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

In this month's roundup:

Global *(compare Global funds here)*

The Managers believe that the pace of change [*driven by technological shifts]* is continuing to accelerate exponentially and is impacting across an ever broadening range of industries and business models. The networking effects often found alongside these technological shifts tend to concentrate the rewards in the hands of fewer and fewer winners, rendering it even more important to search for the individual companies which may benefit.

The sheer range of industries across which this type of change is occurring, means that it is no longer appropriate to see 'technology' as a homogenous group. Today, the main areas of exposure to this type of growth encompass a diverse range of revenue sources and profit drivers, including media, advertising & mobile communications, retail, the auto industry, energy and healthcare.

The Managers strongly believe that this is a particularly exciting time to be a growth investor [*for two reasons*]. First is the compelling nature of change occurring across a widening spectrum of industries and second is a real shift in business models, away from capital intensive growth. In combination, these trends mean the potential rewards on offer for patient stock pickers, investing in the disruptive growth businesses of the future, could be very exciting. In order to benefit from this, one must be a long term investor. *From John Scott, Chairman, Scottish Mortgage*

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The bigger picture around the world looks rather more uncomfortable than even a few months ago. The prospect of rising interest rates in the US is becoming more real, yet the near-term economic outlook for Continental Europe seems to have worsened considerably and strengthened the likelihood of easy monetary policy for some time to come. In addition to these factors, there has been a welcome but unexpected weakness in the oil price. There is potential danger in the Ukraine and in the Middle East with ISIS. There is also less certainty about China's rate of economic growth and the impact of this on the world economy. The weaker Euro should eventually benefit the strong exporters within Europe. In the UK, of course, we face a year of political change, with a general election only a few months away and the recent party conferences have made clear the significant decisions which the electorate faces. *From Strone Macpherson, Chairman, British Empire*

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Economic activity in the developed economies has remained subdued since the financial crisis in 2008. It has taken years for many of these economies to regain their pre-crisis levels and there are some that still have a way to go to attain that level. Perhaps the anaemic recovery is to be expected given the overhang of unprecedented levels of debt across the developed world in combination with ageing populations. Whatever the cause of the disappointing growth, it has left the perception of a degree of slack in the developed economies and given cover to Central Banks to pursue highly accommodative monetary policies. Easy monetary policies have continued for six years following the initial crisis. We will, of course, never know the counter-factual case of how economies would have fared in the absence of ultra-low interest rates and Central Bank bond buying. The effects of these policies on markets, however, have been pronounced. The low yields available on high-quality government bonds have led to a search for yield elsewhere. Yields on other asset classes have been forced down and risk premia compressed. Asset price valuations have been elevated and volatility has been exceptionally low. Can this state of affairs continue?

Despite being tested by rising geopolitical risks, in the Middle East and Ukraine in particular, markets have remained calm up until the last few weeks. It may be that the accommodative monetary policies have anaesthetised investors against such short-term pain, although recent gyrations in markets are testing that thesis.

Undoubtedly, monetary policy in major developed economies will remain 'easy' for the next year in comparison with long-term historical averages. A challenge for investors, however, may arise from the increasingly divergent economic outlook for the developed economies. Persistent deflationary pressures in the Eurozone are likely to lead to further monetary stimulus, while in the US the economic recovery is slow but steady and is driving expectations for a gradual scalingback of monetary stimulus. The US Federal Reserve is expected to end its asset purchases in late 2014 and to start raising US policy rates in the middle of 2015. The UK economy is also performing relatively well and the Bank of England is also expected to commence raising rates in 2015.

Central Banks will, no doubt, be hoping to execute their next moves without unduly alarming the markets. This may prove difficult as investors begin to react to the divergent outlook not only for economies but also interest rates and currency cross rates. We should probably expect that volatility will increase from historical lows in many markets and that some high valuation levels may not be sustainable.

From our perspective, the end of quantitative easing should have a positive impact, as investors become more discerning about which stocks to own. Correlations between securities have decreased and this is an environment in which good stock pickers ought to do well. The "lower for longer" backdrop and buoyant credit and IPO markets remains supportive of companies wishing to extract value from their assets by way of disposals, spin-offs, reorganisations and returns of capital.

The continued outperformance of the US market over Europe is now an extended multi-year phenomenon. US valuations look increasingly expensive versus Europe. At some point, this trend may be subject to reversal. As ever, the short-term direction of stock markets is hard to predict. *From Asset Value Investors, as managers of British Empire*

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Six years after the financial crisis struck, the world economy has yet to address the underlying cause - excessive debt. Admittedly the implementation of loose fiscal and monetary policy has saved the world from the threat of depression, but the level of debt has not improved; indeed it has worsened. In large part that is due to an explosion of credit in the emerging markets, especially in China, where the increase in debt as a percentage of the world GDP was comparable to the increase in developed economies in the period leading up to the crisis. There are no obvious candidates to take over the baton from here, now that China itself looks satiated.

That support from China may have supported corporate profit margins in the US, which have remained at record levels. Historically, profit margins have reverted to the mean and that pattern should continue. With a strong US dollar; weak growth in Europe and Asia; moderate US growth and a narrowing of the fiscal deficit, corporate profits can grow only through a diminishing savings rate or rapidly expanding capital expenditure. Neither looks likely and therefore earnings may disappoint from here. Equities, of course, are still supported by unprecedented levels of stock buy-backs and these may continue. The US market is very expensive, as measured by commonly used fundamental measures of value (cyclically adjusted p/e ratios and Tobin's Q), but also on forward p/e ratios which are at the same level as the 2007 peak.

The nature of the next bear market, whenever it happens, may differ from the past. In part because of regulatory change in the banking system of Europe and the US, liquidity in most asset classes, certainly including equities and corporate bonds, has deteriorated markedly. In poor markets, bid prices could fall away very fast for some smaller company equities and corporate bonds.

Meanwhile, the battle between the strong forces of inflation and deflation continues. In the short term, the slowing world economy and late-cycle increases in supply of commodities are leading to weak prices in oil, gas and industrial raw materials. Good harvests have undermined food prices and, in the UK, supermarket wars are adding further pressure. Nor have wages yet responded to the better conditions in the US or the UK, though the pre-conditions for acceleration are in place, so inflationary pressures are suppressed. The monetary background, however, remains wildly expansionary and inflation still looks to be the ultimate outcome. Indeed, inflation is essential to reduce debt imbalances, as the Eurozone, where the threat of deflation is greater, may find out.

In general, long term returns in all asset classes look poor at current levels of valuation, but opportunities may be better after a bear market amplified by illiquidity. *From Mr T R Pattison, Chairman, Capital Gearing Trust*

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Despite being over five years into the stock market recovery, I still believe there are a number of supports to global equity markets. The strongest are the relative yield attractions of equities versus other asset classes, as well as the fact that, as mentioned in my last report, global fund manager cash balances remain high. Valuations are still close to historic averages for global high-yielding stocks and remain at a discount to the broader market. The macro environment, as discussed above, remains mixed but the powerhouse of the global economy, the US, is performing well. Key for me, as always, is the state of the corporate sector. Profit margins are high and cash generation is strong. Capital expenditure growth remains muted though and I would like to see management confidence return to see this growing again. If companies do not invest, they will not grow and that also has implications for dividends. *From Alan Porter, Manager, Securities Trust of Scotland*

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The external outlook remains a bit of an enigma - with some excellent pluses (a healthy corporate world and very low global interest rates for the foreseeable future to name a couple) but with some negatives (the very uncertain long-term consequences of "quantitative easing" the expansion of central bank supplied money - on a massive scale and the continuing roller coaster growth of government debt all over the world to name another couple of issues). In our own country we have settled the potentially very serious issue of the breakup of the United Kingdom (for the moment at least) but face an important general election next year. Brazil has just had its general election, returning Dilma Rousseff and her PT Party to power. Whatever new policies emerge, we think that the development of Brazil's offshore oilfields will remain a national priority. *From Alex Hammond-Chambers, Chairman, Hansa Trust*

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At the time of writing world equity markets have just experienced another period of nervousness regarding levels of global growth. Although the US and UK economies are performing reasonably well, doubts over the Eurozone and China combined with a degree of geopolitical instability have increased short-term concerns amongst investors. *From Ian Barrass and James de Bunsen, Fund Managers, Henderson Value Trust*

