

April 2014

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 mind up. Please remember that nothing in this note is designed to encourage you to buy or sell any of the companies mentioned.

Global economy

From Tom Walker, manager, Martin Currie Global Portfolio

The US Federal Reserve has started to reduce monetary stimulus, but actual monetary tightening is, in my view, unlikely in the next 12 months. While monetary policy remains supportive, asset prices can keep rising. Compared with interest rates, developed market equities remain inexpensive, so the higher valuation over the last year is no bar to further gains. However, as equity valuations become more stretched relative to their own history, the risk that markets will suffer a set-back when the interest rate cycle turns is enhanced.



Although the earnings yield on equities has fallen, it continues to offer a higher yield than US Treasuries, albeit the gap is narrowing. The valuation of US equities (as captured by the ratio of earnings to share price, known as the price earnings ratio) has risen considerably but could rise higher, history would suggest.

Emerging market equities, in contrast, appear inexpensive relative to their history and relative to developed markets. But we have seen the dramatic impact that money flows have had already on emerging markets. Until their economies are more robust, money flows - driven by the anticipation of less supportive US monetary policy - may continue to dictate market direction.

Over the last five years, equity markets have nearly doubled. It is hard to argue that this is solely based on the fundamentals of economic and corporate earnings growth. Instead, the world is awash with money thanks to the benevolence of central banks and their printing presses. Until this reverses, cash has to find a home and global equities are likely to continue to benefit.

Elevated economic uncertainty has been a fact of life for a number of years now. While not wishing to belittle it, the world often finds a way to muddle through. So we will endeavour to construct a portfolio of companies whose earnings, assets and share prices can best prosper through all the uncertainty.

Since our year end, the situation in the Ukraine has deteriorated and Russia has annexed Crimea. Thus far, the ensuing war of words and visa travel bans has had limited impact on the major markets. However, the isolation of Russia has potentially alarming consequences given its importance as a supplier of energy and as a military superpower.

From Richard Stone, Chairman, Henderson Global Trust

Five years into the market recovery that started in 2009, we remain constructive on equities. Our view is supported by improving economic data, reasonable valuation levels, and the ability of central banks to continue to provide ample liquidity.

UK

From Kevin Allen, Chairman, Chelverton Growth Trust.

In the last few months there has been a stream of good news about the rate of growth of the UK economy and the forecasts for its continued growth over the next few years. This growth has been achieved against a background of inflation falling to 1.7%. Consequently, employment has continued to rise and now stands at an all-time record. With a "Goldilocks scenario" emerging of inflation continuing to fall and growth continuing to rise, the UK economy is looking to be set fair for the next few years.

Gradually, we expect that the UK will begin to see real wages rise as inflation remains at or lower than the current levels and wages begin to rise, albeit modestly in historical terms, to more than 2%. Anecdotal evidence would indicate that UK companies have started to reinvest in their capacity - new equipment, and their capability - recruiting more people.

On the macro-economic/political scene there are major concerns over the posturing of Russia and Mr Putin. Whilst the Euro sovereign debt problems have been pushed from the newspapers, the issues still remain and the cutbacks in government spending in several European countries are beginning to lead to social and political instability. The European debt position is not resolved and only at some distant point in the future, when it is demonstrably cleared up, can we be confident about the European market.

The "rebalancing" of the British Economy continues with evidence that growth is beginning to be created across the UK in most sectors. The Banks appear to still be putting their houses in order at the expense of providing finance to the SME sector and we anticipate that this process will continue for several more years. The emergence of alternative lenders to this sector may well have the result that in a few years' time, when the Banks are looking to increase their lending, they will discover that a number of entrenched new suppliers of capital have established strong market positions.



From Simon Fraser, Chairman, Merchants Trust

The economy is showing signs of recovery although this recovery is fragile with high levels of consumer and government debt and a mixed picture overseas. Over the last five years the stock market has been significantly re-rated from a very depressed level. However our managers are still able to identify strong businesses trading on attractive valuations. Merchants continues to invest in a diversified portfolio of higher yielding assets, with exposure to many different industries around the world. This broad strategy has served the Trust well in the last 125 years, through a wide variety of economic and market environments, and we believe is still appropriate for the future.

