

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

Perhaps, the big story of July was the weakness in the US dollar. Oil rebounded from recent lows and Bund yields edged up. Emerging markets had a good month, the MSCI Emerging Index was up 4% in sterling terms.

Global

After last month's distinctively pessimistic tone, commentators seem more upbeat, typically justifying equity valuations on improving fundamentals.

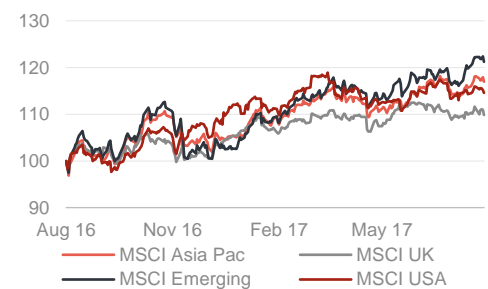
Peter Hewitt, manager of F&C Managed Portfolio, suggests that political uncertainty may be obscuring improvements in underlying economies. He favours Europe, Asia Pacific and Emerging Markets over the more highly rated US market. Richard Killingbeck, chairman of Bankers, is cautiously optimistic, saying the picture for revenue and earnings growth is more positive than for some time. Lucy MacDonald, manager of Brunner, echoes this, saying that the good momentum of analysts' corporate earnings estimates is a good signal for the stock markets. Simon Fraser, chairman of Foreign & Colonial, concurs and believes rates rises should be modest. The folks at Alliance Trust expect higher levels of volatility. Dr Pohl, chairman of Athelney, is more cautious and favours capital preservation.

Exchange Rate	31/07/17	Chg. on month %
GBP / USD	1.3215	+1.5
USD / EUR	0.8445	-3.5
USD / JPY	110.26	-1.9
USD / CHF	0.9669	+0.9
USD / CNY	6.7266	-0.8

Source: Bloomberg, Marten & Co

MSCI Indices rebased to 100

Time period 31/07/16 to 31/07/17



Source: Bloomberg, Marten & Co

	31/07/17	Chg. on month %
Oil (Brent)	52.65	+9.9
Gold	1269.44	+2.2
US Tsy 10 yr yield	2.2942	-0.4
UK Gilt 10 yr yield	1.230	-2.1
Bund 10 yr yield	0.541	+16.3

Source: Bloomberg, Marten & Co

UK commentators seem cautious overall. The election result could mean a greater chance of a soft Brexit

Rate rises are coming. A more normal economic environment could favour value investors

Growth is coming through which helps support valuations

Commodities markets coming back into balance, oil prices too low

Brexit concerns are driving a flight to quality but, unless we have a recession, property outside London may be more resilient

United Kingdom

Andy Pomfret, chairman of Miton UK MicroCap, says corporates have been prioritising buy-backs and dividends over long-term capex. The managers of that fund highlight the stagnation of world productivity and say it is important to identify companies investing in attractive capex opportunities. Duncan Budge, chairman of Artemis Alpha expects unsettled conditions for at least the next couple of years. The managers of that fund think the election result has made a soft Brexit more likely. They also make the point that many companies have been flattered by currency moves since the referendum, masking weak underlying performance.

Crispin Latymer, chairman of BlackRock Throgmorton, thinks a rate rise is likely although any increase is expected to be gradual to avoid unsettling markets. The managers of that fund say the potential for further political surprise or economic setback, coupled with high valuations, may curb any upside. Alastair Munday, manager of Temple Bar, looks forward to rate rises and the unwinding of QE – he believes central bankers are dropping hints that this is on the cards. He thinks that would help value investors. Paul Trickett, chairman of Aberforth Smaller Companies, sees a greater synchronisation of recovery among individual economies than at any point since the financial crisis - the global policy response could have a greater long-term significance than the UK's domestic issues. The managers of that fund say the actions and comments from central banks in the last week of June suggested concern about reflationary pressures and a more hawkish stance on monetary policy. They also think that markets have become overly fearful of volatility and illiquidity.

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Europe

The managers of Fidelity European Values say earnings are currently growing in double-digits year on year and think that, despite the many political threats, the ultimate driver of markets is real dividend growth.

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Commodities and natural resources

Ed Warner, chairman of BlackRock Commodities Income, says low valuations and the chance of a recovery in commodities prices could boost the sector. The managers of the fund think companies have been repairing balance sheets rather than investing in new production and this is bringing supply and demand back into balance. They also believe that, on a two year view, oil prices are unsustainably low.

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UK Property

Mark Burton, chairman of AEW UK REIT, thinks it is too early to see what the impact of Brexit on the UK property sector will be. The managers of the fund point out that the market has started to regain the value it lost in the immediate aftermath of the vote. They say that, outside Central London, there are fewer concerns about occupier demand and the greatest risk is of a Brexit-induced recession. Retail property specialists, Intu, have seen a flight to quality in the UK. As yet, UK consumer spending has not been affected materially – they point to the Bank of England's forecasts that wage growth will overtake inflation as we go into 2018 as a sign that

things might be ok. They have some exposure to Spain where they expect that recent strong economic growth will persist.

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Technology

A sector that can deliver growth even against economic headwinds

Julian Cazalet, chairman of Herald, thinks companies with genuine growth may become more expensive. We recently published a **note** that includes the manager of that fund, Katie Potts', thoughts on the sector. Robert Jeens, chairman of Allianz Technology, says the heightened sense of overall risk levels does not alter the growing importance of new technology across the global economy and hence the case for strong relative performance. Walter Price, manager of that fund, points out that the growth in technology is coming from the creation of new markets, rather than simply GDP growth.

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Other

In addition, we have comment on the healthcare sector from BB Healthcare, on the debt sector from TwentyFour Income Fund and a detailed look at the financials sector from both the chairman and managers of Polar Capital Global Financials.


