and Asia where the political and economic imperatives for addressing environmental issues are increasingly apparent. We believe our longer-term investment thesis remains intact and that the structured push towards a more sustainable global economy is continuing apace.

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Private equity

(compare private equity funds [here](#))

Howard Myles, chairman, Aberdeen Private Equity: In my 2016 Half Yearly Report I expressed some concern over the uncertain policy direction in the US given the then imminent US election and also noted our caution on the Eurozone, due to continued growth issues in this region.

The outcome of the US election is now known, though uncertainty remains in a number of areas. Despite initial setbacks on dismantling 'Obamacare', the House of Representatives has now voted to dismantle the Affordable Care Act, with potential sweeping changes to the US Healthcare system. However, it remains to be seen whether the President will secure sufficient support in Congress to carry out other parts of his programme.

In Europe, political volatility seemed to ease after the May 2017 French Presidential vote and the calling of a snap UK general election for June 2017, where it was widely expected that Prime Minister May would prevail with an increased majority. The subsequent 'hung-parliament' result will probably lead to a change of approach to UK/EU Brexit negotiations (from both sides), increased volatility for sterling in the shorter term, and almost certainly further change in the UK political landscape. Slightly tempering this volatility, and looking further afield, the failure of Italy's main parties to agree on a new election law, could mean that Italian elections are now pushed out further to 2018.

Private Equity as an asset class has continued its strong post Global Financial Crisis run with further buoyant fund raising. With the substantial capital raised by PE funds in 2016 it is of little surprise to see the value of older, unspent private equity commitments ('dry powder') continue. In 2016 the value of these unspent commitments was estimated at \$821bn. Much of this relates to mega sized LBO funds. Purchase multiples have remained at historically high levels, and while they appear to have decreased from their recent highs in 2015 and 2016, they remain expensive at 9.4x EBITDA.

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Alexander Barr & Colin Burrow, managers, Aberdeen Private Equity: More recently global markets have been characterised by lower volatility driven by a variety of factors, the most significant is likely to be the combined 'relief-trades' post the recent US and French elections, with the belief that there was some certainty that Brexit would happen. As the Chairman notes in his review, the unforeseen 'hung-parliament' result from June's UK General Election has significant implications for not only the timetable for the UK's exit from the European Union, but also the 'soft' vs. 'hard' nature of that exit. In addition to this, and the inevitable change we are likely to see in UK politics, we expect greater shorter term volatility on key sterling currency pairs and some impact on UK and European public equity indices.

Specifically in the US, we have seen the VIX volatility index trading at historically low levels. These levels incorporate the 'pro-domestic' sentiment after Donald Trump's election (and of course all ongoing talk of extra-normal Russia relations and impeachment). During this period we have seen renewed levels of US equity buying, much of that seemingly from US retail investors.

We counsel some caution given these horizon risks (particularly on changes to the nature and timing of Brexit), but it is clear that US consumer and business sentiment has improved since the Presidential election, allowing the Federal Reserve to tighten with a 25bp hike in interest rates in March 2017. President Trump has brought a unique style to the Presidency, much of it highly controversial. Looking through that, our bias towards the US lower mid-market (in respect of our more recent US investments) should benefit from any pro-domestic corporate stance that is increasingly likely from this US Administration.

In emerging markets, Chinese GDP growth has edged up (to 6.8% in Q4 2016), but non-financial corporate leverage remains high and efforts continue by Chinese authorities to contain and reduce these levels. Asian markets and their private equity opportunities remain interesting to us and we are as focused on the macro issues as we are on GP due diligence, given the many risks.

Private equity valuations remain high, in absolute terms, though they continue to ease relative to aggregate highs recorded in 2015 (10.3x). Based on data from S&P LCD this level had fallen to 10x in 2016, and has slipped further to 9.4x (Q1 2017 data). Across our global investment programme we see a spread of valuations, but with our increased focus on smaller funds in more regional markets, we tend to see transaction multiples come in at below this level.

Calendar year 2016 has proved to be an extraordinary year for this asset class both in portfolio activity levels, investor interest and fund raising, the latter being a key litmus test for near term sentiment (but not necessarily for longer term returns). With \$347bn raised by 830 private equity funds closing in 2016 there is no shortage of capital in the sector. We note with interest the ongoing polarisation in the sector i.e. more dollars being raised by fewer funds. Relative to the above statistics, in 2015, 945 funds raised \$329bn. As this continues it is inevitable that dry powder levels will rise if the industry wants to keep valuations in some degree of check. Restraint and sensible paced deployment of LPs' commitments is to be lauded, though too great a delay will inevitably hurt headline IRRs over time.