From Ian Barby, Chairman, Invesco Perpetual UK Smaller Companies

In terms of the year under review, the most surprising aspect may be the lacklustre performance of the emerging economies, just as it was thought that they were somehow immune from the effects of the banking crisis that started in 2008. Clearly, reduced demand from western economies as belts were tightened due to austerity measures has had more of an effect than first thought and any suggestion of a "de-coupling" from the west has now been dismissed.

Whilst this region may seem disconnected from the fortunes of smaller companies in the UK, the effect of a "hard landing" for the Chinese economy and the ramifications worldwide should not be underestimated. Given the likelihood of some level of domestic stimulus ahead of the 2015 General Election, [we] remain positive for future returns.

From Jonathan Brown and Richard Smith, Portfolio Managers, Invesco Perpetual UK Smaller Companies

The beginning of 2014 has seen a continuation of last year's strong performance, with the Numis Smaller Companies Index (ex Investment Companies) rising 6.4% (total return to the end of February). There are however, potential headwinds in 2014 - in the shape of reduced central bank stimulus, historically high valuations and a new issue market that shows signs of overheating. Nevertheless, with the economy on a sounder footing and the potential return of M&A activity after the one of the quietest years on record, we remain optimistic about further positive returns in the coming year.

UK Property

From Chris Russell, Chairman, F&C Commercial Property Trust



The economic environment in the UK has improved over the past year and this should help to support the momentum in the commercial property market. While there are concerns about developments in the Eurozone and emerging markets as well as uncertainty as to when interest rates will start to increase, in the absence of any major economic disappointments the year ahead should be another successful one for the asset class. The Managers expect London and the South East to continue to outperform other regions in 2014, but with a broadening of investor demand towards some UK regions and properties containing secondary characteristics.

From Paul Orchard-Lisle, Chairman, Standard Life Investments Property Income Trust

The improved business climate in the UK has given new impetus to the property market. There is strong demand from investors for well let and well positioned property, creating a significant uplift in prices. The occupational market has been slower to respond, with few tenants prepared to commit to new leases with a term certain of more than 5 years. So far, we have seen little evidence of rental values increasing.

My expectations for the future have to be tempered by the uncertainty of the outcome of the General Election expected in 2015. Even so, I believe that real estate will remain a favoured asset class and that we will see continuing demand for good secondary holdings. It is the occupational market that is and will remain the more fragile, and we will need to be alert to keep our good tenants and to fill voids by lettings to companies that have a positive long term future.

Asia Pacific

From Pierangelo Bottinelli, Chairman, Symphony International Holdings

In terms of business outlook, there will likely be headwinds in Asia in the short-term, but the fundamental growth drivers for the region remain intact. The US Federal Reserve's tapering is anticipated to increase capital outflows and provide some disruption to financial markets, but we do not expect this to have any

material ongoing impact to the operations of our investee companies. We remain optimistic that our businesses will continue to benefit from growing consumerism in the region.

From Michael Kerley, Portfolio Manager, Henderson Far East Income

We remain positive on the outlook for the region in the medium to long term but recognise that market direction will be dictated by macro factors in the short term. The slow withdrawal of quantitative easing combined with the strength and sustainability of the recoveries in the US and Europe and the degree of economic slowdown will be key to determining returns. Valuations in Asia however are attractive relative to their own history and other world markets and companies are cash rich with strong potential to increase dividend pay outs over time. We will use any market volatility as an opportunity to acquire quality high yielding or high dividend growth companies at attractive prices.

From Allan McKenzie, Chairman, Edinburgh Dragon



Recent developments foreshadow several risks confronting the region. Although the US recovery bodes well for Asian exporters, it has also boosted the case for the Fed to raise short-term interest rates sooner than expected. That could trigger a global reallocation of capital, which will intensify market volatility.

China's financial reforms will also have a significant impact on regional markets. The widening of the yuan's trading band from 1% to 2% underlines policymakers' commitment to allow market forces to play a greater role in the economy and markets. Amid accelerating financial deregulation however, risks from a bursting of the shadow banking bubble are worrying. One company has already defaulted on its bonds and several other trust products are reportedly on the brink of default. Your Manager remains cautious about China, as Beijing's tougher approach to shadow banking could lead to more asset price volatility.