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Total world debt (public and private), which was 160% of GDP in 2001, reached 215% in 2013 and continues to rise. Such a debt burden inevitably lowers growth, which will ultimately lead to a default on the debt through inflation. Many shareholders ask us where the inflation will come from, particularly when, unlike in the 1970s, labour has little power to demand higher wages. They forget the prospect of inflation by debasement of the currency. An ordered example followed the devaluation of Sterling in 2008, which led to headline levels of inflation of 5.6% by September 2011. A more egregious illustration has recently occurred in Russia, where the rouble has declined in value against Sterling by 25% this year. A Russian student recently interviewed on Radio 4 gave a flavour of the damagingly fast effects of debasement, 'The most painful part is of course food ... for example, for a pack [sic] of milk. It was around 50 roubles in mid-August and now you can go and see it for 65, 70; sometimes more than a 50% rise.' The recent temporary upsurge in the forces of deflation is making the debt burden on the world economy ever heavier, and in the absence of strong growth only inflation can in the long run reduce it. *From Sebastian Lyon, Investment Adviser, Personal Assets Trust*

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This report is being written following an October that lived up to its traditional billing of being a difficult month for equity markets. This was disagreeable, but in these circumstances it is important to look on the bright side and keep faith with the asset class. Setbacks are always with us and, as we say, October is traditionally an unsettled month. But far and away the best bet is that equity markets will settle down, and then push ahead. The fact is, being as objective as possible, that we see plenty of reasons to be optimistic about equity markets.

[*One*] reason to keep constructive is to think through some of the implications of even the so-called bad news depressing equity markets. In the UK Tesco has had a shocker, dragging down all the food retailers. But the real reason for its malaise is technology. Technology is cutting profit margins for many traditional retailers. Not good for the retailers, but wonderful for consumers. Prices are coming down. The same is true for energy. We've seen it argued that the oil price is down - 25% in just 4 months - because the world's economy is slowing down. Maybe, but far more likely it is because technology is releasing new, unthought-of reserves of hydrocarbons and producing ever more energy efficient homes, work places and vehicles. That drop in the oil price is best construed as a multi-billion boost to consumer incomes and corporate balance sheets. Expect inflation to stay low, but real growth to pick up in response. Equities will recover their poise soon enough. *From Nick Train, manager of Lindsell Train*

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Markets have returned to a more febrile state, having digested the news that Europe is exhibiting little to no growth, and expectations for the future are no better. The US and UK economies seem to be in better shape and Asia, in particular China, continues to grow, albeit at a slightly lower rate than we have been accustomed to in the recent past. Companies trade at prices on listed markets in the US and UK that leave little room for disappointment, as evidenced by the sharp negative reaction to some of the recently announced profit warnings. The prices being paid for unquoted companies are underpinned by the availability of cheap credit and the volume of equity that has been raised by funds, which are now finding it difficult to deploy under their time constrained models. *From Will Wyatt, Chief Executive, Caledonia Investments*

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Global Emerging Markets *(compare Global Emerging Markets funds here)*

Emerging market economies in general have continued to grow at a faster rate than their developed counterparts. For the global economy, the effects of quantitative easing by various governments around the world are likely to be a dominant factor both with the provision of exceptional levels of liquidity by governments and the largely unknown effects of the ending of this experiment. Emerging markets were not as significantly affected by the financial crisis and have continued to perform relatively well. China has been an engine of growth and, while this has slowed somewhat, it is encouraging to see government policy stimulating domestic demand. We see the growth of such demand as the key to the future in many countries. *From Peter Smith, Chairman, Templeton Emerging Markets*

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A number of weaker than expected monthly indicators such as retail sales and industrial production from China, lower commodity prices and speculative flows into US dollar assets caused nervousness and volatility in emerging markets towards the end of the reporting period. However, we believe that a growing US economy, substantial monetary easing in Europe and Japan, and strengthening domestic factors in many emerging markets could present an attractive opportunity for investors. We remain of the opinion that longer term trends in emerging markets such as investor-friendly reforms in a number of countries (including China, India, South Korea and Mexico), moves to reduce trade barriers, major strides in technological expertise within emerging market economies, and the rapid growth in the numbers and spending power of middle class consumers all provide the basis for sustained economic growth and rising corporate profitability across many emerging markets. Meanwhile, we continue to identify individual emerging market companies that we believe trade at relatively attractive valuations.

Moreover, it is important to remember that emerging market countries now represent a large share of world economic activity and equity market capitalisation. The news that a BRICS development bank is being established is a demonstration of the increasing economic strength of emerging market nations. Many investors are underweight in emerging markets and are realising that this could represent a risk. As a result, emerging markets reported significant fund inflows during the second half of the period. The long-term investment case for emerging markets has not changed. Three key themes remain in place: emerging markets' economic growth rates in general continue to be markedly faster than those of developed markets; emerging markets have much greater foreign reserves than developed markets; and the debt-to-GDP ratios of emerging market countries generally remain much lower than those of developed markets. *From J Mark Mobius, Templeton Asset Management Ltd., managers of Templeton Emerging Markets*

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UK *(compare UK funds here)*

Undoubtedly, there are challenges ahead. Having jumped the hurdle of the Scottish referendum, the UK has other challenges in order to maintain a stable political situation which is favourable to equity markets. There may well be further volatility as the market considers the outcome of upcoming events such as the general election, as well as the ever present question of when interest rates might rise, and by how much. Of course, there are also events occurring overseas that could disrupt confidence in UK companies. However, many companies can be bought at attractive valuations, particularly compared to other asset classes. *From Lynn Ruddick, Chairman, Fidelity Special Values*

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Despite increased volatility towards the end of the period, we remain confident in the outlook. We view the recent sharp decline in commodity prices and bond yields as providing an effective monetary stimulus to an already improving economic situation on both sides of the Atlantic. The rush into many large company stocks for their bond-like characteristics has stretched valuations, despite the same companies often experiencing deteriorating fundamentals, making such stocks vulnerable to underperformance. In contrast, the sharp sell-off in many domestically orientated, medium sized company stocks, in spite of ongoing improvement in their underlying fundamentals, [*provides*] an opportunity to add attractively positioned stocks at lower valuations. *From Thomas Moore, Portfolio Manager, Standard Life Investments, Standard Life Equity Income*

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Uncertainty and volatility have returned to the fore. Recent data from Germany has been poor and given its role as the engine of European growth, weakness here makes it less likely that the region can return to growth without structural reform and a pick-up in bank lending. China, although still delivering growth well ahead of that emanating from developed markets, is slowing. Its economy is also transitioning and this effect can been seen in the decline in many commodity prices. The Federal Reserve is expected to raise interest rates during 2015. A similar situation exists in the UK, though the MPC is coy about giving clear guidance. Whether investors will concentrate upon the positives; namely that this suggests a more established economic recovery rather than the negative of extraordinarily cheap money being removed, remains to be seen. Investors are currently very focussed on the threat of deflation in Europe and the belief that the ECB can avert this via some form of quantitative easing programme. It is unclear what form such stimulus would take. If this is not delivered as expected it is likely to be taken negatively by markets.

Much has been written about the impact that dollar strength is having on corporate profits. It is worth remembering that unless it strengthens further, the effect of this move is now beginning to annualise. Additionally it is one of the factors weighing on the oil price. I would not care to attempt to forecast the future direction of the oil price but it is currently providing a very significant amount, by some estimates in excess of $2.5bn daily, of stimulus for the global economy. Importantly this is directly benefitting both companies and consumers. *From Anthony B. Davidson, Chairman, Shires Income*

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While sterling's rise has been a challenge, the last 12 months have been a relatively good environment for many companies, with the prospect seemingly of more growth - at least in the UK and US - to come. Stock markets were therefore not prepared at the end of this summer for a subsequent worldwide downgrade in growth expectations, accompanied by a general fall in investor risk appetite.