With this polarisation, our greater concern comes with the levels of investor alignment and governance in larger funds. Good GPs (across all size brackets) are offering appropriate alignment, but it is by no means universal. We have seen relative (to fund size) levels of GP commitment fall, and for a number of high profile funds, the removal of hurdle rates, the latter creating some negative headlines for the industry, though we and many other LPs have worked hard behind the scenes to lobby for greater LP alignment via these other factors.

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Edmond Warner OBE, chairman, Standard Life Private Equity: On the back of three years of record distributions from private equity funds and increasing allocations to private equity, the fundraising environment in Europe and North America for leading private equity fund managers is strong as investors seek to deploy capital into the asset class. As a result, the global overhang or "dry powder" to be invested by the private equity funds has increased, however, available capital in Europe remains within historic ranges.

The value and volume of European buyouts continued to grow. Mid-market transactions remain the largest component, however, 2016 saw a marked increase in larger deals greater than EUR1 billion in value. 2016 continued to be a positive year for exits although both value and volume peaked in the first half of the period.

Average purchase price multiples for new investment activity continued to rise as a result of available equity capital and high levels of competition for quality companies. While debt markets continue to be supportive of private equity transactions, leverage remains below pre crisis levels.

Overall 2016 was a challenging year in the secondary market. Total volumes were down on 2015 with \$37 billion transacted and the quality of deal flow was relatively poor. As a result, the more attractive opportunities in mainstream or "plain vanilla" European and North American limited partnerships were priced aggressively. Deal flow was dominated by older "tail-end" portfolios and more complex fund restructuring transactions with only 5 deals of over \$1 billion announced. The combined effect resulted in a fall in average pricing.

A number of these pressures eased in Q1 2017 as activity levels increased due to a strong flow of larger transactions coming to market. While the combined dry powder targeting secondary trading has risen to record levels, the market is expected to become more balanced during the remainder of the year.

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Property

(compare UK property funds [here](#))

David Hunter, chairman, Custodian REIT: Recent experience has reinforced Confucius' time honoured maxim: "Wisdom is knowing you cannot predict the future". At the time of writing we are in the midst of an election campaign with a predicted, but not entirely predictable outcome.

Property investment and occupational markets continue to exhibit a less than perfect correlation, which is slightly at odds with expected theory that occupational demand drives rental growth which in turn drives valuation increases. This aspect makes the outlook for total returns harder to predict as external influences can cause investment markets to move in a contrary fashion. While the occupational market has strengthened through the year and rental growth has taken hold across large parts of regional economies, the investment market has been more volatile. I anticipate that occupational demand combined with a limited supply of new development will continue to drive rental growth across regional markets, supporting a low vacancy rate and securing dividends and long-term capital growth.

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Richard Shepherd-Cross, manager, Custodian REIT: Demand is back and in aggregate yields have recovered most of the ground lost in 2016, albeit retail yields continue to soften while industrial yields continue to harden. Does the return of strong demand suggest that the market has yet to peak? We are not unduly concerned by this risk. Capital growth has been driven by the prospect of rental growth and not by underlying yield compression, lessening the risk of a reversal of gains made in the near future.

Is fear driving market demand for long dated income with indexed linked rent reviews? Is this reflective of the fear of weak economic growth and weak property markets in the near future? This possible weakness is not our experience in regional economies. We are witnessing rental growth driven by a lack of supply and very limited speculative development. We are enjoying low vacancy rates and tenants are happy to commit to extending leases or agree rental increases, demonstrating a confidence in their businesses.

Are open ended property funds still fearful? The Financial Times reports fund managers are sitting on between 18-30% in cash, which amounts to over GBP3bn of cash, or 20% of total funds. While this is explained as being appropriate caution in the face of current and feared redemptions, this strategy can be doing nothing to enhance returns.

One challenge affecting the whole market is the limited supply of property being offered to the market. This shortage of supply, in part, might explain the significant cash reserves of the open ended funds. A lack of suitable opportunities may cause investors to sit on their hands, but it also creates a vicious circle, with potential sellers fearful of not being able to re-invest their capital receipts.

