January 2015

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)*

Since the onset of the global financial crisis more than five years ago, the investment background has been characterised by low growth, low interest rates and the outright purchase of financial assets by central banks. The combination has been extremely supportive for the prices of both bonds and shares. Extremely low returns on cash have forced savers into either penury or ever riskier forms of investment, and central bank purchases of the safer types of bonds have pushed investors even further towards embracing risk in order to secure returns. The decision of the US Federal Reserve to bring its programme of asset purchases to an end is therefore a potentially important milestone. Its impact may, however, be mitigated by the expansion of Bank of Japan's asset purchase programme and expectations of something similar being attempted by the European Central Bank. The US economy appears healthier than those of many of its trading partners, helped in part by the growth in production of oil and gas from shale. Europe is facing the risk of deflation, the growth of the Chinese economy is slowing, and Japan remains in a fragile condition. Given the weakness of global growth and the deflationary impact of lower energy and other commodity prices it seems unlikely that inflation will become a problem beyond the boundaries of states like Venezuela and so it seems more likely than not that interest rates will stay low for some time.

If the background is likely to remain similar in most important respects to that of the last few years, we have to ask ourselves whether the pattern of relative performance within markets will also be a straightforward extrapolation of the recent past. In particular, we have to ask whether the strong relative performance of US equities will continue and whether the very largest companies in the market will perform better than their smaller counterparts. While this may happen, there are also reasons to believe that the relatively elevated valuations that are prevalent in the US market make companies vulnerable to disappointment and, over the long run, the largest companies in any market rarely prove to be as rewarding as investments in smaller companies with more scope to grow. *From James Ferguson, Chairman, The Monks Investment Trust PLC*.

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Although markets have continued to grind higher, the constructive outlook outlined in our last annual report remains essentially unchanged. While absolute valuations are no longer 'cheap' we are hopeful that global equities will add to their first half gains over the remainder of the year. Not only do long-term averages fail to capture the uniqueness of the current investment backdrop (record low interest rates, alignment of shareholder interests with policymakers, return of capital to shareholders) but - even after outpacing Treasuries by c. 40% in 2013 - stocks continue to look attractive versus most alternatives and especially so against cash where negative returns appear all but certain. Whilst we acknowledge that this unusual investment backdrop must normalize at some point, we expect policymakers to continue to tread carefully given the uneven recovery and the risks associated with deflation. This view - somewhat at odds with consensus earlier this year - is less controversial today because world economic activity has continued to disappoint with forecasts for 2014/2015 global growth 0.4% and 0.3% lower respectively since the end of our fiscal year. The pursuit of more sustainable / higher quality growth in China has continued to present challenges elsewhere in the global economy with sharply lower commodity / energy prices impacting a number of emerging and oil-sensitive economies (including Brazil, Russia, and Venezuela). Meanwhile European growth disappointed, in part because of weaker demand from China, compounded by appreciation in the Euro-Yen exchange rate. Although markets have rebounded impressively from their October lows, a number of indicators (German bund yields below 1%, Eurodollar at 1.25, oil below $90) suggest that the risk of another growth scare remains elevated.

Fortunately, the economic outlook is not all 'doom and gloom' as the US recovery has remained on track driven by continued improvement in employment conditions and consumer confidence. Sustained energy price weakness may also be less indicative of demand deficiency than in the past because US hydraulic fracturing ('fracking') has resulted in US oil output reaching its highest level in 28 years. As such, lower energy prices should be considered more positively and are likely to support developed world growth, with the oil price declining c. $26/barrel from June highs to period end. Some estimates suggest that a $20/barrel decline in oil could potentially be worth as much as $140bn (c. 0.8% of GDP) to the US economy over a full year. Benign input prices, together with continued slack in labour markets beyond the US, have left inflation below central bank targets in most advanced economies. With most central banks / policymakers therefore focused on deflation (rather than inflation) risk, we expect highly accommodative monetary policy to persist into 2015, as should the remarkable alignment of interests between policymakers and investors (amply demonstrated by recent events in Japan) that have underpinned risk assets since 2009. The one potential (and important) exception to this is the US where labour markets have continued to tighten, unemployment falling to 5.8% in October. Although the end of tapering in October essentially marked the commencement of a tightening cycle, we expect US policymakers to continue to tread cautiously regarding the timing / pace of interest rate hikes given the risks associated with slower global growth and pronounced US dollar strength.

Over the coming half-year we are hopeful that the combination of earnings growth and modest revaluation of risk assets should continue to drive equity market returns. While we acknowledge that equities are no longer 'cheap' the investment backdrop remains highly unusual, reducing the relevance of long-term valuation averages and bull market duration. Stocks continue to look well supported by near-record corporate margins and strong balance sheets, US non-financial companies said to have $1.65tr in cash at mid-2014. Although much of this cash is held overseas, stock buybacks should remain at elevated levels, accounting for c. 82% of free cash flow in Q2'14 reducing the outstanding number of shares in the S&P 500 by 1.3% during the prior twelve months. Having exploded into life earlier this year, M&A activity - worth more than $2.66tr during the first nine months of 2014 - should also help reduce supply supporting equity valuations. However, the recent US government crackdown on tax-inversion transactions may continue to dampen near-term activity and refocus attention towards more growth-orientated combinations (exemplified by the aborted $52bn acquisition of Shire by US pharmaceutical company AbbVie). While we remain constructive on markets, we expect our bullish prognosis to be further tested over the coming months / years because equity valuations and the duration of the bull market already exceed long-term averages. These challenges are likely to take the form of "growth scares" and will tend to occur when equity markets and investor sentiment are extended, as was the case in September / October. While we do not expect a significant setback, a number of our preferred indicators (implied volatility, investor sentiment) are suggestive of less favourable near-term risk reward. *From Ben Rogoff, manager of Polar Capital Technology*

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Although more than half a decade has elapsed since the nadir of the financial crisis, interest rates remain extraordinarily low and major areas of the global economy continue to struggle. In the US, which has fared better than other regions over the past year, the US Federal Reserve has recently ceased to purchase financial assets and is now contemplating an interest rate rise in 2015.