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Martin Currie is an active equity specialist, driven by investment expertise and focused on managing money for a wide range of global clients. Our investment rationale is considered and focused. As bottom-up stockpickers, our investment team aims to make the connections others miss, identifying, scrutinising and challenging the best money-making ideas in our ambition to deliver attractive consistent risk-adjusted returns for our clients.




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A high conviction, global equity portfolio that aims to deliver long-term growth in excess of the capital returns of the FTSE World Index.




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of Scotland



A high conviction, unconstrained global equity income portfolio that aims to deliver a rising income and capital growth by investment in global equities.



Martin Currie
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Global

(compare Global funds [here](#))

Peter Hewitt, manager, F&C Managed Portfolio: Given what has taken place over the past year, first with the unexpected result in the EU Referendum, then with the unexpected result in the US Presidential election, it is difficult to believe the magnitude of positive returns that have been achieved by equity markets. Political events have dominated the media and have served to confuse as it is the economic fundamentals which tend to determine the direction of financial markets. In this regard the fundamentals in terms of growth, inflation, interest rates and ultimately corporate profits and dividends came through much better than had been anticipated a year ago.

Once again in the UK, politics take centre stage. An inconclusive General Election result has bequeathed a Government that is fragile at best and with the imminent onset of Brexit negotiations it appears that, for the UK, there will be a protracted period of uncertainty which if events went awry have the potential to upset financial markets. With an unpredictable President it appears similar sentiments could affect the US. In comparison, Europe and Asia Pacific appear almost as an oasis of calm.

Using recent years as a guide, perhaps all of this uncertainty serves to obscure what is going on in underlying economies and by focussing on key trends in the fundamentals will allow a better analysis of prospects for financial markets. In this regard the potential for all the aforementioned uncertainty to weaken sterling further and for the fragile government to reverse austerity and embark on a programme of more stimulus would likely support equity markets. However, neither is guaranteed and meantime it is clear the UK is slowing with higher inflation squeezing the all-important consumer such that real incomes are under pressure. Encouragingly, the US recovery continues, although the timing of a boost from the promised tax cuts of President Trump remains unclear. Meantime the Federal Reserve continues its policy of trying to normalise interest rates by moving them higher. Europe is at last experiencing stronger growth with both inflation and interest rates at low levels and Asia Pacific is benefitting from stimulus measures taken by the Chinese government and as such is experiencing stronger growth also.

Over the last few years global markets have been led by the US which has performed strongly. Valuations in the US, where the forward P/E of the S&P Composite is 17x are elevated, and robust earnings growth, which is being delivered, is needed to justify current levels. Europe on the other hand is also beginning to achieve strong corporate earnings growth. It has taken a very long time in Europe, however recovery is genuine and equity market valuations are, whilst not cheap, attractive on a relative basis. Similarly growth is improving and valuations are reasonable in Asia Pacific and Emerging Markets. In the case of the latter, there are signs that a long period of underperformance is drawing to a close. Which leaves the UK, where investor sentiment is adverse and confidence is low and yet large global companies based in the UK could benefit from the synchronised recovery evident internationally and any further weakness in sterling. This would benefit primarily the FTSE 100 Index. For UK mid and small cap companies the environment could become more challenging.

There may well be setbacks and with volatility at such low levels, when these occur they could be both sharp and uncomfortable. That said, the global outlook remains constructive for equity markets. In terms of investment strategy, further progress from current levels is likely to be driven by earnings growth and not multiple expansion and in this regard that should favour Europe, Asia Pacific and Emerging Markets over the more highly rated US market. Prospects for the UK are less certain although the

present political difficulties have not prevented the FTSE All-Share Index moving to a new all-time high.

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Richard Killingbeck, chairman, Bankers Investment Trust: In reviewing my past statements to shareholders I have referred to the potential negative impact of global politics on investor sentiment. I have been too cautious. Yet as I write this report the political instability in the UK, following the general election, could still generate unwelcome surprises and the outcome was certainly not the strong mandate which the Prime Minister was seeking ahead of the "Brexit" negotiations. The twists and turns of these negotiations will definitely impact UK sentiment during the next two years.

Elsewhere the focus will remain on the economic backdrop and the ability of the corporate sector to improve revenue and earnings growth. On both fronts the picture is more positive than for some time and, despite an uplift in inflationary expectations, there has been no disconcerting jump in wage inflation which gives greater confidence that this inflationary increase will be temporary.

Thus, overall I remain cautiously optimistic regarding the short and medium term outlook for equity markets.

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Lucy MacDonald, manager, Brunner: Expectations of a continued economic upswing and the still generous monetary policy of the leading international central banks should be positive for equities. Moreover, the good momentum of analysts' corporate earnings estimates is also a good signal for the stock markets. At the same time, divergent monetary policies in the US and Europe and persistent political uncertainties might result in elevated volatility. In this environment, active management is required to augment returns.

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DR E Pohl, chairman, Athelney Trust: The news is grim: terrorist outrages, political chaos and the Grenfell Tower tragedy have dominated headlines in recent weeks and months. Elsewhere, the economy appears to be slowing and productivity is a national disgrace. Credit growth has been running at over 10 per cent since June 2016 while household savings have collapsed to 1.7 per cent of disposable income, the lowest reading since the data series began in 1963. The British people are deeply divided: there is a majority neither for a hard exit nor for remaining in the EU. There is neither a majority for the Conservative vision of continued austerity nor for Labour's vast tax and spending gamble. A divided House of Commons and Cabinet reflects a divided country. A sensible aim would be to try to hang onto the gains made in the first half.