There is a fear that the high street will lose out to on-line retail. This concern is causing many to divest themselves of high street property and acquire logistics and distribution assets in their place. While we believe that many convenience retail locations and smaller market towns will weaken as people change their shopping habits, this cannot be said of all retail locations. We believe in strong regional retail towns, particularly those with a high tourist footfall and those with a diverse leisure offering including coffee shops and restaurants in their town centres. Shopping remains one of the nation's favourite leisure activities.

The widespread demand for distribution and logistics properties has the potential to create a bubble in market pricing if the current trajectory continues. Greed triumphing over fear. We are vigilant about the pricing of investment opportunities in this sector but we believe pricing is still at sustainable levels, given the real prospect of rental growth.

While there appears to be more fear than greed in the market, greed is never too far from the surface. One recent phenomenon has been the rise of local authorities buying real estate, funded by cheap money from the Public Works Loan Board ("PWLB"). Local authorities, who can borrow up to 100% of a property's value from the PWLB, invested over GBP1bn during 2016, often outside their local authority area in a push to close the funding gap, as central government reduces direct financial support. Our experience of the rising activity of local authorities in the market is that they are having an inflationary impact on pricing, perhaps because they are too focused on short-term income returns rather than the long-term risk of capital depreciation.

In conclusion, we believe there is strength and longevity in the occupational market and across regional markets, with good prospects for low vacancy rates and rental growth. We believe that fears of short-term volatility in the economy may be pushing

investment into long-term income strategies, making this segment of the market very expensive. However we believe the impact on the property market of many of these fears may be misplaced. The demand for industrial investment property let with long-term, RPI-linked income is risking the stability of market pricing. We believe the abundance of cheap debt is pushing some market protagonists to understate the inherent risks of property ownership and over-price property.

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Workspace: The commercial real estate market is swinging on an axis and the pendulum of demand is moving firmly towards highly designed and super connected space let on flexible terms.

Business owners all over London are looking at their space requirements and considering a range of new factors when assessing their occupational requirements. They are taking into account employee commutes, availability of meeting and breakout space outside the four walls of their office, proximity to excellent coffee, gyms and safe cycling routes, as well as the quality of the technology infrastructure and the neighbourhood community which can provide so many additional benefits to their business.

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James Agar, manager, Ground Rents Income: There continues to be sustained deal flow in the ground rent market, driven by both established players backed by institutional money and an increasing number of smaller new entrants. Pricing for large-scale, Retail Prices Index (RPI)-linked assets remains robust, as investors seek good-quality, inflation-linked income. A recently-published report by Savills shows that ground rents which review to RPI annually and every five years now attract yields of 2.5% and 2.7% respectively. This is in line with our own transactional evidence, such as an annually-reviewing, multi-site build-to-rent scheme which has recently attracted bids of just less than 2.5%. Savills also highlighted that the average ground rent yield in 2016 reached an historic low of 3.5%, down from 5.7% in 2010, which represents an increase of 63% in capital value terms. Furthermore, the value of ground rents to be created over the next five years is forecast to exceed GBP400 million a year. This is being driven by the continued urban development of apartments and is likely to improve market liquidity.

Ground rents and landlords have, however, attracted media attention in recent months regarding perpetual 10-year doubling rents and new-build leasehold houses. As a consequence, some institutional buyers have withdrawn from bidding for any form of doubling ground rent assets and pricing has weakened accordingly. Subsequent to the date of the accounts, Taylor Wimpey, a large listed housebuilder, announced a GBP130 million balance sheet provision to cover disputes over house leases granted to its customers with 10-year doubling ground rents.

The historic low yields on ground rents are increasingly being seen as an attractive way for businesses to raise cash from their property assets, while retaining the right to continue operating from their premises as long leaseholders. One such recent deal was a business with steadily growing revenues and earnings looking to raise more than GBP50 million by selling the freehold of many of its properties and leasing them back subject to RPI-linked ground rents. While similar in nature, the risk profile of such deals can be somewhat different to residential ground rents, and it reaffirms our belief in carefully reviewing all deals on their own merits.

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Renewable energy

John Laing Environmental Assets: Despite the current political and economic uncertainty in the UK and Europe, in particular following the UK referendum on membership of the EU in June 2016, the outcome of the recent elections in the UK and France, impending elections in several European countries and the recent US election result, we believe that investing in a diversified portfolio of assets in the wider environmental infrastructure sector and providing consistent long-term income with NAV resilience remains achievable.