An increase in US interest rates has the potential to have a destabilising impact on global markets as the stimulatory measures employed since the financial crisis have relied upon the creation of additional debt. Investment markets are therefore likely to remain in thrall to the deliberations of the US Federal Reserve and other central banks.

More positively, the recent sharp fall in the oil price is likely to have a stimulatory impact on economic activity and, if maintained, should filter through into an increase in consumer disposable income. *From Douglas McDougall, Chairman, Scottish Investment Trust*

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Successful smaller companies create their own long term opportunities and these are only very marginally influenced by the prevailing economic conditions over the investment cycle. Fundamentals will ultimately prevail. Nonetheless short term macro developments do influence investor sentiment and impact trading conditions for businesses. This in turn results in periods of notable market volatility.

Although the US Federal Reserve has concluded its bond purchasing programme, the Bank of Japan has announced an additional Yen10tr in monetary easing and the Japanese Government Pension Investment Fund has announced its intention to increase its holding in domestic equities from 12% to 25%. Elsewhere, Europe continues to be stubbornly unresponsive to stimulus measures, the UK is performing better than many predicted while China's economic growth remains somewhat subdued in comparison to recent years as it moves from an export to consumption led economy. All these factors have and will continue to fuel market volatility.

The current global business environment is unprecedented with regard to innovation and the ever increasing role played by technology in both building new businesses and disrupting incumbents. In this more dynamic world, it is the nimble, more innovative smaller businesses that are best positioned to prosper as they lack the bureaucracy of larger incumbents while the technology at their disposal has radically changed both the trajectory and magnitude of growth that a small business can achieve. Assessing what is proven and tangible alongside what has promise and long term potential is vital. Being able to identify the companies that value innovation, which have both a cultural acceptance of it and a means to develop commercial opportunities around it, is key to unearthing the market leaders of the future, and is a key focus for the Managers. *From David HL Reid, Chairman, Edinburgh Worldwide*

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The outlook for financial markets remains challenging. Asset prices have been inflated by the extraordinarily loose monetary environment prevalent since the financial crisis. The frictions caused by economies at different stages in the recovery process may further exacerbate issues surrounding the longer term effects of such unconventional policy response.

It seems likely that returns over the next five years will be lower than those seen in the immediate post-crash crisis phase. However, economic recovery in the United States looks well established and recent oil price falls will provide a boost to consumers and industrial companies around the world.

We continue to feel that emphasis on real assets over monetary assets, which have been at the centre of policy response, provides further potential to grow dividends and provide capital growth. The diversification offered within a multi asset approach should continue to reduce volatility and enable advantage to be taken of tactical opportunities as they arise. *From Seneca Investment Managers, managers of Seneca Income & Growth*

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UK *(compare UK funds here)*

The lack of investor appetite for small and mid caps that became apparent ahead of the Scottish referendum in September 2014 has continued to provide a headwind to performance. The problem is that the momentum in domestic corporate earnings is not yet strong enough to compensate for a slowing Eurozone macro outlook and investor nervousness can been seen in the magnitude of short term share price falls in stocks that disappoint. *From Chelverton Asset Management Limited, managers of Smaller Companies Dividend*

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The outlook for the global economy is uncertain. In Europe, the threat of deflation remains and shows no signs of returning to growth. Chinese growth looks to be slowing. It is still significantly ahead of that achieved by any developed economies but it is well below the double digit levels previously seen with potentially material consequences for other economies, given China's status as the world's second largest economy. The US's position is improving but it remains heavily indebted and although the asset purchase programme has halted, the US has given no indication of how it will be unwound. Interest rates look likely to rise on both sides of the Atlantic.

In the UK, there have been mixed signals as to the timing of interest rate rises not to mention the uncertainty as to the UK political landscape with the approach of the 2015 general election.

We believe there are some reasons for optimism. Equities remain attractive relative to fixed interest with investors seeking a yield looking to equity. However, the Manager's expectations for growth in profits throughout 2015 remain cautious. Currently the market is forecasting just over 4% growth for smaller companies in 2015. The pressures caused by the recent period of sterling strength appear to be easing and the recent falls in the price of oil may prove to be a more effective stimulus for the economy than that provided by central banks. *From The Earl of Dalhousie, Chairman, Dunedin Smaller Companies*

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It is easy to be quite gloomy about the prospects for the global economy. Europe shows no signs of returning to growth and the longer recovery takes to materialise the greater the danger of the region falling into deflation. Some of the peripheral economies are actually doing quite well but it will be the core countries that determine the region's prospects and they are doing less well. The European Central Bank has promised action but to date they have neither quantified the size of any stimulus nor the mechanism by which it would be delivered. Indeed it is unclear if they could actually engage in quantitative easing even if they wanted to.

Chinese growth looks to be slowing. It is still significantly ahead of that achieved by any developed economies but it is well below the double digit levels we have become used to. That could have material consequences for other economies, given its status as the world's second largest economy.

The US is doing better but it is worth remembering just how indebted the country is. They have stopped their asset purchase programme but they have given no indication as to how they expect to unwind it. Meanwhile as we write, the Government has enacted another Continuing Resolution. Not that long ago such action would have been considered remarkable.

Interest rates look set to rise on both sides of the Atlantic. Central bankers can keep obfuscating but it will eventually need to happen the alternative being growth that is so weak that ultra-low rates need to continue. Any increase will require adjustments by companies and consumers alike.

In the UK there will be an election next year. Markets dislike uncertainty and it is currently very difficult to divine the likely outcome. To hope for a business and markets friendly result seems quite optimistic.