Political risk is another key consideration. Pivotal elections in India, Indonesia and Thailand are likely to dominate headlines over the next few months. The constantly evolving political situation in Thailand bears watching. The longer the crisis drags on, the worse it will be for foreign investment and the stockmarket. In India, while leading contender Modi's pro-business stance has boosted investor sentiment, he is likely to face a fractious coalition government if he wins. On the other hand, Jakarta governor Joko Widodo's recent presidential nomination has spurred hopes of the possibility of a cleaner and more efficient government in Indonesia.

While cognisant of the above-mentioned risks, it must be reiterated that Asia's long-term prospects remain undiminished. The region is home to quality companies, underpinned by rising middleclass wealth, favourable demographics and increased urbanisation. Companies able and willing to exercise caution now should reap the benefits further down the road. Consensus earnings per share growth for Asia ex Japan is close to 40% for 2014, while the region currently trades on a decent multiple of 12 times price-to-earnings.

From Gillian Nott, Chairman, Witan Pacific

As our new Company year began, investors appeared to be sceptical about the sustainability of the economic recovery in Japan and concerned about the adjustment problems of other economies in the region to a world of lower commodity prices and the need for more broadly based growth which is less reliant on exporting to the Western world.

However, it is noteworthy that, despite the scepticism, the Japanese economy has (since the Abe government took power in late 2012) delivered stronger economic growth than other developed economies, with faster growth in Company earnings. The authorities appear more determined than in the past to deliver economic recovery so, despite 20 years of economic disappointment, it seems unduly negative to assume they will fail.

The long-term drivers of rapid economic growth in Asia (including infrastructure and housing, low costs and high investment levels) are not immune to cyclical disappointment and periodic mismanagement but investor sentiment may have become too negative, coloured by recent market disappointment. There is a risk that the longer-term positive strategic factors are being disregarded in the preoccupation with tactical concerns over economic reforms in some major economies and over the reduction in liquidity stimulus from the US Federal Reserve. For the first time in a number of years, much of the region is trading on lower valuations than Western markets, while the perennial laggard, Japan, may have become a contributor to regional growth, after two decades as a backwater.

Looking to the longer term, Asia, remains a region of immense opportunity as living standards rise and consumers obtain increased spending power.

Japan

From Jonathan Taylor, Chairman, Schroder Japan Growth

It has been a year since Prime Minister Abe introduced his radical programme to reinvigorate the Japanese economy. 12 months on it is noticeable, for all the publicity the measures have generated, how little the stock market has risen in sterling terms, with the rise in equities largely offset by the currency's fall. It should be noted, however, that sterling has been amongst the strongest currencies during the period. Both the market strength and the currency weakness were targets for the measures, in the hope that they will stimulate domestic demand and inflation, but as UK investors we clearly hope the former is larger than the latter.

It is therefore reassuring to see the Manager's belief that valuations and profit improvements are supportive of further market strength. The key long term judgement remains whether "Abenomics" will succeed. Whatever the first year has shown, it will be a long time before we know, but at the least Japan is making a genuine attempt to break the pattern of the last 20 years.



Thailand

From Nicholas Smith, Chairman, Aberdeen New Thai

Thailand's political situation remains fluid, and the deep-seated divide is showing no sign of abating. With the government unable to follow through on vital infrastructure spending, delays in planned public investment may add to growth risks. Also, ongoing protests may hobble foreign investment and tourism. Neither economic growth nor corporate earnings is expected to inspire this year.

Thailand, however, has seen variations of this before. The past 20 years of economic prosperity throughout most of the country has seen increasing expectations from, and wealth emanate to, the previously rural population in the north. This group is changing to a growing urban middle class which has seen, and expects to continue to see, its power reflected in the ballot box. Unsurprisingly the Bangkok middle classes and the

previous administrative establishment, who have wielded immense power outside the ballot box, feel threatened. This changing social demographic, together with the Army seemingly resolved to stay out of politics, will naturally lead to a stronger political base for democracy in the Kingdom. While these past months seem potentially more of a watershed than the coups and demonstrations of the past, matters will be resolved through national consensus. Thailand should rebound and be stronger for it. Improving external conditions, namely a recovery in the US and Europe, could help buttress exports this year, partially mitigating the impact of the political unrest. In the longer term, the nation is poised to be a beneficiary of rising regional trade. Its strategic geographical location gives it access to fast-growing frontier economies, such as Vietnam and Myanmar, whose young populations will be the future drivers of Southeast Asian growth.