The last two months - as in the third quarter of 2013 - are a reminder of the risks in a world where so much economic activity and stock market liquidity is sensitive to short-term economic forecasts and central bank policy. Growth expectations for the UK and US economies remain robust despite forecasts coming down. Monetary policy will diverge, with the prospect of higher US and UK interest rates next year while both the ECB and the Bank of Japan are expected to ease policy further. Rising US and UK interest rates typically coincide with a pick-up in earnings but could lead to a de-rating of the market, particularly among mid and small cap stocks. The UK market also has the uncertainty of the General Election in May 2015 and a possible EU referendum to follow.

We believe that UK equities remain well placed for modestly positive returns, with valuations - at historical average levels, but still cheap relative to other asset classes - supporting the current market level. *From Schroder Investment Management Limited, as managers of Schroder Income Growth*

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The outlook for the UK equity market is likely to be volatile for the foreseeable future. The key issues that will continue to overshadow the performance of the equity market remain the interplay between growing investor pessimism on the global economic outlook and the ability of policymakers to create the conditions to reinvigorate growth prospects where necessary. The recent performance of the Eurozone and the Chinese economies, in particular, is concerning as prolonged weakness in these areas, and the deflationary forces that are exported, will undoubtedly have an impact on other developed economies such as the US and the UK, which have been performing relatively well in 2014. The overall background for revenue growth is likely to remain subdued into 2015 and will give rise to further profit warnings, which have been a feature of the recent news flow in the market.

The influence of the central banks in this environment is becoming weaker as their two main policy levers, interest rates and liquidity, have been fully exploited for a number of years. Their last remaining option is to use speeches and policy guidance to influence the behaviour of economies and market participants. But this power also has its limitations as the markets grow tired and sceptical of unfulfilled promises. It is certainly the case that policymakers are keen to change the current policy stance which has survived largely unchanged since 2008. However, any change in monetary policy, be it through the tapering of QE or a move in short-term interest rates provides another headwind for the markets in the near future. Given the recent economic news it is likely that the anticipated increase in rates in the US and UK will be deferred until 2015 as there is very little sign of inflation pressure in these economies despite rapidly falling levels of unemployment.

The political backdrop both domestically and internationally has taken on more relevance in the recent past and is likely to remain an important influence for the next twelve months. The changes in the political agenda ahead of the UK general election in May 2015 are likely to be another source of uncertainty for the UK stock market.

The market falls in recent weeks have started to factor in some of these concerns and it is true that equities continue to look attractive relative to other asset classes, but many valuations still look elevated where share prices do not appropriately anticipate the risk to earnings and cash flows that is likely to be realised. *From Mark Barnett, Portfolio Manager, Perpetual Income & Growth and Keystone Investment Trust*

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The process of "normalising" monetary policy is far from over and as policy makers and central bankers continue to strive to balance the rate of recovery with the withdrawal of monetary support it remains likely that equity market fragility will persist. This has become particularly evident in recent weeks when a slew of weaker data and the re-emergence of deflationary concerns caused a sharp pull back in markets, which stabilised only when the Bank of England's Chief Economist once again allayed concerns by pushing the date for any potential interest rate rise further out into 2015. *From D Warnock, Chairman, Troy Income & Growth*

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With a stuttering global economy and inflation below 2% in many developed markets, central bankers seem to have been granted a pretext for a continuation of loose monetary conditions. Interest rates have been at historical lows for over five years. During this time the balance sheets of both the Bank of England and the US Federal Reserve have also increased five-fold. As we have often written such a monetary experiment is without precedent and extrication from its clutches will be easier said than done.

The deflationary implications of tighter monetary policy at a time when economic growth is not strong enough to withstand it are neither politically nor economically palatable. Falling prices result in profitability declines, deferred consumption and higher unemployment. Central bankers seem committed to avoiding such an outcome. Federal Reserve Chair Janet Yellen cites the lowest inflation measure available to support her argument: The latest ex-shelter CPI measure in the United States was 0.9%. This is perilously close to the deflationary knife's edge. Many Eurozone countries are already close to deflation and the currency bloc's overall rate of consumer price inflation was a mere 0.3% for the year to September 2014. Central Bank President Mario Draghi used this figure to support his rationale for Quantitative Easing.

The prospect of deflation is particularly detrimental to highly indebted companies: the fixed amount due for repayment can come to dwarf the declining profitability from lower priced goods and services. You can be sure that such companies will be the first to cut their dividends when times get tough.

With policymakers intensely focused on the avoidance of a deflationary outcome, future inflation seems the inevitable reverse of the coin. The timing of this is, however, highly uncertain. *From Troy Asset Management Limited, as managers of Troy Income & Growth*

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Investors have become decidedly more cautious over the last six months. Fund flow data published by the Investment Management Association shows that investors began rotating out of SmallCap and into LargeCap during the summer. At just under 14x 12-month forward earnings, SmallCap valuations are neither cheap nor expensive, but may need to offer more compelling valuations before investors are tempted back.

We expect investors to be offered an attractive entry point into SmallCap in early 2015 if the prevailing correction continues. In the meantime, we believe that investors have come to realise that this is not the time to take on high risk: in our view, a low beta and quality focused strategy makes sense. *From Montanaro Asset Management Limited, as managers of Montanaro UK Smaller Companies*

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My caution has been justified by the sharp sell-off we saw in equity markets since the end of August and, although there has been some recovery, fears over slowing global growth, deflation in Europe and news of Ebola cases outside of Africa has led to a deterioration in investor confidence. Whilst this could continue for a while, Central Banks are likely to continue to be supportive and levels of liquidity remain high, so tending to underpin markets at lower levels. *From Hugh Twiss, Chairman, Invesco Income Growth*

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The FTSE All-Share Index has risen strongly over the last six years and, even after the recent fall, remains close to its all-time peak. Whilst there are many headwinds to withstand in the short term, be it slow economic recovery in large parts of the world, low inflation, or the removal of the US economic stimulus, valuations suggest that the long term outlook for returns from investing in the stock market are still attractive. *From Ciaran Mallon, Portfolio Manager, Invesco Income Growth*

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Europe *(compare European funds here)*

The good news is that the financial performance of corporate Europe continues to outpace significantly that of sovereign Europe. October Purchasing Managers Indices for the Euro area were encouragingly ahead of expectations, for both services and manufacturing, and the third quarter reporting season has produced the highest share of companies exceeding forecasts in four years, according to Deutsche Bank. Even on reduced expectations, Euro area gross domestic product is forecast to grow by close to 1.0% this year and next whilst in the US growth is expected to accelerate from around 2.0% this year to 3.0% in 2015. Moreover, the October

Bank Lending Survey showed that overall credit conditions (supply and demand) for the Euro area are easing at the fastest pace since 2006. The greatest risk, perhaps, is that the negative news headlines become a self-fulfilling prophecy in Europe and that financially flush corporates, and somewhat less flush consumers, hold off investing and spending; with a Euro area interest rate of just 0.05%, the European Central Bank's options for stimulus are becoming more limited.

In spite of the macro background, European earnings have been recovering since the first quarter of 2013 and smaller company earnings have been growing fastest. We continue to find well managed businesses with strong franchises, sound balance sheets, positive operating momentum and attractive valuations. *From Jim Campbell and Francesco Conte, Investment Managers, JPMorgan European Smaller Companies*

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Following the substantial rise in share prices seen in the previous financial year and the slower than expected recovery in corporate earnings in the year under review, European equities are trading at more demanding valuations. Like other equity markets, those of Europe face wider geopolitical and economic uncertainties. However, in view of the current accommodative stance being pursued by the European Central Bank and the potential for economic recovery in Europe, we remain fully invested. *From Douglas McDougall, Chairman, European Investment Trust*

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With global growth at 2.5%, minimal inflation and a debt overhang in developed economies, the current accommodative monetary policy stance is likely to continue. Our expectation is for European economic growth to recover in 2015, albeit at more modest rates. From a global equity perspective, we anticipate that we should see reasonable returns from equities over the next few years, although this could be punctuated by periods of correction. *From Dale Robertson, Edinburgh Partners, managers of European Investment Trust*

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The outlook for 2015 is for continued recovery in growth around the world. Potential risks are a deterioration in the situation in the Ukraine, and geo-political tensions with Russia, but the support announced by the ECB only starts to come into play strongly from the end of this year, so the impact on credit and confidence should start to become apparent from the first quarter onwards. The recent fall in the oil price will also help to support consumer confidence. Valuations are attractive on long-term comparisons, and the yield on equities still looks very enticing relative to other asset classes. *From Stephen Macklow-Smith, Alexander Fitzalan Howard and Michael Barakos, Investment Managers, JPMorgan European*

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Emerging Europe *(compare Emerging European funds here)*

What happened in Russia has been, rather unfairly, a setback to the development of a more robust investment case for the Emerging European region as a whole. It has demonstrated how easily a fragile institutional structure can be derailed by politics. Despite the power games being played out in Turkey, and the dependence of Central Europe on the Eurozone, prospects for good long run investment returns in this region have only been enhanced by the value created by the sell-off.