However, there are some reasons for optimism. We have observed a number of times over recent years just how attractive equities are relative to fixed interest. That may indeed be a reflection of the over valuation of fixed interest rather than the cheapness of equities but it remains the case that if investors want a semblance of yield then they have to look to equities. For three years now the profits delivered by European companies have materially disappointed relative to the expectations of analysts at the start of the year. This year the expectations for small companies as a whole are for growth in profits of 4.1% over 2015. That is hardly inspiring, but equally it is more achievable than the double digit growth expectations analysts normally pencil in at the start of a year. So, perhaps there is a recognition of the sluggishness across the global economy and hence less of a likelihood of disappointment. In aggregate valuations are not expensive relative to history, though there is a spread of multiples across the market and many better quality businesses still command a premium rating.

One aspect that has caused many companies difficulties this year has been the strength of sterling. This pressure is now easing. We would not care to endeavour to explain either the recent decline in the oil price nor the likely future price of oil. But we do believe that the benefit of the falls will be felt directly by businesses and consumers. This impact has been estimated at $2.5bn daily relative to when the price was $100. This is direct stimulus for the economy and should prove more effective than that provided by central banks. *From Aberdeen Asset Management as managers of Dunedin Smaller Companies*

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Given that there has been a great deal for markets to worry about, and that any pockets of cheer have been isolated, the resilience of most equities over the period was welcome. Will that continue? From geopolitical concerns to the end of quantitative easing in the US, worries are plentiful. Moreover, on the whole the valuations of equities have risen more rapidly than their cash flows, and so could be especially vulnerable to any sudden shock.

Yet investors may take comfort from the fact that interest rates look set to remain low for the foreseeable future. In general, corporate results have been positive, and in the last few weeks there has been a pick-up in takeover activity. *From John Dodd & Adrian Paterson, Fund managers, Artemis Alpha*

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Listed UK companies in aggregate have frequently failed to achieve profits growth in line with expectations in recent times. There have been plausible explanations including sterling's strength and the market's relatively large number of commodity and energy companies which disappointed. With the uncertainty of next year's General Election and a possible slowdown in Europe, investors need reassurance that companies are still capable of higher profits and dividends. *From Alan Clifton, Chairman, Schroder UK Growth*

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Having delivered a broadly flat performance in 2014, the aggregate valuation of the market has not changed significantly. Commentators expect low single digit earnings growth in 2015, which is slightly lower than had been anticipated for 2014 a year ago. Earnings expectations have been scaled back during the course of 2014 and projections for global growth have been cut.

Share valuations remain close to their long-run average, which provides some comfort in the market's aggregate level and, in general, risk and reward appears to be more broadly balanced than in the recent past. The UK equity market is not cheap, but equally it is not excessively expensive. The prospects for the market's more domestically-focused companies remain reasonably positive. Falling unemployment and signs of real wage growth should support the British consumer. Interest rate rises, when they materialise, have been anticipated and are likely to be relatively small.

Following a de-rating of the more cyclical sectors in 2014, some relative value has emerged. The media sector also catches the eye, similarly, the software sector is presenting interesting opportunities. Conversely, some of the more defensive companies with more resilient earnings streams have re-rated strongly in 2014. Among the UK-focused companies, the Manager sees value in the domestic banks and house builders, despite the latter being among that small cadre of companies to have benefited in the past year from earnings upgrades. However, it is worth bearing in the mind that the general election in May could prompt volatility among the house builders, along with other potential targets for political intervention such as gaming companies, bus and rail operators and utility firms. *From Philip Mathews, Schroder Investment Management Limited, managers of Schroder UK Growth*

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Asia *(compare Asian funds here)*

Asian economic growth has continued to decelerate, with muted growth in exports reflecting a lacklustre global economic recovery. However, while growth may have slowed, it continues to compare favourably with that found in developed markets. Asia stands to benefit from recent commodity price weakness as the region is a net importer, particularly of crude oil. With the exception of Malaysia, lower oil prices will improve Asia's trade balances. This in turn will lead to more buoyant liquidity conditions. Moreover, given that a number of Asian countries subsidise prices at the pump, their fiscal accounts also stand to benefit from cheaper oil. At a corporate level, lower commodity prices may also provide some benefit to the margins of manufacturing companies. Meanwhile, it is encouraging to see genuine signs of economic reform across the region, not just in China and India, but in countries such as Indonesia and South Korea. While we do not expect reform progress to be smooth, these forces for change could be positive for Asian equity markets.

Recent market volatility has served to remind investors that Asian equity markets remain sensitive to changes in the global liquidity environment, with increasing attention given to the effects of a swift rise in US interest rates, although this is not a scenario we consider likely. However, we are mindful that an acceleration in US economic growth ahead of expectations, which could justify such policy tightening, would likely be positive for Asian exports growth, a traditional driver of Asian equity market performance. We believe that there are attractive investment opportunities in our universe and that valuation levels across Asian equity markets appear reasonable, relative to history and compared to developed equity markets. *From Carol Ferguson, Chairman, Invesco Asia*

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Asian economic growth has decelerated over the past few years as exports growth has remained muted, in line with weak global economic growth. However, the region's growth profile continues to compare favourably to that of developed markets with recent commodity price weakness being increasingly supportive given Asia is largely a net importer. For example, the weakening oil price is allowing India to remove costly diesel subsidies, helping reduce its budget deficit. At a corporate level, lower commodity prices and a slowdown in wage inflation is helping to stabilise margins, which is supportive for the region's earnings growth outlook. Consensus earnings growth forecasts for Asia Pacific ex Japan have been stable so far this year, and are currently around 9-10% per annum for both 2014 and 2015, bringing valuation levels for the region to 12.0 times 2014 expected earnings, which remains reasonable relative to history and against developed equity markets.