Latin America

From Richard Prosser, Chairman, Aberdeen Latin American Income

Regional stockmarkets have steadied somewhat after a shaky start to 2014, but the Fed's ongoing reduction of its monetary stimulus and its future policy actions are likely to continue influencing market sentiment. A further slowdown in Chinese growth could also add to market volatility. Within the region, investor attention will likely be focused on Brazil and Colombia, where both incumbent presidents are seeking re-election. But while Colombian president Juan Manuel Santos's electoral chances are boosted by robust economic growth, record-low unemployment and the absence of significant political scandals, his counterpart in Brazil faces the challenge of convincing an increasingly sceptical electorate that the economy can return to better health. President Dilma Rousseff, or whoever wins the election, will have to increase taxes, make deep budget cuts, and come up with other concrete measures to address Brazil's financial imbalances.

Progress on much-needed reforms in Brazil has disappointed and since the period end, Standard & Poor's (S&P) has downgraded Brazil's sovereign external debt risk rating from BBB to BBB-. Our Manager has advised however that critically S&P changed their outlook from negative to stable and that neither the bond market nor the currency market reacted to the downgrade, confirming that it had been expected in the market. The rationale for moving the outlook to stable rested on Brazil's institutional, fiscal and external balance sheet strength and its large and diversified economy. Mexico's progress on the reform front has been especially encouraging. The slew of reforms, notably the opening of the energy sector to private investment after seven decades of state dominance, is expected to attract more investment inflows and revive growth. The recent upgrade of the country's sovereign domestic debt rating is a reflection of optimism over these reforms. Mexico is now only the second (Chile is the other) in Latin America with an "A" rating. A planned increase in government spending, previously delayed by the transition to a new presidential administration, will further bolster economic prospects. Meanwhile Chilean president Michelle Bachelet, who returned to office for a second term, has promised to forge ahead with tax reforms - including a corporate tax hike to finance plans to provide universal education - despite the economic slowdown.

In the long run, the region's fundamentals should remain supportive of growth. In general governments have relatively low levels of debt compared to the more developed economies. Demographics are favourable, while increasing consumer wealth is driving growth in domestic demand. Potential growth rates, despite being downgraded in recent months, also compare favourably against many of their developed counterparts.



From the managers of Aberdeen Latin American Income

In the last decade, Latin America has witnessed the compelling combination of an expanding middle class and accelerating economy. However, growth has faltered recently. A revival in fortunes would require structural reforms, but this will take time to bear fruit. Nevertheless, we remain confident about the region's long-term outlook, supported by favourable demographics and resilient albeit moderating domestic demand. The key is for companies to refocus on core businesses and exercise prudence during the lean periods. Furthermore, valuations have become attractive, which could generate buying opportunities for long-term investors.

Hedge funds

From Saltus Partners LP, managers of Acencia Debt Strategies

The opportunity set for managers continues to benefit those with established global platforms which can look across the capital structure and underwrite various asset classes. Looking forward, it is expected that the underlying managers will continue to favour complex, catalyst-driven investments over beta oriented or macro investments. Based on low levels of defaults, volatility and yields as well as high returns in 2013, the logical expectation would be for low future returns. Unfortunately, forecasting, as the last five years has shown, is a tough business. Few, if any, would have thought that the global central banker's experiment would have resulted in a potentially deflationary environment rather than a repeat of Weimar Republic style inflation. Experience in the industry tells us that the winds will change direction.

CLO market

From GSO / Blackstone Debt Funds Management LLC, managers of Carador Income Fund

The first half of 2013 was marked by a relatively rapid credit spread tightening in the U.S. loan market accompanied by high levels of loan refinancing and repricing compared to the 2012 levels and a consequent negative revaluation of U.S. CLO Income Notes. As we start 2014 there still remains some ongoing refinancing in the underlying U.S. loan market as borrowers continue to seek lower rates from retail and institutional loan investors. However we believe the quantum and speed will be less than seen last year.

The strength of the primary CLO market in 2013 already looks like it may be moderated in 2014. The AAA tranche of a CLO makes up approximately 60% of the cost of finance of the structure, and as such it is one of the most material drivers of the excess spread that will be available to Income Note investors. Uncertainty surrounding the implementation of the Volker Rule is currently limiting bank involvement in the CLO Senior Notes and driving CLO AAA spreads wider. Until the Volker Rule position is clarified we expect CLO issuance to trend at lower volumes than 2013.