Companies are still getting better. The world is becoming more interconnected and growth opportunities in these markets dwarf anything to be found in the developed world. Setbacks such as we have seen drive stock markets to valuation levels that fully reflect the risks. The major uncertainty remains timing. Investors who have the stamina will undoubtedly benefit as conditions normalize, but it would be wrong to ignore the possibility that things might get worse first. We did not foresee what would happen this year, and there are no predictions here except to repeat `There is nothing permanent except change'. *From Steven Bates, Chairman, Baring Emerging Europe*

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While recent developments surrounding Ukraine give some hope for further de-escalation, the negative impact on Russian business has certainly been felt. The 3 main vectors along which these policies affect our strategy are as follows:

First, the Russian state will play a more active role in business and, while seeking to mitigate the effects of international sanctions, will adopt a policy that will favour higher re-investment rates over dividend payouts in strategic sectors.

Second, on the currency front, the Russian Central Bank may well favour a gradual depreciation of the Russian Rouble as this is the key to unlocking a powerful self-help mechanism which leads to import substitution, so supporting the Kremlin's main constituency in rural areas and mining communities. In these circumstances, inflation will remain elevated.

Third, while we can see a scenario in 2015 where the relationship with the European Union and the US improves on the back of the mutual interest in de-escalation, the immediate impact on the Russian economy might not necessarily change the economic outlook. While access to international bond and money markets would help to supply liquidity and support growth, we sense that it will take substantial trust building exercises by the Russian government to revive confidence in companies, small and large, and allow for a pick-up in investment led growth.

Looking forward, we see a broad based, diversified set of opportunities for the Company. Investor expectations are depressed because of the crisis in the Ukraine, and while energy prices have been falling substantially over the last quarter, Russian self-help in the form of import substitution might substantially soften the blow. Valuations are very low.

Turkey, although having experienced substantial volatility over the course of the last 12 months, should be one of the largest beneficiaries of lower global energy prices. Additionally the extremely busy election calendar over the last couple of years now comes to an end. After having voted in the 2015 parliamentary elections, Turks will be able to enjoy a record period of almost 5 years without major elections, paving the way for the acceleration of the structural reform agenda promoted by the ministry of finance and the ministry of economics.

Central European markets are likely to suffer from subdued economic activity in their main trading partner (Germany), but will be able to tap into EU cohesion funds which should balance somewhat the impact of poor German demand. *From Matthias Siller, manager, Baring Emerging Europe*

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Asia *(compare Asian funds here)*

As I write there is considerable volatility in global markets caused by geopolitical uncertainty in the Middle East and Eastern Europe. In Hong Kong "pro-democracy" protests have raised uncomfortable questions for the Chinese government. Uncertainty has also been exacerbated by fears on the impact of the Ebola virus globally. In Europe concerns are being expressed on the sustainability of what is an anaemic economic recovery. The latest forecasts from the IMF were generally pessimistic. Asian markets are not immune to external events. Chief among these is the timing of a Fed interest rate hike, given the steadily-improving US economy. A sooner-than-expected increase is expected to cause renewed outflows from riskier assets, but the view of your Manager is that this is likely to be more of a short-term jolt than a sustained slowdown. The hope is that such a normalisation of monetary policy could help shift investor focus towards corporate earnings and companies with good and improving fundamental prospects.

While sentiment is currently very fragile across all global markets, Asian economic growth is likely to remain relatively strong in comparison to other regions over the long term. Improving demand from the US should benefit regional exporters, while the recent elections in India and Indonesia have buoyed business sentiment. *From Allan McKenzie, Chairman, Edinburgh Dragon Trust plc*

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With the rebound in global stock markets in the second-half of the period, it is worth noting that Asian shares are still trading at a significant discount in valuation terms to developed markets. Asian companies also have much lower debt levels measured against global peers. At the same time, the region boasts higher economic growth rates, and hence, we continue to see attractive opportunities despite rising markets. Into next year, the US Fed's plan to raise interest rates would raise corporate borrowing costs, but the portfolio's balance sheet strength would put it at a relative advantage in this respect. Any rate hikes would also be dependent upon better US economic data, which should mean improved demand for Asian goods and services. Elsewhere, in terms of China's slowdown and Europe's apparent stagnation, continued selective stimulus in China and additional quantitative easing in Europe could help support demand. Several [*stocks*] were buoyed by progressive election outcomes, but expectations are high and the actual pace of reforms may disappoint. The need for their governments to cut subsidies and balance budgets also means cost increases for businesses. *From Aberdeen Asset Management Asia Limited as managers of Edinburgh Dragon*

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The outlook for the global economy and the performance of Asian equities is uncertain given the unwinding of unconventional monetary policies, slowing demand growth, surplus capacity in a number of industries, political tension and elevated asset values. A high level of public sector debt is a concerning feature of many economies globally as central banks are being forced to adopt highly unorthodox measures to promote and support growth. Longer term, ramifications of global money printing are still unclear. In the light of these challenges, markets are likely to remain volatile and we remain cautious, especially after recent developments in Ukraine and the Middle East. On a more positive note, most Asian economies are net energy importers and countries such as India are benefiting from a significant fall in oil prices.

Much of the above uncertainty is already reflected in the high valuations of quality consumer companies, as many look to their defendable franchises and strong cash flow generating characteristics as a place to hide at a time of minimal cash yields. In contrast, quality cyclical companies are less popular. Nowhere can current valuations be deemed especially attractive. *From Wee-Li Hee and Angus Tulloch, First State Investment Management (UK) Limited as managers of Scottish Oriental Smaller Companies*

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Arguably the main issue facing investors arises from credit markets rather than equity markets. The latter do not look excessively expensive in valuation terms, but credit markets look like the unnerving mirror image of where they were in 2008. Then, borrowers faced potentially ruinous rates to access credit. Now there appears little discrimination in credit as Spain's borrowing cost converges towards Germany and the US. Meanwhile, it is difficult to ignore the rise in geopolitical risks and continued signs of deflationary pressures, in particular a slower growth trajectory in China. This makes us nervous about predicting short term market direction.

More specific to Asia has been rising investor optimism over government-led economic reform which has become a major theme in China, India, Indonesia and Korea. We wish new leadership in India and Indonesia well, but progress is likely to be very slow going and current euphoria will be subject to severe testing. For Korea, we need to see more convincing evidence of better corporate governance than has been in evidence thus far.

Attention in the region has shifted to China where growth has stabilised amidst a more stimulatory environment in recent months. This has generated a more positive trend for Chinese assets over the summer. The currency has started to appreciate mildly again and property prices have stabilised. While this may appear good news, our firm view is that there is already too much credit in the economy which really needs a sustained period of tightening, not more loosening, to resolve the bad debt problems. There is significant value in China that can be unlocked by reforms and a shift in economic direction but not until some of the past excesses have been recognised.