There also appears to be growing acceptance of China's gradual transition towards a slower, more sustainable growth environment. Recent Q3 GDP growth may have been slightly ahead of expectations, but it was still the lowest recorded since 2009 and was met with a muted reaction. Employment levels have remained robust, largely thanks to the growing contribution of the tertiary, or services sector, which is key in rebalancing the economy away from capital investment towards domestic consumption. Meanwhile, as in much of the region, we are seeing genuine signs of economic reform in China. While we do not expect progress to be smooth, these forces for change could be positive for Asian equity markets, particularly given the more moderate growth outlook. *From Ian Hargreaves, manager, Invesco Asia*

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Arguably the main issue facing investors is posed by 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, for example, 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. In India and Indonesia progress is likely to be very slow going and current euphoria will be subject to severe testing. However, India has a number of other factors that should support the market including falling inflation, an improving current account and scope for an upturn in capital spending after seven years of decline. For Korea, we need to see more convincing signs 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 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 view is that there is already too much credit in the economy which really needs a period of tightening, rather than 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 re-assurance that the longer-term scope for domestic demand growth in Asia remains ample. Our key preferred markets in the region are Hong Kong, India and Thailand. *From Schroder Investment Management Limited, managers of Schroder Asia Pacific*

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The single most important determinant when discussing the outlook for Asian equities is earnings growth. As 2015 approaches, the analyst community is yet again forecasting region wide earnings growth of approximately 12-14% for the year ahead. That rate of growth seems slightly optimistic, probably by about 2-3% points, and is subpar by historic standards. In fact, it is reminiscent of the years 2011-2014, during which calendar earnings growth has been 2-10%. Understanding economic reform and the effect it has on investment and consumption patterns is essential. Presently, there is no evidence to suggest that trade will accelerate above of its low growth plane.

The good news is valuations remain undemanding, both in absolute terms and relative to US and European stock markets. Asian balance sheets are generally sound. Historically, Asian stock markets have traded in a price/book value range of 1.5-1.8x, but we need to see higher earnings growth and a higher return on equity to propel current markets higher.

Currency could be a key factor in 2015 also. So far in 2014, Asian currencies have been gratifying stable after depreciating in 2013. Weaker commodity prices are generally good for Asian economies and currencies. Indonesia is the exception as it is a major exporter of iron ore and palm oil. The question is will a strong Dollar vs. the Euro and Yen exert pressure on Asian currencies too?

Finally, the direction of the mainland China economy will play a major role in determining the outlook for Asia in 2015. Globally, investors are concerned about China's property market and the level of debt. Presently, transaction activity in the property sector is improving, buoyed by accommodative government policies, but prices are still gently falling. Overall, the slowdown is orderly and does not seem to pose a risk to the banking sector. The same can be said for the overall debt levels in China. Deleveraging will occur in the future, and it will be a headwind to growth, but a debt crisis is not expected. As risk attitudes toward China improve, so too sentiment will improve toward Asia overall. *From Ted Pulling, Sonia Yu, Jeff Roskell, Investment Managers of JPMorgan Asia*

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Europe *(compare European funds here)*

In last year's report I noted that investors continue to face a tug of war between macro and micro. When it comes to Europe one can only say "plus ca change". The past year has provided yet more examples of the same: prime among this year's reasons to be fearful include anxieties ranging from Russia's annexation of Crimea and associated activities in Ukraine to the increasingly dismal economic performance in Italy and France. It is at such times that we are reminded of the adage that the stock market is not the economy.

At the political, and indeed monetary, level, Continental Europe has differentiated itself from the USA and UK. The latter have demonstrated a decisive willingness to cleanse their respective banking sectors, liberate their product and labour markets and, of course, bloat their central bank balance sheets. Europe, on the other hand, has eschewed monetary and fiscal stimulus in favour of internal revaluations to rebalance the Eurozone. We would expect further strain from this approach in the year ahead. Europe is determined to apply discipline to force reform on the Union. This strategy runs significant risks and history has shown that it may take a crisis to force a change of course. In particular unless Germany begins to hurt economically, it is unlikely that a change of strategy will occur. In the event that fiscal policy is loosened in Germany there will be a large sigh of relief from neighbouring France and Italy, both persisting with incompatible social and economic policies. In this respect, it is a welcome sign that the German economy is now weakening. Might Ms Merkel finally loosen her purse string?

One major source of relief for the European economy would come in the shape of a weaker euro and recent months have offered encouragement in this respect. This, too, provides that reminder to the investor: Europe's stock markets house a group of global businesses who happen to have been born in Europe and as such their prospects are not inexorably linked to the European economy.

Your Board and Fund Manager anticipate that the coming year will offer less of a tailwind as far as equity markets are concerned. Valuations are far from the bargain basement and, after all, this bull market is now long in the tooth. *From Rodney Dennis, Chairman, Henderson European Focus Trust*

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USA *(compare North American funds here)*

Recent data suggests continuing U.S. growth with less positive trends in Europe and elsewhere. The recent economic strength in the U.S. also suggests that the Federal Reserve will begin to normalise short term interest rates next year. This view is reflected in the strength of the U.S. dollar which is currently trading at its best level since the summer of 2010.

As liquidity is withdrawn with the end of the Federal Reserve's quantitative easing programme, the likelihood of higher interest rates and the return of volatility, we expect a portfolio of high quality companies to outperform. *From Simon Miller, Chairman BlackRock North American Income*

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We remain constructive on the U.S. economy given improvements in U.S. employment data and benign levels of inflation. Improved employment prospects and lower energy prices have contributed to a rise in consumer confidence, which has rebounded to its long-run average. Additionally, U.S. consumer balance sheets are stronger, with debt service relative to disposable income at its lowest level in thirty years. On the corporate side, U.S. manufacturing data remains strong and corporations are flush with cash. With strong balance sheets and increasing business confidence, we see the potential for acceleration in their capital spending. We believe these factors point toward improving growth ahead for the U.S. economy. *From Bob Shearer and Tony Despirito, BlackRock Investment Management LLC, managers of BlackRock North American Income*

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Brazil *(compare Latin American funds here)*

Following the close election outcome, there will be pressure on the re-elected president to balance the interests and expectations of a divided electorate and to change her economic policies in the absence of external growth drivers. Early indications, particularly the appointment of Joaquim Levy as finance minister, have raised hopes of more market-friendly policies from the new administration. The Investment Managers remain positive. *From Howard Myles, Chairman, JPMorgan Brazil*

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Fiscal adjustment will be high on the political agenda as we move into 2015, particularly with Rousseff returning for a second term. Although this is likely to lead to increased volatility, it will also provide attractive investment opportunities.