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Law Debenture: Global equity markets have been moving upwards since the spring of 2009, but the global bull run will not continue indefinitely. In the UK, there are signs of a slowdown. Valuations are at the higher end of their long term range so equity investors need to be increasingly careful in stock selection. With interest rates continuing at historically low levels, and in the absence of alternatives, the income (and income growth) available from equities continues for the time being to make them look a relatively attractive asset class.

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Simon Fraser, chairman, Foreign and Colonial: Broadening global economic growth and an upturn in corporate earnings along with subdued inflation rates and borrowing costs continue to support equity markets.

It is not just the US where the fundamental picture has brightened. The Eurozone has plenty of spare capacity and has seen increased growth momentum. The corporate sector there, having disappointed consistently in recent years, is producing solid earnings growth and a potential reinvigoration of the EU under the progressive French President Macron and German Chancellor Merkel could yield further gains. In the Emerging Markets, with China continuing to deliver solid growth and Brazil and Russia exiting recession, the premium over developed market growth rates has begun to expand once again.

The UK is something of an outlier amongst major global economies. The picture here appears challenging with a squeeze in real incomes underway and increased political uncertainty.

Importantly for equity investors, corporate earnings are showing increased vigour, and this strength is helping to push global equity markets on to new record highs. The combination of low inflation levels, supported by improving earnings momentum along with a synchronised economic upturn is fuelling optimism on the outlook for corporates. In addition, within equity markets, a growth strategy has returned to favour, with technology stocks leading the way.

Inflation levels remain low and, while central bankers are likely to continue on the path of policy normalisation, rate rises should be modest. Indeed, the absence of inflationary pressures is helping to extend the economic cycle and the environment remains one where corporate earnings should continue to support equity prices. Despite potential challenges we continue to see opportunities in equity markets. Nonetheless, a world of easy monetary policy has inflated valuations across multiple asset classes and so we should not be surprised to see greater headwinds to shorter-term market progress as and when interest rates rise further.

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Alliance Trust: We continue to expect higher levels of market volatility. Periods of strong equity market returns coupled with low expectations of volatility in the market, as observed in recent months, are typically followed by periods of higher volatility. We believe that future equity returns over the longer term are unlikely to keep up with the exceptionally strong returns of recent years. This may be exacerbated by the possible gradual reduction in monetary stimulus or raising of interest rates by the main central banks.

We also believe that the high-level market view masks significant dispersion between companies, providing an excellent environment for active stock selection.

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United Kingdom

(compare UK funds [here](#))

Andy Pomfret, chairman, Miton UK MicroCap: Growth was plentiful during the period of globalisation. However, as bond yields have moved down to ultra-low levels, many mainstream corporates have prioritised increasing buy-backs and dividends over long-term capex, while world productivity has stagnated.

The recent election and many unanswered questions arising from the Brexit process have increased levels of uncertainty. In past similarly challenging periods, it has been the greater vibrancy of the smallest quoted companies, with their ability to quickly adapt to changing circumstances and opportunities, that has driven premium returns. Specifically, it is their ability to find more capex opportunities with attractive cash paybacks that will drive the outperformance of these stocks in future.

The largest companies may have been at the centre of attention during the year under review as investors digested recent momentous events. But, at a time when dividend growth across the markets is more uncertain, we believe that ongoing earnings and dividend growth of microcaps could lead many of the companies to generate premium returns for an extended period.

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Gervais Williams and Martin Turner, managers, Miton UK MicroCap: Whilst the recent general election returned a minority government, the prior policies of working towards a stable, business-friendly environment remain in place. However, the election has added a further degree of uncertainty as the UK negotiates its withdrawal from the EU.

Economic momentum was already more temperate compared with the plentiful growth during the period of globalisation. However, world productivity has stagnated over the last ten years, so it will become all the more important to continue to identify those companies investing in attractive capex opportunities. Ultimately, we continue to identify plenty of microcap stocks with the prospect of an attractive cashflow from these kinds of investments going forward. These companies should be well positioned to generate a truly sustained rise in earnings and cashflow.

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Duncan Budge, chairman, Artemis Alpha: During the period under review, stock markets have had to cope with an extraordinary succession of unexpected events: Britain's decision to leave the EU, the election of President Trump and the U.K. general election. Inevitably these events have had implications for currencies and markets generally.

The uncertainty surrounding the Brexit negotiations and the results of the general election are likely to contribute to unsettled conditions for at least the next couple of years.

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John Dodd and Adrian Paterson, managers, Artemis Alpha: As investors have attempted to anticipate what the recent general election and its aftermath might mean for Brexit and, by extension, the UK economy, politics is exercising a greater influence than usual over the UK market. As the prospect of a comfortable majority for the Conservatives faded and vanished, Sterling fell. Dovish comments from the Bank of England's Mark Carney added to the downward pressure on the pound. As overseas earners, the mega caps of the FTSE 100 Index have been beneficiaries of this weakness. But returns from small- and mid-caps, which tend to be domestic earners have been more modest.

In broad terms, the election has made it more likely that there will be some form of 'transitional' deal for the UK after the two-year negotiating period with the EU comes to an end in March 2019. This reduces the risk of a 'no deal' or 'hard' Brexit. A further positive for the economy is that inflation should start to drop, helped by progressively easier year-on-year comparisons for the oil price. This, in turn, should reduce the

squeeze on the real incomes of consumers. That ought to help stocks with a domestic focus. At the same time, the UK market's overseas earners, most of which are large caps, have benefited from strong earnings momentum because of Sterling's fall since the referendum. A weak pound has, in some cases, masked weak underlying performance. These companies could be exposed once support from the currency fades.

That politics and other macro matters continue to exercise so much influence over the market is frustrating. But history suggests that it won't last: in time, underlying company fundamentals always prevail.