If the hopes for reform may prove misplaced, there are some positive supports for the region. A combination of steady global economic expansion and falling commodity prices is beneficial to the regional export outlook, and industrial and information technology sectors are important components of the equity markets. National balance sheets are also, in general, sound with high savings rates, foreign exchange reserves and positive current accounts. These provide reassurance that the longer-term scope for domestic demand growth in Asia remains ample. *From Schroder Investment Management Limited, as managers of Schroder Oriental Income*

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The creation of liquidity through quantitative easing ('QE') programmes by central banks has been the primary driver of the secular bull market in financial assets across the board since the global financial crisis. However there is much less evidence that liquidity has percolated through to the real economy. The Federal Reserve has been steadily "tapering" bond purchases as they appear to have exited from QE despite mixed and deteriorating data showing that, while the US economy has some traction, the picture elsewhere shows little evidence of a pickup in world trade. Deflationary forces are prowling in China and Europe. The benchmark 10 year US Treasury yield falling to 2% in October is symptomatic of these trends. Weak commodity and oil prices declining 25% since June are a silver lining for industry and permit central banks to keep interest rates low. Many geopolitical issues are exacerbated by fragmentation in trouble spots around the world due to waning American hegemony in foreign policy. Russian sanctions and the zealous regulation of banking and finance have an unintended consequence of crimping the free flows of capital; perhaps the greatest threat to the forces of globalisation since the Berlin Wall fell.

I do not want to appear unduly gloomy even though the short-term outlook is occluded. Your board believes that the Asian region as a whole has set itself a fundamental path to growth in the medium term that provides a compelling case for investment. Providing politics stay on an even keel, Asia will continue to flourish from the growth in per capita incomes and a burgeoning consumer society with associated urbanisation and investment in infrastructure. The new BJP government in India appears to be implementing ground breaking market reforms and ushering in a nascent credit cycle creating fertile investment opportunity. Valuations are not stretched. *From Harry Wells, Chairman, Martin Currie Pacific*

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We remain positive on the long-term prospects for the region. In the nearer term, the continued tentative improvement in the global economic environment should provide a positive backdrop for Asia. In addition, earnings expectations are now at a more realistic level than where they were at the start of the year and the valuation of the market is relatively attractive, trading at 1.5x book value, a discount to the long-term average of 1.9x. However, this in part reflects return on equity in the region also being below its historic average, while Asian markets are also facing a number of real challenges both at the country and global level. The consequences of geopolitical risk loom large, as does the prospect of normalising interest rates in the US with the potential negative knock-on effect on Asian currencies and fund flows.

Having recently visited India, we have increased conviction that there is genuine change taking place. There is a strong focus on improving transparency and decision-making, addressing theft and corruption, tackling the high level of inflation, reducing government subsidies and dealing with the numerous stalled infrastructure projects. We do not expect a near-term boost to growth from these measures but expect that the benefits could start flowing through in 2015/2016.

Despite the improved export figures in China, the economic data have deteriorated in recent months, with some commentators expecting GDP growth to have slowed to closer to 7% in the latest quarter, from 7.5% in the second quarter. The government's 2014 target of 7.5% looks to be at risk. Policymakers do have levers that they can pull to try and boost the sluggish economy and housing market but they will have to take a measured approach given the overriding issues with credit quality in China.

Elsewhere across the region, Korea and Taiwan are also benefiting from an improvement in exports to developed markets but there will be a negative impact on the economy in Hong Kong in the shorter term from the democracy demonstrations and continued political fallout. The political situation remains in flux in Indonesia, which could provide a stumbling block to newly elected president Jokowi Widodo's plans for significant reform. Although the political landscape has stabilised in Thailand for the time being, the interim military government's plan is to stage another round of elections in October 2015, which could lead to further unrest and instability. *From Andrew Graham, manager, Martin Currie Pacific*

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I believe the case for Asian income remains attractive both in absolute terms and relative to other equity income strategies. Low levels of debt, rational capital expenditure and strong cash flow generation should ensure dividend sustainability while strong underlying economic growth and a gradual adoption of a dividend culture will drive higher pay-out ratios and dividend growth over time. Asia also offers diversification not only in terms of country and currency but also from the wide range of sectors available for the income investor which provides exposure to areas of growth not normally associated with income portfolios. *From John Russell, Chairman, Henderson Far East Income*

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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 end of quantitative easing in the USA and the probable start of a series of interest rate increases, the sustainability of the U.S. recovery and renewed weakness in the Eurozone 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 tremendous potential to increase dividend pay outs over time. *From Michael Kerley, Manager, Henderson Far East Income*

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China *(compare Asian single country specialist funds here)*

My view on the macroeconomic outlook is that growth will be subdued. The market sometimes gets so engrossed in headline grabbing numbers such as GDP and property prices that they are possibly missing the real long-term opportunities; reform and the shift to a consumer-driven economic model. These risks need to be monitored but I think they are manageable. I believe that growth will be slower than in the past but it will still be at an enviable rate in a global context, providing a good environment for individual companies to grow. This is particularly true for companies that lie within areas of the economy that the Government wants to see grow at a faster rate than the general economy, for example consumption.

One of the big stories to focus on for 2015 will be the implementation of reform. These reforms will provide a solid foundation for China's next phase of development, and include the opening up of financial and capital markets, the introduction of market-orientated price mechanisms across a range of sectors, improvements in efficiency and profitability of State Owned Enterprises and the release of pent-up consumer demand via changes in social welfare, such as the hukou system. This, coupled with attractive valuations makes China an attractive opportunity for investors.

The China market is trading at 9.5x price-to-earnings ratio compared to the S&P 500 trading at 18x yet its companies have enjoyed strong earnings growth over the last few years. I am expecting companies in the portfolio to increase earnings by over 20% in the coming year, and at some point this is expected to be reflected in stock performance. *From Dale Nicholls, Portfolio Manager, Fidelity China Special Situations*

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Japan *(compare Japanese funds here)*

The global context facing Japan is not encouraging. The end of the US Federal Reserve's quantitative easing programme may unsettle financial markets, given the uncertain outlook. The US and UK are expanding at a healthy pace, but China's economy is moderating and Germany's stumbling growth risks tipping the Eurozone into another recession. Ultimately world trade drives export demand, so what is happening elsewhere will have a significant impact on Japan. Additional stimulus has recently been rolled out with renewed large scale quantitative easing by the Bank of Japan. The announcement by Japan's biggest public pension fund GPIF of an increase in its asset allocation to equities, is also a positive although it may be a while before government led efforts finally turn around the economy. However, time is on Abe's side for now. Although Abe's approval ratings may have waned, his support is relatively high with the opposition DPJ in disarray. The next election is not due for another two years, but speculation is mounting that Abe may call an early election in an attempt to lock in his mandate for a further four years and allow a delay of the planned 2015 sales tax hike.

Meanwhile, the gathering pace of change unfolding across the corporate landscape appears promising. Many Japanese companies have recapitalised with robust balance sheets. Management, too, are increasingly shareholder friendly - the recent jump in share buybacks and higher dividend pay-outs are a testament to that. There is also greater emphasis on corporate governance, with the more progressive companies appointing external directors. The recent introduction of the stewardship code, similar to the UK's, is also expected to enhance investor engagement with management. The Board remains positive about Japan for these reasons. *From Neil Gaskell, Chairman, Aberdeen Japan*

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India *(compare Asian single country specialist funds here)*

Whether the economy has stabilised and is poised for a recovery remains to be seen. Much hinges on the Government's resolve. At the time of writing, the BJP has consolidated its power by securing victories in two crucial state elections, which should reduce policy hurdles. Any doubts over the Government's desire for reform have also been partially allayed by the removal of diesel subsidies, a prickly issue that should alleviate fiscal imbalances in the longer term. Certainly, the fall in global oil prices provided the latitude to do so. Meanwhile, the coal ministry has demonstrated its determination by allowing the private sector to continue to mine commercially, in a riposte to the Supreme Court's earlier decision [*suspending a number of mining licences*].

These are encouraging developments that should further support the market. Yet, easing infrastructural bottlenecks, removing red tape and addressing other structural flaws may take months to implement and years to bear fruit against India's fractious political backdrop. The immediate danger is that the Government loses momentum or the will for continuing reform. Nevertheless, the long-term appeal of the market remains. India's best companies thrive in spite of uncertain policy-making. Well-tested management with both ambition and execution, as well as a shareholder-friendly culture, stand them in good stead. It may take several more quarters to see a broad-based recovery in earnings, but cost cuts and restructuring are starting to pay off. *From Hasan Askari, Chairman, New India*

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The wave of positive sentiment generated by Narendra Modi's landslide election victory seems to have given way to a realisation of just how complex and colossal the task of overhauling India is. However, markets still have support, particularly given the cautious optimism on the economy, with business and fiscal conditions looking more stable than they have in some time. With the latest inflation readings falling to a five-year low, helped in part by the sharp decline in global crude oil prices, there might be scope for the Reserve Bank of India to soften its stance on monetary policy, providing some momentum to the burgeoning recovery. Meanwhile, the BJP's wins in the two most recent state elections have hopefully provided the impetus it requires to hasten reforms. Its ensuing announcements on diesel deregulation, gas pricing and coal sector reforms were particularly encouraging.