The immediate challenge for the new Rousseff administration is to defend Brazil's investment grade credit rating, which the country is at risk of losing if major fiscal adjustments are not forthcoming. After a recent visit to Brazil, it is our understanding that the government is aware of the risks associated with losing investment grade status and it is very keen to maintain foreign direct investment flows.

To defend Brazil's investment grade rating, we believe the government will need to show a commitment to more orthodox economic policies. The early signs are positive. For example, the new finance minister, Joaquin Levy, is not only market friendly but he has already taken some very sensible actions, such as increasing interest rates to show the government's commitment to tackle inflation, and releasing guidelines for the 2015 budget that include a reduction in government spending, a cut in subsidies and an increase in taxes. These are all measures that are needed to bring the country's economy back into order.

On the currency front, the real has continued to depreciate this year, and we are now more comfortable with an exchange rate of 2.60 to the US dollar. Any further depreciation will likely be because of the higher inflation level in Brazil compared to the US. Meanwhile, the weaker currency should boost the competitiveness of Brazilian manufacturers and exporters.

Despite the positive signs from the new government and the boost provided by a weaker currency, we still believe that the economy will only grow very slowly in 2015. However, it is very important to remember that in the short term there is very little correlation between GDP growth and market return. *From Sophie Bosch De Hood and Luis Carrillo, investment managers of JPMorgan Brazil*

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

Locally, China's property policy has inflected towards selective easing measures, which historically has been a strong positive indicator for the domestic economy. The Shanghai-Hong Kong Stock Connect is an important event given its implications for China's financial liberalisation. Despite the collapse in the price of oil, there has been no broad-based upgrade to exporter earnings to reflect the implicit tax cut for global consumers. The confluence of these factors keep us optimistic on Greater China and we expect markets to be supported into the year-end. Valuations are generally undemanding, and we believe the Chinese government's determination to maintain stable growth will pave the way for further structural reforms over the medium to long-term which should support a relatively healthy outlook. *From Howard Wang, Emerson Yip, Shumin Huang, William Tong, Investment Managers, JPMorgan Chinese*

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China Outlook

[*There's a]* 'new normal in China', which is how President Xi Jinping interpreted the slow-down in China's growth last May as the economy moves from investment to consumption and productivity for its main engines for growth. Maintaining a balance between continued economic growth and the need to rein in excessive local government debts and shadow banking activities while at the same time having to mediate between conflicting regional and sectoral interests will remain a challenge for policy makers. Nonetheless, that China is entering a new phase of its modernisation and development is becoming increasingly clear.

Widespread restructuring at regional government levels with sustained focus on anti-corruption measures, new policies to address issues related to unequal income distribution, plans to restructure state--owned enterprises ('SOE's) for improved operating efficiency, and environmental protection are current priorities. There is recognition that the excessive building development so prevalent in cities across China has to slow. Instead, attention will be diverted to life-quality matters like welfare, health and education as well as supporting services such as insurance. There is opportunity for venture capital to develop new businesses ranging from telephony to robotic engineering to life sciences, from entertainment to alternative energy, and from waste management to warehousing and logistics.

Nowhere are the signs of the generational change sweeping China clearer than in the e-commerce sector. For investment managers, the opportunity to invest in innovative growth companies despite the macro-economic slow-down will be enormous. Good corporate governance will remain a challenge, but as more Chinese companies aim to become world-class, this can be expected to become less of a problem over time. The recently established Shanghai-Hong Kong Stock Connect should give the Shanghai 'A' shares market a liquidity boost while encouraging more eligible local companies to seek a listing with international investors in mind. *From William Knight, Chairman, JPMorgan Chinese*

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We expect the macroeconomic environment to recover from August's extreme low base, due to the continued fall in interest rates, as well as the People's Bank of China's liquidity injection. The government is likely to continue its mini stimulus policy, avoiding a hard landing and providing enough cushion to carry out further structural reforms. Property, the key factor for the weak macroeconomic environment, should also see improvements from lower interest rates as well as the removal of Household Purchase Restrictions in most cities. We do not expect major stimulus policy on the cyclical side as the government puts more emphasis on reform.

On the structural reform front, we have seen good progress, such the 'hukou' (residents' registration) reform which potentially may enable 200 million migrant workers to settle in urban areas, the start of farm land reform to address income inequality and boost consumption, pilot programmes for local asset management companies to address high local government leverage, and pilot state-owned enterprise reforms. We expect 2015-16 will be a critical period to see the implementation of reforms already announced, as well as the launch of further and more complex reforms, such as those related to income distribution.

The market's valuation at 8.9x forward one-year price to earnings, with earnings growth in the high single-digits, is undemanding (vs. mid-cycle 12x). We believe the market could remain volatile as investors weigh up the impact of the reform-induced slowdown and the resulting better quality of growth. *From Howard Wang, Emerson Yip, Shumin Huang, William Tong, Investment Managers, JPMorgan Chinese*

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Taiwan Outlook

Taiwan has consistently produced companies at the forefront of technology with strong links both to Silicon Valley and the large market in mainland China. Despite the political turmoil earlier in the year which was triggered by an initiative to deepen economic cooperation with the mainland, cross--strait commercial relations in general remain buoyant. Tourist arrival from the mainland is already a major source of income for local companies, and good investment opportunities continue to be available. As an off--shore centre for Renminbi, Taiwan is second only to Hong Kong in volume in Asia. *From William Knight, Chairman, JPMorgan Chinese*

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Growth in export orders continued to be boosted by the new i-Phones, where demand remains very strong. The momentum of electronics from the launch of new Apple products will continue through the remaining months of 2014. However, expectations for the iPhone6 are already very high. With a lack of other near--term catalysts and along with muted turnover, the Taiex may continue to trade in a tight range. The Taiwanese government is planning to introduce new measures to boost the stock market, which may improve trading volume.