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Crispin Latymer, chairman, BlackRock Throgmorton: Overall, the outlook for the UK and global economy appears to be generally positive, with improving economic data generated by the UK, Europe and the US. However, there are still a number of significant risks and headwinds present, not least the effect of US President Trump's protectionist policies and the impact of sustained uncertainty around Brexit negotiations. In the UK, economists have forecast rising inflation and a fall in consumer spending as the effect of Sterling's depreciation and the rise in import costs are passed on to the UK consumer through price increases. With UK inflation now above the Bank of England's 2% target, a rise in interest rates this year may be seen, although any increase is expected to be gradual to avoid unsettling markets.

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Mike Prentis and Dan Whitestone, managers, BlackRock Throgmorton: Markets have remained firm based on generally good economic data around the world, however the most recent UK GDP growth has been weaker than expected, whilst wage growth remains lower than inflation. Political developments have continued to be at the forefront, with the unexpected call for a snap general election in the UK and subsequent outcome of a hung parliament.

The unexpected result in the election has undoubtedly increased the uncertainty around Brexit negotiations and may have an impact on business investment decisions and could damage consumer confidence.

Meanwhile, valuations are not cheap and although earnings growth has been good, an increasingly large number of companies trade on more than 20 times forecast earnings. Given this and the potential for further political surprise or economic setback, the share prices of UK small and mid-caps may find it difficult to make further progress over the coming months.

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Alistair Munday, manager, Temple Bar: In recent years, the success of different styles of equity investing has become a slave to bond yields with, in general, Value investors finding progress hard when bond yields have been low and falling. We would therefore expect any significant increase in yields to reverse this trend swiftly; should it occur, many investors are poorly placed for such a reversal.

The language of central bankers modified in late June with hints of a reversal of Quantitative Easing (QE - the printing of money to purchase bonds) and the requirement for higher interest rates as advanced economies return to more normal conditions.

In briefings, the central bankers have raised a number of issues: 1] significant increases in asset values may have created false prices and driven mis-allocation of

capital; 2] the effects such increases have had on wealth inequality; 3] the unknown long-term inflationary effects of loose monetary policy; 4] unemployment is falling, possibly to a level which would stimulate inflation; 5] interest rates need to be higher ahead of the next recession.

Markets shrugged off this change in tone, believing either the central bankers were all talk or that any weakness in markets following implementation of this strategy would quickly force its cessation (or even reversal).

While we would prefer to sideline banker/market noise, and focus on picking individual stocks from detailed bottom-up analysis, we cannot ignore the changing attitudes of central bankers. Their previous decisions have driven bond and equity markets to very high valuation levels, and investors should be alert to the likely consequences of a change of tack. We identify three scenarios.

Scenario 1: interest rates rise across the yield curve and QE is reversed, with no significant effect on economic growth. We believe this would depress asset markets. After all, if interest rates return to historical levels, equity ratings should also revert to long-term norms. However, it is unclear whether the monetary authorities have the nerve to watch bonds and equities fall without acting.

Scenario 2: rising interest rates slow economic growth, dampening inflation expectations. This would probably be good for government bonds and for asset classes with valuations most closely linked to bond yields. Precious metals might also benefit if markets worry that central banks would find difficulty in unwinding QE. This scenario implies a continuation of low interest rates, low inflation, sub-par economic growth and no significant increase in government spending. However, around the western world politicians have recently been left in no doubt of voters' resentment of the status quo. As this scenario appears to be unsustainable, we should prepare for scenario 3.

Scenario 3: if central banks fail to increase rates and reverse QE while inflation falls and/or there is an equity market crisis, markets may price in the risks of further QE or, more likely, increased government spending. Or governments may authorise the creation of helicopter money (ie money printed specifically to be used for increased government spending - a neat blend of monetary and fiscal policies). We assume this would be a very good outcome for precious metals, a bad outcome for bonds (as investors would suspect that governments are desperate to generate inflation) and a mixed outcome for equities. We believe equities most closely correlated to bonds would struggle, relative to those less sensitive to interest rates.

We believe, broadly, that markets are approaching the end of an era. The long-term trend of globalisation has had very deflationary effects and, combined with extreme monetary policy, has driven bond yields down to very low levels. The current mood among electors and politicians suggests that the globalisation trend of the last few decades could give way to trade barriers, tariffs, protectionist policies and restricted movement of labour, plus greater use of fiscal policy. The consequence of scenario 3 is likely to be a more inflationary future and one, with government debt so high, which the authorities would welcome.

The changes underway in central bank attitudes and actions, after nearly a decade of ultra-accommodative policies, may well unsettle markets, leading to a re-appraisal of valuation criteria and enhanced volatility. In such an environment, where predictions become unreliable, strict adherence to our value investing approach becomes more important than ever. The general performance of the value investing style, compared with alternatives, hinges critically on an increase in interest rates towards more historical levels of normalcy.

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Paul Trickett, chairman, Aberforth Smaller Companies: In a period of twelve months, the UK has gone from being viewed as possessing a stable political and economic backdrop to being confronted by significant change and challenge. Such periods clearly bring risks for the investor but they will be resolved with the passage of time and can also offer attractive opportunities. In contrast to the UK, the outlook for the global economy has improved over the past year, with a greater synchronisation of recovery among individual economies than at any point since the financial crisis. At this level, the predicament facing financial markets is whether the recent rise in yields is a harbinger of sustained global reflation. Were this to be the case, equities as an asset class would benefit and the value investment style would likely out-perform. In contrast, a return to deflationary pressures would in all probability see a continuation of the broad trends witnessed since the financial crisis and equities would see leadership revert to their quality and growth cohorts. Such global shifts may well have a greater long term significance than today's domestic issues.

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Aberforth Partners LLC, managers, Aberforth Smaller Companies: What the past one and a half years demonstrates is that value style fares better when optimism about economic activity rises. Conversely, deflationary forces represent a challenge to value but a boon to the growth style.