Whilst it will take some time for the exact details of arrangements post exit from the EU to emerge, government policy commitments for clean energy continue in the UK and climate change remains one of the important areas of focus, not only for the UK but globally. The UK has ambitious domestic targets, with the Climate Change Act of 2008 establishing a target to reduce its emissions by at least 80% from 1990 levels by 2050. The Act established a system of five-yearly carbon budgets, the fifth of which was formally approved by Parliament on 30 June 2016 and aims to limit annual emissions to an average of 57% below 1990 levels by 2032.

In addition, electricity capacity margins remain especially tight in the UK, compounded now by increased uncertainty as to whether planned additional electricity interconnector capacity with Europe will be built following the UK's exit from the EU.

As an EU member, the UK is required to generate 15% of its energy from renewables by 2020 under the European Union's Renewable Energy Directive. Although by leaving the EU, the UK may no longer be obliged to hit these targets or any successor targets (unless agreed as part of any secession agreement), the renewables projects required to meet the 2020 target have already been largely built or are expected to be commissioned. In respect of longer-term commitments, the Climate Change Act's ambitious carbon reduction targets will require a substantial and continued contribution from renewables.

[*Last year*], we commented on the fact that the UK and European renewables markets in 2015 and 2016 had continued to be affected by low electricity prices, mainly driven by consistently falling oil and gas prices since the end of 2014. In recent months, and particularly since the EU referendum result, spot electricity prices have recovered and we have also seen an increase in forecast electricity prices, particularly over the short term. This has largely been driven by the movement in sterling exchange rates, with higher import prices for dollar/euro-denominated coal and gas inputs for the electricity market. As gas-fired power stations tend to set the marginal cost of electricity in the UK, natural gas price rises tend to result in higher electricity prices.

The timing and extent of changes to electricity prices will depend on a range of factors, including the impact of continued pressure on the UK capacity margin due to planned closures of coal-fired generation plants and the continued delay in the commissioning of new nuclear plants.

The secondary market for environmental infrastructure projects remains both active and significant. Whilst activity in UK solar has inevitably tailed off following the removal of ROC incentives, opportunities still remain. As for wind, the early removal of green subsidy support has impacted developers but there remains a large number of existing operational projects and projects to be completed under existing transitional arrangements to provide a strong secondary market in the short to medium term.

Although smaller in number, the Investment Adviser has been pleased with the level of environmental infrastructure opportunities outside of wind and solar that it has seen, particularly in the biomass and bioenergy sectors.

The Chancellor's first Autumn Statement on 23 November 2016 outlined his priorities for taxes and spending in the wake of the referendum vote and, as anticipated, this included a statement confirming the Government's support for investment in UK infrastructure.

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NextEnergy Solar: 2016 marked another very strong year for renewable energy worldwide as renewables added 138GW of net power generating capacity in 2016, compared to 101GW from coal, gas and nuclear. The cumulative amount of installed renewable generating capacity as at 2016 stood at 2,006GW. This trend is expected to continue, with renewable energy increasing its share of energy produced as well as of new capacity added to the global grid. Out of this total global share of the market, solar PV constitutes today a 330GW of installed capacity and is estimated to grow to 600GW by 2020, based on publicly announced targets.

The transition to cleaner energy is driven and defined by important considerations, including the need to address climate change, emissions of greenhouse gases into the Earth's atmosphere, the relative rapidity in the construction of renewable energy plants, concerns about reliance of hydrocarbon sourcing and imports, the relative ease of constructing clean energy plants as well as the rapidly declining unit investment cost of renewable energy installations.

Developed countries and economies in transition across the globe continue to embrace renewable energy as a key energy source to satisfy increased energy demand and replace obsolete power generation plants.

The Paris COP21 Agreement was ratified by 146 Countries worldwide. It sets out a global action plan to put the world on track to mitigate the negative consequences of climate change by limiting global warming to below 2degC. Governments agreed to undertake rapid reductions thereafter in accordance with the best available science and to come together every 5 years to set more ambitious targets.

The Department for BEIS reported that at the end of 2016 energy from renewables represented 24.4% of all electricity generation in the UK, and solar PV represented c.12.4% of renewable generation for the full year 2016, which is a percentage change increase of 36.1% from the previous year to a record 10.3TWh.

On Friday 26 May 2017, the UK achieved a first time solar power record as 8.7GW of solar power was generated at 1pm representing an impressive 24.3% of the entire power demand in the UK. Also, earlier in April 2017, news reported how Britain went a full day without using coal to generate electricity for the first time since the 1880s.

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