In the near term, there should be some volatility in share prices, with companies reporting September sales and third-quarter results in the coming weeks. Share prices should react well to positive earnings and a positive outlook given the recent correction. However, international fund flows could be a drag if the outflows continue into October, though government-related funds are reported to be bargain hunting. Overall, fundamentals remain strong and valuations are still modest. *From Howard Wang, Emerson Yip, Shumin Huang, William Tong, Investment Managers, JPMorgan Chinese*

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Hong Kong Outlook

The Shanghai-Hong Kong Stock Connect is expected to increase liquidity on the Hong Kong Stock Exchange. Despite the international publicity surrounding the 'Occupy Central' movement, it does not appear to have had any profound effect on either the Hong Kong property market or share prices. However, the longer term consequences could be more worrisome if these protests are not peacefully resolved within a short time *From William Knight, Chairman, JPMorgan Chinese*

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While there has been moderation in the confrontations between the protesters and police, there remains the risk of a negative turn, especially since there are no obvious paths to resolving the differences between what Beijing authorities have prescribed and what the protesters are demanding regarding electoral reform.

Should the protests wind down in an expeditious and orderly manner, we believe the economic impact would be limited. However, the longer-term consequences could be more worrisome if these protests are not contained. For example, group tour suspension from mainland China could significantly impact retail sales in Hong Kong, given group tours constituted almost 10% of Hong Kong's tourist arrivals in 2013. While the property market has proved resilient in the first wave of the 'Occupy Central' movement, it remains vulnerable to the prospect of rising interest rates in the US. *From Howard Wang, Emerson Yip, Shumin Huang, William Tong, Investment Managers, JPMorgan Chinese*

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Macau Outlook

The fundamentals of the Macau gaming industry remain intact, particularly the mass gaming segment. However, the short-term headwinds have become stronger due to the slowdown of the Chinese economy as well as the government's anti-corruption policy stance. Another negative factor is the full smoking ban in casinos, starting in early October. Political turbulence and the prospect of rising rates would suggest caution for Hong Kong equities. The upcoming Shanghai-Hong Kong Stock Connect programme could provide a short-term boost to select stocks. We target high quality stocks that benefit from high barriers to entry in their market segment, as well as those that stand to benefit from the economic stabilisation and reform progress in China. *From Howard Wang, Emerson Yip, Shumin Huang, William Tong, Investment Managers, JPMorgan Chinese*

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India *(compare Asian single country funds here)*

We believe that a stable, reform-oriented and determined government is a very positive development. The bottom-up outlook for India continues to improve steadily. Although global uncertainties may weigh on markets in the near term, we remain resolutely bullish from a medium to long term perspective as we believe that the new government has the potential to influence the fundamental drivers of equity returns. *From Rukhshad Shroff and Rajendra Nair, Investment Managers, JPMorgan India*

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

Sentiment in equity markets continues to be impacted by concerns over global growth. Equity markets have also been impacted by geopolitical concerns over events in Ukraine and the Middle East. Frontier Markets are more sensitive to internal economic and political developments than their Emerging Market and global peers which has helped them to outperform despite this challenging backdrop. With lower levels of indebtedness, good prospects for underlying growth and low correlation with both Developed and Emerging Markets, the Frontier Markets universe continues to offer considerable diversification benefits and is an attractive option for long term investors. *From Audley Twiston-Davies, Chairman, BlackRock Frontiers*

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Despite the strong performance of Frontier Markets over the last three years, valuations are still attractive. In the past some nascent asset classes have performed well, perhaps too well, leading to dislocation between market enthusiasm and underlying fundamentals. Thanks to the resilience of corporate earnings across the universe we are not observing this trend in Frontier Markets.

We also note that, despite the increased popularity of Frontier Market investing, correlations between Frontier Markets and both Emerging and Developed markets have declined. This highlights the portfolio diversification benefits for international investors. It is for this reason that we believe Frontier Markets represent a compelling opportunity for long term investors. In addition, the combination of the countries with the fastest growing GDP, the best demographic profiles, the lowest government debt and a substantial commodity endowment where it is also possible to invest in companies on some of the lowest valuations in the world provides an unrivalled investment opportunity. *From Sam Vecht & Emily Fletcher, managers of BlackRock Frontiers*

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Commodities *(compare Commodity & Natural Resources funds here)*

After a two year period which saw commodity prices in freefall, the middle of 2014 was forecast to offer hope and a promise of stability. The reality was a renewed slump as commodity prices continued to decline and with limited investment appetite for exploration stocks. Gold, in particular, failed to recover, with bullion having fallen 30 per cent from its highs and mining stocks having declined further.

As the flags of surrender are raised and the signs of market capitulation accumulate, we are more than ever convinced by the merits of [providing finance to resource companies]. While the sector continues to languish, the protection provided by geographic and commodity diversity is vital. *From Lord St John, Chairman, Global Resources Investment Trust*

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Oil

I write this against a darkening backdrop of an imminent price war in Oil, seemingly provoked by the success of the unconventional oil producers. Saudi Arabia's stated intent to retain market share is creating downward pressure on the oil price and will undoubtedly lead to a volatile environment in the sector until balance is restored. The world, and OPEC in particular, has become used to oil prices above $90 over the last five years and it remains to be seen how long the producers can withstand low prices before taking remedial action. *From David Norman, Chairman, New City Energy*

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Uranium

In my last report, I suggested that we might be very close to the bottom of the market. Uranium continued to fall for a while but, having traded at US$28 per pound, it has steadily improved and at the time of writing moved up to $43.