The first six months of 2017 highlighted threats to the continuation of the reflation trade. In the US, Donald Trump's ability to deliver his vaunted fiscal stimulus has been undermined by the investigation into Russian interference in the election. Meanwhile, it would appear unlikely that the political fluidity that has characterised the UK in recent years is set to change in the near future, notwithstanding the higher chance of a softer Brexit that has come with the election result. Indeed, given such political uncertainty, it is remarkable that economies themselves have not proved more vulnerable. As the half year mark approached, a further complication arose.

Whether coincidental or co-ordinated, the actions and comments from central banks in the last week of June suggested concern about reflationary pressures and a more hawkish stance on monetary policy. As long as the central bankers have correctly assessed the risks, higher interest rates and by extension higher government bond yields should be good news: ten years from the start of the financial crisis, a normalisation of monetary conditions would suggest improved economic prospects and would bode well for the value style. However, the condition at the start of the previous sentence is important: if interest rate rises prove too aggressive, they will stifle the recovery, suppress bond yields and prolong the stockmarket trends with which we have become familiar since the financial crisis.

Fear of volatility and illiquidity has been elevated since the financial crisis and remains so. The valuations of companies whose profits grow, albeit not in a smooth fashion, are penalised, all the more so if these companies are small and their shares happen to be traded infrequently. The Managers believe that, unless we are now doomed to a future without economic progress, it is likely that the valuations presently available will continue to support further good rates of returns over the long term.

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Europe

(compare European funds [here](#))

FIL Investments, managers, Fidelity European Values: The market is highly valued, relative to historical norms, and expectations for future earnings growth are also high. This can be a risky combination! The good news, however, is that earnings are currently growing in double-digits year on year and bond yields have, to date, remained supportive to equity valuations. Central bankers, at the recent gathering at Sintra in Portugal, seem to be signalling more normalisation in monetary policy in the coming months. This has resulted in some upward pressure on bond yields with a consequent negative impact on equities which may continue to restrain market progress. Politics remain unpredictable. There are some big elections on the horizon in continental Europe, most notably in Germany this autumn and Italy early next year. The latter is seen as more of a risk to confidence in Europe but the last year shows that a strengthening European economy, which we are seeing, albeit from a low base, can trump political worries in equity markets. Many investors are concerned that the recent lack of volatility will prove the calm before the storm. It is, however, difficult to predict what will upset the apple cart. The conventional list of suspects includes Trump's protectionism, China tightening its monetary policy and geopolitical shocks. The ultimate driver of markets, in aggregate and specifically, is more prosaic: the real dividend growth of companies.

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Biotech and healthcare

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

Paul Major and Daniel Koller, managers, BB Healthcare: We have found the sector macro environment year-to-date both vexing and perplexing in equal measure. One might have hoped that the Republicans had a clear vision and strategy behind 'repeal and replace', with some seven years to prepare for the opportunity to re-cast the healthcare debate but, in the end, the whole process has proven shambolic. We can empathise with those investors who have decided to eschew the sector until there is greater clarity.

Amidst all the noise and polemics, we are trying to remain focused on the operational and R&D progress of the companies in which we are invested. There, we see many reasons to be optimistic with regard to the longer-term outlook and the historically low absolute valuations implied for many of these companies will hopefully not persist. Moreover, the attractive multi-factorial positive drivers on the demand side for healthcare products and services are undiminished.

We look forward to the forthcoming reporting season and the likely closing of the legislative window for any sort of healthcare reform (around September). To our mind, the Republican priority has always been tax reform and it seems logical to try and implement these tax proposals before Congress breaks for the midterm elections in 2018, after which the party may no longer have the votes to realise its ambitions.

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Commodities and natural resources

(compare specialist commodities and natural resources funds [here](#))

Ed Warner, chairman, Black Rock Commodities Income: After a challenging period, the natural resources sector remains out of favour with investors. However, an improvement in mined commodity prices has allowed the mining companies to repair balance sheets and reinstate dividends, and the Investment Manager remains positive on the outlook for capital returns over the near to medium term. It has been more challenging in the energy sector but, given recent share price falls, a number of the energy companies are trading at more attractive valuations which have the potential to deliver significant upside over the next 1-2 years with the likelihood of higher oil prices over the medium term. While conditions are likely to remain volatile in the short term, should markets begin to acknowledge the relatively low valuations in the sector and anticipate a recovery in commodity prices, a re-rating of share prices over the medium to long term is to be expected.

Further, following the dividend cuts seen across the Company's investable universe in recent years, it is encouraging to note improved cash-flows for many mining companies, which are likely to feed through into an increase in dividend income.

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Olivia Markham and Tom Holl, managers, Black Rock Commodities Income: The rise in commodity prices over the last year has allowed the mining sector to repair balance sheets and reinstate dividends. We expect the mining sector's performance to remain somewhat volatile in the near-term and linked to short-term changes in sentiment towards China. In the medium to long-term, we expect positive company fundamentals of improved free cash flow and strong balance sheets to drive a re-rating of share prices. The impact of the mining sector slashing capital expenditure and underinvesting in new projects over the past five years is beginning to be seen in the stagnation and even decline in the production of some mined commodities, which has helped tighten the balance between supply and demand, which is supportive for prices. We would expect this encouraging commodity backdrop to remain in the near future as there is a lack of development activity currently underway and very few projects that can be quickly brought online.