As is true for most emerging markets, India's wellbeing also hinges, in part, on the global economy. Any sudden movements from the US Federal Reserve on interest rates, or a protracted slowdown in Europe, could unsettle domestic markets. That said, the backdrop of soft commodity prices is distinctly to India's advantage, because these account for more than half of the nation's imports. *From Aberdeen Asset Management Asia Limited, Investment Manager, New India*

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Vietnam *(compare Asian single country specialist funds here)*

Domestic macroeconomic conditions remain supportive of the continuation of the current bull market into a fourth year, the VNI [*Vietnam Index*] having bottomed with the end of the last mini-cycle at the beginning of 2012. How easily the macro translates into further gains will, in our opinion, be determined by the Government's willingness and ability to deliver ongoing improvements in the stock market.

The relaxation of foreign ownership limits has been pending for over a year now, possibly due to a combination of the need to unravel the issue of conflicting legislation with some resistance in the hard core, who perhaps both mistrust foreign investors in general and misunderstand the nature and long-term economic benefits of a fully functional stock market. Add to this a seemingly more inclusive decision-making process (equals less decisive) at the top of the pyramid and Vietnam runs the risk of continuing to retard progress beyond the attention span of foreign institutional investors and that would be a great pity.

There is no doubt that Vietnam is currently in a sweet spot as far as foreign direct and fixed income investors are concerned, with impressive flows continuing into electronics plants and supporting industries in particular as the Government, buoyed by recent success, considers further sovereign bond issues. The equitisation to listing process, however, which should be providing welcome new supply to the stock market, is unfortunately teetering on the edge of being a complete waste of time. The Vietnam Airlines IPO was lauded locally as being a success having been oversubscribed by a whisker due to two local banks having taken up over 98% of the shares. With no foreign institutional participation whatsoever and no firm listing date in the plan we would question that interpretation. If we understand economic theory at all, raising money from foreign investors by privatising state owned enterprises would have an impact on the overall size of the economy whereas selling overpriced state assets to local banks (one of which is 77% owned by the state) is more akin to taking money out of one pocket and putting it into another.

Our fear is complacency; that Vietnam is ostensibly now doing so well from a macroeconomic perspective that the two crucial reforms that will aid the development of the stock market - namely more supply and better access for foreign investors (who can already buy up to 100% of subsidiaries of listed companies but only 49% of the listed entity itself for some unfathomable reason) - have disappeared from the list of things that will provide benefits to the advance of the country as a whole. The danger is that over-confidence makes you think you can get the timing right within the cycle and you figure out that you got the length of the cycle wrong when it is too late to do anything about it. The Government may of course (we hope) prove once again that it knows what it is doing in spite of increasing scepticism (at least from equity market commentators) and make the necessary adjustments sooner rather than (too) late(r). Time will tell but for the time being at least there are definite early signs of disappointment at the slow progress of reform. *From Kevin Snowball, investment manager, PXP Vietnam*

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Latin America *(compare Latin American funds here)*

International investors remain wary of a sooner-than-expected interest-rate hike by the US Federal Reserve. This has also underpinned US dollar strength and weakened commodity prices, further subdued by disappointing data from China. However, other central banks are keeping monetary policy loose. China has steadily increased stimulus measures to meet its target 7.5% GDP growth rate. Monetary policy in Europe is diverging from the US and UK, as the European central bank looks set to increase the effect on rates and liquidity by asset purchases.

There are some positive political developments within the region including Mexico's promising energy. Despite market disappointment at the narrow re-election of Brazil's President Dilma Rousseff after the year end, there is pressure from both local and foreign investors for market-friendly reforms to generate economic growth and tackle inflation. In Argentina, an agreement with holdout creditors regarding debt repayments is possible next year, after a key legal clause expires. This should help to rebuild trust among foreign investors. *From Richard Prosser, Chairman, Aberdeen Latin American Income*

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In stark contrast to the stock market losses witnessed in the first half of the financial year, Latin American markets appear to be on the road to recovery. However, the region's solid showing masks the diverging prospects of individual nations. Dilma Rousseff's win in the recent elections is likely to weigh on the Brazilian stock market in the near term. That said, her narrow margin might compel her to tighten fiscal policy and implement the economic adjustments necessary to restore growth and confidence. On a brighter note, still-low unemployment should prove supportive for future growth, and a solid pipeline of infrastructure auctions bodes well for investment. Chile, which was the worst-performing market, may continue to be hampered by low copper prices and political concerns in the short-term. In Mexico, recent data appears to support expectations that the economy is shaking off the sluggishness it experienced in 2013. Reforms to open up the long-closed energy sector to private investment bode well for growth further down the road, although investor optimism is reflected in Mexico's relatively elevated valuations. Despite the macroeconomic uncertainty, we see plenty of value in the region. *From Aberdeen Asset Managers Limited as managers of Aberdeen Latin American Income*

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Biotech & Healthcare *(compare Biotech and Healthcare funds here)*

The biotechnology and healthcare sectors have provided very strong returns to investors over the last decade. We believe the outlook for these sectors continues to be positive. The key underlying factors behind this growth remain intact and are as follows:

- Medical sciences innovation - improved understanding of biology enables more efficient drug discovery and medical device development. The sector has consistently provided novel treatments for diseases of high unmet medical needs. We predict the next ten to twenty years will be an era characterised by the launch of many new drugs driving continued strong earnings growth for the sector.
- Biotech integration with Pharma - biotech remains a feeding ground for larger companies seeking new innovative products. This has been a major driving force of mergers and acquisitions within the sector and is set to continue. In the first half of 2014, biotech was an important component of the $315.3bn M&A deals in healthcare.
- Regulation - the regulatory environment in the US and in Europe has improved leading to better clinical trial design, higher internal competence and new development paths.
- Healthcare reform - in the US and other significant markets, reform is pushing for a more broadly, more efficiently delivered system and is resulting in a larger number of patients receiving care.
- Demographics - ageing populations around the globe continue to demand and pay for improved healthcare.
- New markets and customers - increasing prosperity around the globe, particularly in high density populations such as China, India and South America, has provided patients and healthcare suppliers with the means to pay for healthcare. This materially widens the market for any product or service that provides a demonstrable benefit to the patient.
- Company valuations remain appealing - healthcare indices such as the NBI may be at historical highs, but the fundamentals of the companies behind these indices remain compelling. Compared to the last material high around the year 2000 - the value of biotech companies is now supported by very real revenues and profits, with prices relative to long-term growth rates at very reasonable levels.

Set against these positive fundamentals for the sector, there is increasing pressure, particularly in the US where prices tend to be highest, to justify the current price of drugs, devices and healthcare services. While this does put pressure on profits for 'me too' drugs, innovators who are able to demonstrate improved efficacy and/or savings in the delivery of healthcare will continue to price at a premium.

The outlook for earnings growth generation in the biotechnology sector continues to be strong, and is expected to remain intact for the next decade. This optimistic outlook is supported by the increased output of drugs from biotechnology companies. With the greater understanding of disease and an accelerating rate of discoveries in bioscience, there is the real potential for an unprecedented period of value creation in the biotechnology industry. *From SV Life Sciences Managers LLP as Investment Manager of International Biotechnology*

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The development of new products and the prospect of merger and acquisition activity continue to be key drivers for the biotechnology sector. Our Portfolio Manager, OrbiMed Capital LLC believes that large capitalisation biotechnology companies, in particular, offer good value opportunities due, in part, to positive earnings prospects for 2015 and beyond. Against this back-drop, the Board remains confident about the future performance of the biotechnology sector with the portfolio being well-positioned to benefit from this positive outlook.