The general impression was that the turnaround was caused by the change in direction by one of the Japanese precincts which stated that its nuclear reactors would be restarted during the course of next year. While this obviously had an effect, there is no doubt that from a producer point of view there were little in the way of profits to be generated at that level. Secondly, and perhaps more importantly, there was no chance of new production being established at anything like that level.

There has also seen a sea change in how the product is marketed. Until very recently most business was conducted by the consumers on long term contracts. Seemingly this is becoming increasingly less important and most business is now conducted through the spot price. There is a precedent for this as in the case of Iron Ore; long term contracts have largely disappeared and virtually all business is completed on the spot market.

I retain my optimism featured in the last report. When a commodity falls to a level where virtually no producer makes a profit, it is purely a matter of time before a recovery takes place. In the case of Uranium there were other contributory features. Until last year world markets had largely been supplied from Russian stock piles. The agreement with the Americans has now been terminated and Russia has indicated that it is no longer a seller into the International markets. While the American utilities have been happily buying into a falling market, the recent rise will certainly polarise their thoughts. I would anticipate that if the rise continues, next year will see a number of American utilities arrange off take agreements with either existing producers or those with the ability to commence production within the foreseeable future. Either way it would be very positive for the sector. *From George Baird, Chairman, Geiger Counter*

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Environmental *(compare Environmental funds here)*

Once again the period was rich in developments from an environmental policy perspective. Most notably, the debate around investment in fossil fuels gained in intensity with a number of high profile institutions and sovereign wealth funds reviewing their investments in this area. Significantly, Norway's $880bn Sovereign Wealth Fund, which has been amassed through oil production, is presently reviewing its exposure to fossil fuel investment. Similarly, the Rockefeller foundation announced its plans to withdraw money from the sector. University foundations in many parts of the world are following a similar path.

Divestment in fossil fuels is an idea based on ecological and economic grounds. Fundamentally, if world leaders hope to keep their pledge of limiting global warming to 2 degrees Celsius, a great deal of the current fossil fuel reserves will have to stay in the ground. Therefore, the rationale for divesting in these assets is that they could become unproductive (or "stranded") with associated financial risk. The other motivation for divestment has moral underpinnings, whereby investors are sending a message to governments that more needs to be done to transform our economies away from fossil fuel dependence. One potential impact of this pattern is a flow of investment capital into areas such as alternative energy and energy efficiency. *From Perry K O Crosthwaite, Chairman, Jupiter Green*

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Environmental issues continue to grow in importance among politicians, corporate leaders and consumers. Moreover, from wind turbines to industrial metals recycling to energy efficient light bulbs, green companies are increasingly taking a lead role in addressing "mainstream" issues such as rising populations, changing demographics, urbanisation, rising global consumption and the resultant increase in resource scarcity. Importantly, products offered by these businesses are becoming more cost competitive when compared to those offered by mainstream counterparts across. Our research suggests that the process of "mainstreaming" has a long way to go. *From Charlie Thomas, Jupiter Asset Management Limited, Investment Manager, Jupiter Green*

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Healthcare *(compare Healthcare funds here)*

The pharmaceutical sector is no longer as cheap as it was in 2010 but the Price Earnings Ratio is still only in line with, rather than at a premium to, the market average. With the patent cliff now a distant memory investor focus has moved on to emerging drug pipelines and which companies have the best growth potential. The signs here are good with large pharmaceutical companies turning to the biotechnology sector as a source of new drug ideas.

Merger and acquisition activity in the sector will likely continue notwithstanding the proposed introduction of new US Treasury rules that will make tax inversions less attractive. Many drug companies are spread too thinly and need to consolidate in areas of strength whilst disposing of less profitable businesses where they have insufficient critical mass. Eli Lilly, GSK and Novartis have already been involved in a three-way asset swap and it seems likely that there will be other similar deals in future. We believe we have entered a period of disruptive change for healthcare which should provide plenty of opportunities for us to make money for our shareholders. *From James Robinson, Chairman, Polar Capital Global Healthcare*

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We continue to hold a positive stance on the pharmaceutical sector. Over the last twelve months, a steady flow of positive clinical news shows that drug pipelines are strengthening and that the earnings outlook for the pharmaceutical sector is set to improve. On a broader healthcare view, fundamentals remain positive as the impact of Obamacare begins to drive an increase in patient volumes and utilisation over the coming quarters.

We have also begun to see more evidence supporting our view that a period of disruptive change in healthcare has begun – this is a key driver of the consolidation trend that we have seen across the healthcare sector over the last year. We recognise that disruptive change can result in major winners and major losers and so our focus is to identify those companies with services or products that provide better and/or more cost-effective care for patients.

Importantly, despite a strong move in share prices over the last four years, valuations do not seem to be stretched – P/E multiples are back to long-term historical averages for most healthcare sub-sectors. Healthcare looks to be well positioned compared to many other sectors in terms of both growth prospects and current valuation. *From Dr Daniel Mahony Gareth Powell, Investment Manager Investment Manager Polar Capital Global Healthcare*

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Infrastructure *(compare Infrastructure funds here)*

The UK Government published the 2014 National Infrastructure Plan ("NIP 2014") in early December 2014. It restated the government's long held belief that infrastructure investment is likely to be a key driver of the nation's output, productivity and growth rate. The NIP 2014 detailed a pipeline of just over £325bn of infrastructure projects to be developed by 2020/21, primarily in energy and transportation.

The UK uses a model of infrastructure investment whereby financing and delivery is split between the public and private sectors. The NIP 2014 outlined the government's intention to finance around 65% of the planned development (GBP214.4 billion) purely though private investment.

There has been an acknowledgment that infrastructure developers have only a limited capacity for financing infrastructure projects on their own balance sheets and that there will be sizeable opportunity for project finance investment.

Such project financing, expected to total GBP79 billion to 2020-21, will be in the form of long-term debt and equity that is repaid from the cash flows generated by operational projects.