Rebalancing in the oil market is taking longer than initially expected and oil prices are likely to remain range bound through to the end of 2017. However, on a two year view, we believe that oil prices are unsustainably low and will need to move higher to incentivise the investment required to offset the declines in non-OPEC, ex-US oil production. OPEC's production cut is helpful in accelerating the rebalancing of the oil market, but the rebound in shale production has put a near-term cap on the oil price. We expect the trigger for an improvement in oil prices and energy equities to be meaningful declines in non-OPEC, ex-US production and subsequent declines in global inventories. The latter has already begun (albeit at a slower pace than we anticipated) and should accelerate through the second half of 2017. We believe the recent share price falls have left many energy companies trading below fair value.

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Debt

(compare debt funds [here](#))

TwentyFour Asset Management, manager, TwentyFour Income Fund: Performance is often significantly influenced in the short term by market sentiment however, and while events such as the US election would appear to have little direct impact on UK borrowers' ability to fulfil their mortgage obligations, they have frequently upset the markets' risk appetite.

As such, the expected elections in Italy later in the year, as well as ongoing issues such as the Brexit negotiations and other geo-political events will continue to present potential hurdles for market performance. Such changes in market sentiment typically allow for excellent opportunities to [*invest*], as the underlying bond performance is normally not threatened, and sharp recoveries such as that experienced after the first quarter of 2016 generally occur. However, the current risk appetite of the market does not allow for such opportunities to persist for a long time.

Counterbalancing this will be the ongoing technical mismatch in the European ABS market. Following a first quarter of negligible supply of high yielding ABS issuance, but with seemingly increasing demand, should external events leave the market untouched there would appear to be a clear impetus for ongoing positive performance.

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Financials

(compare specialist financials funds [here](#))

Robert Kyprianou, chairman, Polar Capital Global Financials: Sentiment towards the financial sector has changed significantly since a year ago. At that time I described the sector as 'unloved and unwanted' but with substantial value waiting to be realised. Since then the sector has come back onto investors' radar screens and into their portfolios. Valuation has been an important factor in the recent interest in the sector, coupled with a more supportive political backdrop following the election of President Trump and recent election results on the European continent, which suggested key countries had stepped back from European scepticism and extremism for now.

Looking forward, further encouragement for the sector is likely to come from a more supportive economic background for financials generally. Stronger growth and rising interest rates are particularly supportive for banks. Although economic prospects by region are not uniform, they generally include one or both of these supportive elements. In the US the post Trump-election growth optimism has waned recently as concerns have appeared over the implementation of the Administration's programme. However, the Federal Reserve has embarked on a cycle of Federal Funds rate increases which seems to be robust against evidence of soft inflation. One explanation for this is their concern over the impact of low short term interest rates on bank net interest margins which, if not addressed, could lead to a reluctance to lend or lending at the wrong price.

Meanwhile the growth story is moving towards regions and countries outside the US. In Continental Europe there is clear evidence of a broad-based recovery sufficient for

the ECB to end its downside bias in rates, with growing talk of tapering in its bond buying programme on the near term horizon. In the UK, the Monetary Policy Committee has become more open to rate rise increases, which may now be in prospect as early as 2018. 'It's the economy stupid', with the implications for rates, is likely to be the supportive rallying call for financials going forward. Although there is no sign of an end to the regulatory barrage imposed on this sector, there is clear evidence that regulators and policy makers are more sensitive to the impact on financial institutions, which could soften deployment going forward.

The sector has seen significant change since the financial crisis in 2008, especially banks in the West. Reaction and responses to that crisis are largely over. However, the pressure for further change remains, the primary drivers being regulatory evolution and Fintech. Pending regulatory programmes, from MIFID II and SMR, to MREL and 4MLD, will continue to require responses and adaptations of business models across the sector including banks, brokerages, insurance companies and asset managers. Fintech promises even more profound changes, especially for the established banking sector for whom it is both a threat and an opportunity. A driver of greater operating leverage for established banks, Fintech also presents opportunities for their disintermediation by new players. These new entrants are also changing the way business is done, as the old relationship, branch-based model migrates to electronic platforms and online information gathering and record keeping.

Closer to home, the surprising election outcome following a surprising Brexit vote has created a level of political, economic and financial uncertainty in the UK not seen since - well, I don't know when! A more pragmatic approach to Brexit negotiations is likely but it is not clear what this means. There is no appetite for another election soon in the ruling Conservative Party, but in the meantime, with no real majority, the parliamentary process is severely compromised. An easing in austerity is forecast but will it be enough to offset a slowing economy? The Bank of England now looks divided on the best course for monetary policy; and what damage will be done to Britain's financial system and institutions as Europe maximises its leverage is by no means certain.

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Nick Brind and John Yakas, managers, Polar Capital Global Financials: The sector's performance remains very reliant on the outlook for economic growth and therefore interest rates. For example, the recent relative share price weakness of US banks relative to the underlying US equity market and conversely, share price strength of European banks relative to the underlying European equity market, reflects the more positive macro data, but also political news, emanating from Europe.

As higher interest rates equate to higher profitability for the sector, the correlation of the sector to bond yields i.e. the forecast for interest rates a few years out is, not surprisingly, very high. In the US, net interest margins of banks, the difference between what they earn on loans and pay for deposits and other funding, have risen following the recent increase in US interest rates. Similarly European banks have highlighted the sensitivity of their earnings to any increase in Eurozone interest rates.

Outside of selective pockets of weakness in auto lending and credit cards in the US, asset quality remains very benign. Banks have consistently surprised by putting aside less in provisions to cover loan losses than had been expected, reflecting the relatively benign economic environment. New accounting rules will, however, force banks to take higher provisions for all loans, but these are not expected to be material and will be smoothed over a number of years.

With respect to regulation, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision, were meant to meet in January to announce final proposals on capital requirements for the banking sector. However the meeting was postponed on the back of US and European regulators being unable to come to an agreement.