Despite the biotechnology sector witnessing volatile market conditions in recent months our Portfolio Manager's focus remains on the selection of stocks with strong prospects for capital enhancement and we reiterate our belief that the long-term investor in the sector will be well rewarded. *From The Rt. Hon. Lord Waldegrave of North Hill, Chairman of Biotech Growth Trust*

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Following a selloff in March and April, biotech stocks rebounded and are now close to an all-time high, as measured by the Nasdaq Biotechnology Index. We believe the sector remains fundamentally strong, and the case remains good for continued outperformance. Valuations remain attractive among the major biotechnology companies, and we believe that they still do not fully incorporate the reacceleration of growth from new products that we have previously detailed. For example, Gilead Sciences launched its new blockbuster drug for HCV, Sovaldi, which is expected to generate nearly $12 billion in revenue this year. Yet even with this success and strong stock performance this year, the shares are only trading at 11x consensus 2015 EPS.

The strong performance of Puma Biotechnology and Vertex Pharmaceuticals following positive phase III results highlights the importance of clinical data releases to catalyse stock appreciation in the sector. We expect an abundance of clinical catalysts over the next year. We have previously noted that immuno-oncology has become a major focus among investors. This field has experienced substantial breakthroughs over the past several years and will have very active news flow over the next year.

M&A activity will continue to be a major catalyst in the sector. Although acquisitions for tax inversion had become popular in healthcare, this manoeuvre was more common among specialty pharma companies rather than traditional biotech. We therefore see little change in the attractiveness of biotech companies for acquisition, and see the ongoing weaknesses in pharma pipelines as the main motivation for M&A. *From Sven Borho of OrbiMed Capital LLC, Portfolio Manager, Biotech Growth Trust*

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Infrastructure *(compare Infrastructure funds here)*

Competition for Core infrastructure investments continues to increase, driven by the growth in demand for long duration assets in a low interest rate environment. The asset class continues to attract interest from existing specialist financial investors, but also increasingly from investors such as large pension funds, sovereign wealth funds and insurance companies, a number of which have developed direct investment capabilities. Underlying investors have continued to increase their allocations to the infrastructure sector and remain under-invested relative to their target allocations. In addition, fundraising in the infrastructure market has reached pre-crisis levels: in 2013, an estimated £39bn was raised in the private market, the highest level since 2008.

These trends, combined with the availability of debt finance for infrastructure investment on attractive terms, continue to drive the price of some infrastructure assets higher, and projected returns lower. Nevertheless, we continue to believe that, over the long term, Core infrastructure can provide attractive risk-adjusted returns relative to other asset classes, with low volatility.

A number of large European utility and energy companies are implementing non-core asset disposal programmes, and some specialist financial investors are beginning to realise assets in existing funds to return capital to investors or prove valuations.

In primary PPP and low-risk energy projects, the primary project markets continue to offer attractive opportunities to invest. Returns offered by this type of investment have remained relatively stable over the last five years. The market opportunity is healthy, as resource-constrained governments in Europe open up the provision of a number of services through PPP-type transactions. We estimate that the current equity opportunity across Europe has now reached approximately £1bn per annum and expect it will grow further, as programmes are expanded across a broader spectrum of sectors. *From 3i Infrastructure*

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The secondary market for social and transportation infrastructure continues to attract new investors and this in turn is exerting upward pricing pressure, particularly in the UK where the supply of investments in operational PPP projects has decreased. The primary market pipeline is subdued and unlikely to show increased levels of activity until after the UK general election next year.

Markets outside the UK offer potential investment opportunities as their infrastructure procurement programmes continue to develop. *From Graham Picken, Chairman HICL Infrastructure*

Demand from investors for infrastructure investment opportunities continues to grow, with some commentators estimating that there is over US$100bn of equity capital available for investment globally. A portion of this is being targeted at lower risk, operational, social and transportation infrastructure concession projects with availability-based revenue flows.

The UK has procured over 700 PFI/PPP projects, and this has created continued investor focus in terms of secondary market activity. The number of new secondary investments opportunities is declining, as most investment opportunities have now been acquired by long-term, buy and hold investors. With continued investor interest and a reducing supply of new investment opportunities, we have seen prices rising throughout 2014 and currently, there are no signs of this abating. Pricing discipline remains key.

With limited progress being made on the UK Government's National Infrastructure Plan, other than the Priority Schools Building Programme, the supply and demand imbalance in the UK is not expected to change in the near term.

In addition to the UK, we are focusing attention on other developed countries and regions such as Europe, Australia and Canada where relative value on a risk adjusted basis can be higher than in the UK. We are encouraged by the continuing popularity of PPP procurement in these territories and expect to be able to source investment opportunities which offer appropriate returns without compromising on risk. *From InfraRed Capital Partners Limited, Investment Adviser and Operator, HICL Infrastructure.*

Property *(compare Property funds here)*

Central London's economy and its property markets have strengthened further over the summer as London continues to outperform an improving UK economy.

Looking ahead, London is expected to continue to pull above its weight with the Centre for Economics and Business Research ("CEBR") forecasting that London will account for almost a third of all UK GDP growth over the next 5 years, despite accounting for roughly 13% of total UK employment. Moreover, CEBR upwardly revised its forecasts for London employment growth with employment projected to rise by 2.8% over 2014, with growth of 6.1% expected over the next 5 years. As a result, existing occupier demand arising from lease expiries and building obsolescence is now being supplemented by increased demand for expansionary office space in central London, both from existing occupiers and new business entrants to London seeking access to its deep pool of talented labour. Accordingly, under-offer and take-up levels are on the increase, and when combined with current low vacancy rates and limited new office supply, market balance continues to favour the landlord.

In the investment market, confidence in London's economic position and status as one of only a handful of true global gateway cities is undiminished, as it continues to attract new investors from around the world, including from China and Taiwan. In addition, the growing availability of debt funding and investors increased willingness to move up the risk curve beyond core properties means that competition for stock remains intense, reducing yields further and narrowing the yield spread between prime and secondary. However, as expectations of interest rate increases in the UK continue to be pushed back, the real yield spread remains above the long term average. Recent capital market volatility with investors reassessing expectations for global growth amid concerns of Eurozone deflation, emerging markets weakness and a falling oil price, along with a multitude of geopolitical risks, has not as yet impacted the central London commercial property market.

Looking ahead, the development pipeline remains relatively muted compared with previous cycles. Although we continue to expect a pick-up in the speculative development pipeline as developers respond to stronger occupier demand levels and the prospect of rental growth, the significant barriers to development in the West End combined with the lead time between development starts and completions means that we expect it will take several years for any meaningful amount of new space to be delivered. As we highlighted in May 2014, construction costs are beginning to rise, albeit from a low base, with the major cost consultants forecasting annual cost inflation of 3-6% over the coming years for commercial schemes. *From Great Portland Estates*

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Looking forward, from a macro perspective, the UK recovery looks more established, interest rates globally are likely to stay lower for longer and investment flows into UK property remain broad and deep. Some risks remain, notably the UK general election next year along with economic conditions in Continental Europe. In our markets, we expect London to remain strong, particularly in Offices where demand overall is above the long-term average, vacancy rates are low and the pipeline of new space remains constrained. Yields have compressed further, but this is supported by rental growth which now seems to be firmly established. In Retail, the improving economy is feeding through and the lead indicators of rental growth are positive. We see some parallels with London offices where yields compressed before rental growth was fully established. *From Chris Grigg, Chief Executive, British Land*

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Industrial values have increased in anticipation of rental value growth, based on a lack of supply of available modern space following five years of minimal new development and growing occupier demand. There is very limited vacancy in core industrial and distribution locations and occupier-led or even speculative development is likely be a factor in the next phase of these markets.

The office market is running at two different speeds. Modern offices, those in demand from growing, modern businesses are in short supply and in key locations the market requires new development to meet occupier demand. Secondary offices are in over-supply and many are being re-developed for alternate uses, not least under the permitted development rights legislation. Over time this will reduce the over-supply, but I believe the market has some way to go yet.

I believe the High Street is stronger than many commentators have claimed. In the right towns, there is occupier demand and the slide in rental values has eased or even reversed, with evidence of rental growth showing in some locations. Importantly, occupancy levels are high and with the costs of re-letting often lower than in the alternative sectors, retail property continues to be an important part of an income focused portfolio.