Of most relevance to the Company is the expected requirement for project finance in large scale solar, onshore wind and other renewable generation projects of up to c£13bn

There has been a significant increase in the amount of both equity and debt capital available for investment in infrastructure projects both in the UK and globally. The total size of unlisted equity and debt funds with a mandate to invest in the UK is estimated to be c£18bn. London Stock Exchange listed companies focused on investment in UK infrastructure raised c£977m in the year ended 30 September 2014 alone. Institutional investors such as insurers and pension funds are increasingly becoming comfortable with the risk and return profiles of investments in infrastructure and have been upping their allocations to the sector. *From GCP Infrastructure*

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Technology *(compare Technology funds here)*

While headline valuations have expanded broadly in line with the market over the half year, the technology sector continues to look relatively attractive as it trades at just 1.0x the market multiple while boasting 55% of total US non-financial corporate cash. However, IT budgets - the key determinant of revenue growth for most incumbent companies - are expected to grow just 2.6% this year which would represent another year where industry growth failed to keep pace with global GDP. That said, we have to acknowledge that IT spending expectations have been ratcheted higher (0.4% in constant currency) since our fiscal year end, largely due to better than forecast US growth. While this has no doubt aided large-cap outperformance so far this year - small-caps having trailed by 17.5% during 2014 at time of writing - we suspect there is some risk to these higher forecasts (and 2015 expectations) given the recent downdraft in economic activity outside of the US. Furthermore, we continue to believe the new technology cycle has entered a more pernicious phase now that new technologies (epitomized by Cloud computing) have begun to substitute, rather than merely complement existing ones. The shift away from enterprise computing appears to be gathering pace with IBM the latest (and so far, the highest profile) casualty of new cycle deflation - the company recently abandoning its long-term earnings targets citing "the unprecedented pace of change in our industry".

Despite IBM's travails, investors have continued to flock to large-cap incumbent companies this calendar year because many of them have benefitted from a period of stabilization in the PC market while others have belatedly tried to rebrand themselves as would-be 'Cloud' beneficiaries. As a result, a number of legacy incumbents have been able to attract a new audience of investors drawn to vast balance sheets (Apple, Microsoft, Google, Cisco and Oracle between them boasting $415bn of corporate cash) brought into sharper focus by more shareholder-friendly capital allocation policies, the same companies together with Qualcomm buying back more than $86bn of stock and paying out over $30bn in dividends in the twelve months to Q2'14. While we should have been more alive to the risk of a marked revaluation of legacy assets, we are hopeful that this dynamic will ease as the PC unit tailwinds associated with the end of support for Windows XP fading next year. Beyond the PC market, we continue to believe that legacy business models remain "incompatible with cloud computing", evidenced by slower growth and weaker margins at a number of high-quality incumbent companies. This is unlikely to reverse course anytime soon given slower emerging market growth, currency headwinds and greater disruption associated with new technologies. Despite this, many legacy companies are today trading at their highest relative price earning (PE) ratios for years and with some now attempting to deconsolidate businesses (e.g. HP and Symantec) we cannot help think that it is late in the day for the value / large-cap technology trade.

In our opinion, most of these legacy companies are not 'ports in a storm'; rather they are better understood as incumbents being picked off by new competitors, technology alternatives and new cycle deflation. Of course, financial engineering can paper over these cracks, but in the technology sector at least, this is likely to prove a finite process, evidenced by IBM's recent fall from grace. While the impact of vastly cheaper computing has thus far largely been felt by hardware and storage incumbents, we expect new cycle deflation to eventually be felt across the entire spectrum of enterprise IT. Although overall software spending is likely to remain a relative bright spot - 7% growth expected between 2015 and 2018 - demand for IT services may already be impaired by "increased impact of standardisation and automation" associated with this new form of computing. As cloud deflation and substitution risk become more pervasive, so incumbents are likely to turn increasingly to M&A- a process likely to remind investors that free cash flow yields are a flawed measure of value when much of the 'free cash' is ultimately returned to a different set of shareholders, as SAP's $7.4bn acquisition of Concur Technology recently demonstrated. While we cannot know when PE expansion - the primary driver of large-cap outperformance so far this year - will have played out, one of the key financial engineering 'levers' - global tax arbitrage - looks at risk following the US government's decision to clamp down on tax inversion. Synthetic repatriation of offshore cash via domestic debt issuance could also be challenged once sovereign rates (and spreads) begin to normalise. In the near-term, the lack of top-line growth at many of these incumbents is likely to become more apparent over the coming months due to their disproportionate exposure to emerging markets and increasingly formidable foreign exchange headwinds.

In contrast, we expect next-generation companies to continue to deliver growth as recipients of reallocated budgets and/or beneficiaries of new, untapped pools of technology spending as the technology sector permeates into (and reinvents) other industries. Given their relative insensitivity to a still faltering global economic recovery, we are hopeful that investors will begin to gravitate back towards next-generation stocks many of which remain significantly cheaper than they did in late Q1 due to the combination of strong growth and lower stock prices. While the de-rating of next-generation stocks post their March / April highs was largely divorced from their strong fundamentals, the magnitude of the correction more than offset the additional growth they delivered. Our favoured investment areas include online advertising, ecommerce, social media, software-as-a-service, cybersecurity and digital payments, in addition to emerging themes such as robotics, wearable computing and the Internet of Things (IoT).

Given its outstanding performance this half calendar year, it is fitting that the final word should belong to Apple. Despite its size and the maturity of the smartphone market, Apple continues to defy the s-curve evidenced by the company's ability to raise pricing at a time when many of its peers are beginning to more keenly feel the impact of slower unit growth and intensifying price competition. While Apple's valuation has also expanded materially during the half year, this looks more justified as the company executes on a strong product cycle driven by a compelling iPhone upgrade. *From Ben Rogoff, manager of Polar Capital Technology*

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