While there remains some risk that capital requirements for the banking sector are raised by more than expected, for the most part the risk of further significant regulation in the sector has decreased. In the US, the Trump administration's appointees for heads of key regulatory bodies are seen as more market friendly and there is bi-partisan support for reducing the regulatory burden for smaller and mid-sized banks. US banks are also expected to be able to return more capital to shareholders.

Australia is the latest of a long list of countries that have raised taxes on the banking sector, which includes the UK, Belgium, Germany, Poland and Sweden. On top of this a number of European countries have implemented financial transaction taxes and there is a levy on the banking sector to fund the Eurozone Single Resolution Fund. Conversely in the US, expectations are for lower taxes, which, if enacted, would have a significant positive impact on earnings and share prices.

There has been a sharp fall in the yields of banks' AT1 securities (bonds that can be written down or converted into equity even while a bank is still solvent) which should be very positive for the sector as they can be seen as a proxy for cost of equity. As yet equity analysts and the wider market do not appear to factor in the price at which credit markets are willing to lend to the banking sector in their analysis despite the fundamental change in how the sector is viewed by credit markets (although some of this undoubtedly reflects the chase for yield).

Looking forward, therefore we remain very constructive on the outlook for the sector. Outside short-term volatility, if the recent more positive outlook for interest rates continues then this will be very good for the sector. Valuations remain low especially relative to underlying equity markets and while in absolute terms they are no longer as cheap as they were last year, the valuation upside from higher interest rates is underappreciated by the market irrespective of regulatory or tax reform. The potential for increased capital return adds to the attraction of the sector.

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Property

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

Mark Burton, chairman, AEW UK REIT: It is still unknown how the impact of Brexit will unfold and it is likely we will need to wait for some time to know the terms of the UK's exit from the EU and how this will impact on the UK commercial property market. In this period of uncertainty there is a higher chance that the Bank of England will keep interest rates at historical lows and this will maintain the fundamentals of property demand as investors search for yield.

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AEW UK Investment Management LLP, manager, AEW UK REIT: We continue to see a mixed bag of economic indicators in the aftermath of Brexit and, although the process to leave the EU has now begun, the dominant theme remains that of

uncertainty. Many economists had predicted an immediate and significant impact on the UK economy following the vote to leave the EU. Although these predictions did not come to pass, the UK economy suffered a slowdown in the opening months of 2017, as a rise in living costs impacted consumer spending. GDP growth fell to 0.3% in the first quarter of 2017 from 0.7% in the previous quarter (Office of National Statistics). The pound's sharp fall since the Brexit vote has lifted inflation to its highest level for more than three years (Office of National Statistics CPIH Measure of Inflation), putting pressure on consumers' incomes.

The general election on 8 June 2017 created further uncertainty around what happens next with the UK's negotiation to exit the EU, which is likely to continue to prolong caution from investors and tenants.

Brexit negotiations and political uncertainty may continue to slow down the UK economy but the impact on the real estate market should be mitigated by low interest rates. It is hoped that the UK economy will continue to show resilience and the International Monetary Fund has revised its UK growth forecast, now envisaging the economy expanding by 2.0% in 2017, compared with forecasts of 1.1% and 1.5% made in October 2016 and January 2017 respectively.

UK Real Estate Outlook

The property market has proven to be resilient following the initial shock of the Brexit referendum, with MSCI data showing that the market has started to regain the value it lost in the immediate aftermath of the Brexit vote. Central London has the greatest uncertainty over occupier demand but overseas investors are still showing a strong appetite for safe haven assets in the global hub. The shares of the major REITs with significant development exposure to the capital are, however, still at a substantial discount to pre-Brexit prices, reflecting the heightened uncertainty of future demand in the key occupier markets where rental growth is a more important driver of total returns due to the lower (prime) initial yields.

Outside central London there are fewer concerns about occupier demand and the greatest risk to property values is if the economy slips towards recession. Occupiers still seem to be adopting a pragmatic approach to their property needs and so portfolio income returns remain attractive to investors who continue to search for yield in this low interest rate environment. We sense that the weight of institutional money targeting the sector is back to pre-Brexit levels and, if anything, a low level of transactions is as much due to lack of willing sellers because multi-asset investors view property as an attractive alternative to historically low bond yields.

We are not surprised, however to see investors often focussing on the prime end of the market which, at times of uncertainty, tends to be redefined by length of lease and quality of tenant covenant rather than location. Pricing is then driven largely by the yield premium offered by property investments above gilts.

We see risks to future returns from looking at property as being cheap (relative to gilts) rather than acknowledging that this period of historically low bond yields is unlikely to be maintained, particularly if inflation continues to rise. In our experience there are risks to capital preservation when strategies focus solely on relative income yields at the expense of property fundamentals.

In terms of sector focus, we foresee the best total returns in the industrial and logistics warehousing sectors. This is driven in part by online retailers' requirements for distribution hubs around big cities and major infrastructure hubs to enable them to deliver goods more efficiently to shoppers' homes. Forecast total returns for industrial property are 7.1% annualised for 2016-2020 (Colliers International Real Estate Investment Forecasts Q3 2016).

Intu:**UK investment market**

Low interest rates and a weakened value of sterling mean that prime shopping centres continue to attract interest from international investors. Whilst activity was limited in the first half of 2017 as the UK general election took centre stage, good levels of demand remain for quality assets in the UK's liquid and transparent market for large shopping centres.

However, a flight to quality has ensured prime yields remain stable as investors look at the quality and longevity of income streams coupled with rental growth potential in a market where new supply, by way of development, remains low. Against this, yields on secondary assets are drifting outwards due to investors perceiving a relatively poor outlook for such assets.