We believe there is still 'value' in the market despite recent price inflation. Rents are growing in almost all sectors, boding well for long-term capital growth. While yield compression can deliver short-term capital growth, properties are as susceptible to yield hardening as to yield softening and this type of capital performance can be very transient.

The principal driver of short-term capital growth in the last six months has been an imbalance between supply and demand. This imbalance has been driven by a significant 'up-weighting' to property from institutional investors and the strong re-emergence of the open-ended retail funds. At the 2014 peak, upwards of £490m per month was flowing into the retail property funds, the highest level since December 2009. This inflow has led to a collective focus on ever larger lots, firstly in London and the South East and more recently across the main regional cities. This excess demand has put pricing for larger lots under pressure and has pushed valuations up accordingly. *From Richard Shepherd-Cross, Investment Manager, Custodian REIT*

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While it is not difficult to cite issues which make the overall economic outlook on the Continent less than comfortable, we continue to believe that investment in property retains its attractions. Investors continue to seek income-producing assets and the greater willingness of banks to lend to the property industry at a lower cost of debt, supports their ability to pay out that income.

I mentioned in the Annual Report that a key to our optimism has been the very low level of new commercial development since the crisis and the genuine shortage of good quality business space in a number of key markets. It is encouraging to now report that where there is renewed tenant demand this is translating into rental growth as this supply/demand disequilibrium swings in the landlord's favour. *From Caroline Burton, Chairman, TR Property*

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In June [*we*] focused on the disparity in the rates of growth between the Eurozone and the UK. The UK 2014 GDP growth rate consensus of 3% looks achievable. The contrast with the Eurozone has become even starker, particularly with recent manufacturing and export data from Germany showing a marked slowdown in what has been the only country with a real growth story on the Continent. A clear consequence of this very low growth environment is that the cost of money within the Eurozone will remain at record low levels beyond 2015. Investors still seek income producing assets and whilst banks are clearly reluctant to lend to many enterprises, the perceived security of physical property and its steady income is succeeding in attracting bank finance.

With European CPI now running at less than 0.5% annualised, we expect further unorthodox monetary expansion policies from the ECB. The extent and focus of any asset purchase programme is difficult to predict given the range of national interests within the Eurozone.

We do continue to be concerned, in the short term, with the Central London housing market which is undergoing a correction after a very strong run from the lows of 2009.

Our concerns about the lack of rental growth across a broad swathe of European property is tempered by our understanding of the requirements of investors today. In a low growth environment where fixed income offers even less than it did 6 months ago, commercial property yielding 4-5% in markets in equilibrium continues to look attractive. If you can source that exposure through businesses which have sound balance sheets, a track record of further value addition through development and asset management and at a discount to near term asset value then we feel that is a compelling investment case today. *From Marcus Phayre-Mudge, Fund Manager TR Property*

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The UK economy continues to perform well. Economic expansion continues and key indicators remain positive. However, there is increased hesitancy among commentators as global indicators appear to be weaker than anticipated with a lack of clarity of the potential spill over to the UK. The property market continues to see strong investor demand with increased investment volumes across all sub sectors and most geographies across the UK which has led to a further hardening of property yields.

Structural change to the retail market continues at pace. The share of total retail expenditure by location has shifted away from the high street having seen a significant reduction from 47.0% to 38.8% in the last 10 years. Out of town and neighbourhood retail remains robust with small increases in market share in the last 10 years. Online sales continue to increase and now account for 11.2% of retail sales, which is forecast to grow to 22% by 2020.

The interdependency of online and offline is increasingly understood. Retailers are adopting an omni channel approach, which is resulting in the need for an optimum store network that reflects consumer demand for convenience and accessibility. The rise of 'click and collect' will play into the strengths of out of town retail parks, matching the retailer's desire to meet the needs of the shopper.

Fulfilment and logistics remain a key challenge for retailers as consumers continue to demand a wider variety of delivery and collection options. Retailers need a fit for purpose supply chain network which provides efficient fulfilment and gains customer loyalty.

Retail sales have increased for 17 consecutive months demonstrating the improvement in consumer confidence. All retail sales grew by 2.7% year on year to September with online growth continuing its strong upward trend of 10.1% year on year.

Footfall remains negative with a 1.6% decline year on year however this masks the underlying trends in footfall. Shoppers are increasingly splitting their shopping journeys between destination shops and convenience shops. Shoppers are visiting destinations less often but spending more whilst they are topping up and accessing click and collect facilities in more convenient locations resulting in higher footfall and increased frequency in these locations.

With 53% of shoppers only travelling 15 minutes to their nearest store, rising to 88% within 30 minutes, we continue to believe that the convenience destination will be an essential element of the retailer's store portfolio.

Omni channel retailing allows the retailer to meet the multi-channel sales demands of customers in a seamless way. The ability to mix and match shopping channels and delivery options is now the norm. This approach requires a strong store, fulfilment and eCommerce platform that work interdependently with one another. The value of the omni channel shopper is greater than a single channel shopper with 29% of those that click and collect buying additional goods on collection. We expect retailers to continue to embrace this approach and optimise their physical real estate strategies to meet the demands of the consumer.

As a result of the changes to shopper behaviour, the retail distribution market is going through transformational change. The retailer's distribution network is increasingly critical to service stores, the customer directly and build brand loyalty with optimum service. Take-up of logistics accommodation space maintained its steady momentum in the first half of 2014. A total of 6.9 million sq ft was taken with 45% of this accounted for by retailers. Design and build transactions have dominated the take-up of all new buildings, accounting for 91%.

Supply levels continue to decline with an estimated 16% reduction in available floor space over the last 12 months. As a result, developers are increasingly considering speculative development, particularly in prime locations in the South East and M1/M6 corridors.

The 'click and collect' market will play to the strengths of out of town retail parks which require accessibility and convenience. Retailers continue to optimise their store portfolios with click and collect seen as a significant growth area. In addition, the housing market recovery is stimulating expansion in the bulky goods out of town retail sector. Some of this demand has been driven by new entrants emerging from the internet. In the last few years the discount sector has also become more active in the out of town retail market. The level of available space in the out of town market continues to fall, with an estimated total availability standing at 8.8%. Development projects are limited and therefore we expect the amount of available space is likely to remain subdued and with continued occupational demand could lead to increased rental pressures in the better schemes. *From LondonMetric Property*

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Debt *(compare Debt funds here)*

With fundamentals continuing to improve across the board there is good reason to expect that performance will continue to be driven by central bank policy and a demand/supply imbalance in the asset class, rather than any expression of greater specific risk to credit pushing spreads wider. Credit spreads should continue to tighten in European ABS as a specific response to the future commencement of the ABS Purchase Programme, although at current levels they still look cheap to alternatives. While ABSPP will not be able to buy all asset classes and across all ratings, its ability to re-price the parts of the market that it will buy means that as the "ineligible" market starts to look cheap, the ECB-eligible investors will likely sell product into the ECB and move into other assets, creating similar pricing pressure.

Whilst the Bank of England's MPC voted again on a 7-2 basis against changing base rates, Governor Mark Carney noted that the point at which rates should rise was "getting closer". *From TwentyFour Asset Management LLP, as managers of TwentyFour Income Fund*

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Private Equity *(compare Private Equity funds here)*

Private Equity has been delivering strong returns for some time now, post the cessation of the Global Financial Crisis, and for the period under review this is particularly true. Whilst deal pricing is expensive and debt multiples have largely returned to 2007 levels, we still seem to be in a positive environment for Private Equity. GPs [*General partners – the managers of the underlying funds*] are still seeing strong deal pipelines, and their ability to transform and exit these businesses is being proven.

For the Company's 2014 year end Annual Report we commented that "we expect to see strong cash inflows ....as capital markets continue to be accommodative for private equity exits". This has very much been the case over the period. Whilst there may be some shorter term blockages on the IPO exit route, we still see no major impediment to the overall exit environment.

We are still reviewing the UK private equity market though have become more mindful of valuations here. There are also many pan-European managers currently raising funds. *From Alexander Barr, Aberdeen SVG Private Equity Managers Limited, as managers of Aberdeen Private Equity*

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