UK consumer market

Uncertainty from the early stages of discussions of the UK's exit from the EU is creating a mixed picture on the state of the UK consumer. Unemployment continues at record low levels which should in turn drive earnings growth. However, the increase in inflation from the weakening of sterling after the EU referendum vote is causing prices to rise faster than wages at the moment which impacts consumers' disposable income. This is reflected in the Asda benchmark index of household income which has shown a reduction of 2 per cent since December 2016.

Looking further ahead, the Bank of England's forecasts suggest that wage growth will overtake inflation as we go into 2018.

Consumer confidence, as measured by GfK, had remained broadly stable over the majority of the first half of 2017, but has dropped following the UK general election in June 2017, reflecting negative sentiment about consumers' personal finances and expectations for the wider economy.

These mixed messages have not had a material effect on non-food retail spending, which remains unchanged against 2016 (British Retail Consortium like-for-like non-food retail index).

Occupier market

Retail is one of the UK's most dynamic and flexible industries which has always been able to adapt quickly in fast-changing environments. Retailers are facing both economic and structural challenges and the winners will be those with the right stores in the right places, who align their online and instore strategies and who give customers an experience they cannot get elsewhere.

Economic pressures include the impact on retailers' cost bases from the weakness of sterling, business rates revaluations and increases in the national living wage. The current squeeze on disposable income from higher inflation may add more pressure.

Structurally, retailers are still evolving in relation to the opportunities and costs of online shopping with those possessing a strong store network benefitting from click and collect. This enables them to use their existing efficient distribution networks to reduce delivery costs and convert additional sales when the customer is instore.

Considering the challenges that face them, many retailers are looking at fewer stores, but in the best locations offering high footfall from a compelling mix of retail, catering and leisure. This demand is spread across all unit sizes with the powerhouse fashion brands taking larger flagships and introducing their sub-brands, traditional big box

retailers refining their offer to smaller shopping centre size stores, new international and aspirational lifestyle brands successfully entering the shopping centre market and the continued growth in new leisure concepts. Whilst the rapid expansion of food and beverage operators in the last few years is slowing, leisure operators are increasingly looking at shopping centres for their expansion plans.

With our prime portfolio of shopping centres, offering compelling customer experiences and a sophisticated online offer, we are well positioned to meet the demands of this changing world, including the trend of online retailers taking physical stores, although this is still at an early stage.

Retailer administrations in the period remained at relatively low levels.

Spanish market

In recent years, the Spanish economy has had significant growth making it one of Europe's fastest growing economies. Forecasts suggest that this is expected to continue in 2017 with its GDP growth expected to be one of the highest of the major European economies. For the consumer, unemployment is at its lowest level for several years and consumer confidence at its highest. This in turn benefits retail sales which are further enhanced by record levels of tourists.

The investment market remains strong with continuing investor confidence in Spanish real estate supported by an economy that is growing. With the return of bank financing, the weight of money in the market looking to invest in quality assets has continued to strengthen the market. Due to lack of development in recent years, prime regional shopping centres are a scarce asset class which is reflected in good demand.

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Technology

Julian Cazalet, chairman, Herald Investment Trust: The IPO market in the US was particularly poor in 2016. There has been a marginal improvement this year, but pricing is generally unappealingly high. Companies are being held for longer in private hands, but will presumably need an exit at some stage. Not all exits will be trade takeovers.

The background for the sector is positive, but valuations are higher than they have been. Equities seem likely to experience the headwind from central banks' tightening and raising interest rates. Against this background companies with genuine growth may become more expensive. On this basis the sector still has attractions.

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Robet Jeens, chairman, Allianz Technology: The high valuations, continued strength and low volatility of global equity markets sit relatively uncomfortably alongside the significant geopolitical risks present across the world, particularly in the context of the uncertainty surrounding the new US administration's delivery of policy. How long the present bull market will run is a matter of frequent conjecture but the chances of a significant correction must be higher than for some time.

This heightened sense of overall risk levels does not alter the growing importance of new technology across the global economy and hence the case for strong relative

performance for technology investment over the long term. We will continue to see many interesting developments in the technology sector.

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Walter Price, manager, Allianz Technology: Given the ongoing uncertainties in the global economy, from geopolitical challenges to the protracted bull market, the investment team is closely monitoring these risks. However, we remain optimistic about the investment opportunities in the technology sector.

We continue to believe that the technology sector can provide some of the best absolute and relative return opportunities in the equity markets - especially for bottom-up stock pickers. The growth in technology is coming from the creation of new markets, rather than simply GDP growth. Investors need to find companies generating organic growth by creating new markets or effecting significant change on old markets. Sectors such as automobiles, advertising, security, retail, and manufacturing are all being shaped and transformed by advances in technology.

At present, we are seeing a wave of innovation in the sector that we believe has the potential to produce attractive returns for companies with best-in-class solutions. We have also seen a number of companies with present valuations that, in our view, do not fully reflect positive company- and/or industry-specific tailwinds.

Despite high valuations for some cloud and internet companies, we continue to see massive addressable markets much larger than the revenue today. However, we have consolidated our exposure to these areas in select companies having the most compelling solutions and whose business models demonstrate a discernible path to deliver strong earnings and cash flow growth over the next few years.

We are also finding excellent investment opportunities among more attractively valued areas of technology. In particular, certain technology incumbents are making compelling progress on their "as-a-service" offerings.

AI is also becoming a significant trend from consumer goods such as the Amazon Echo to autonomous driving as well as practical applications of AI. We expect AI will increasingly be used to make our lives more convenient.

Lastly, we believe the Augmented/Virtual Reality (AR and VR) theme is poised to accelerate in 2017. This theme has been slow to take off due to insufficient and expensive hardware as well as relatively new software applications. However, declining hardware costs, more gaming software availability, new mobile phones from Apple and Google, and ongoing AR work by Microsoft and Tesla with productivity applications should pave the way for this theme to deliver attractive future growth.

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