March 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 (thoughts from Scottish American, Mid Wynd, Brunner, JPMorgan Overseas, Jupiter Primadona, RIT Capital Partners)

UK (thoughts from Henderson Opportunities, BlackRock Throgmorton, Murray Income, JPMorgan Mid Cap., Temple Bar, Standard Life UK Smaller Companies)

Emerging Markets (thoughts from Genesis Emerging Markets)

Latin America (thoughts from BlackRock Latin American)

Macau (thoughts from Macau Property Opportunities)

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Financials (thoughts from Polar Capital Global Financials)

Private Equity (thoughts from Pantheon International Participations)

Property (thoughts from F&C UK Real Estate, Kennedy Wilson Europe, intu Properties)

Renewables (thoughts from Greencoat UK Wind, Bluefield Solar Income)

Resources (thoughts from City Natural Resources)

Technology (thoughts from Herald)

Global *(compare Global funds here)*

We are encouraged by the economic progress made by the US, UK and certain other markets in 2014. However, such progress brings closer the prospect of tightening monetary conditions including the withdrawal of quantitative easing, which is likely to hinder significant acceleration in economic growth. The recent drop in the oil price, if sustained, may stimulate consumer demand but will of course challenge the earnings and capital expansion plans of oil and gas companies globally, as well as reflationary efforts of governments around the world.

Against such a backdrop, whilst it seems likely that while economic activity may continue to grow at a modest but accelerating rate, we are unlikely to enjoy rapid nominal GDP or earnings growth in the near future. Valuations, while perhaps sustainable, are not low and therefore financial market returns are likely to be positive but not exceptional. *From Dominic Neary, Baillie Gifford & Co, manager of Scottish American*

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The outlook in the short-term is uncertain. Both the UK and US continue to grow their economies, but by contrast many economies across Europe are struggling to generate any growth and are experiencing recessionary and deflationary pressures. The European Central Bank has decided (since the end of the reporting period) to pump money into the system via quantitative easing to try and stimulate growth, but the success or otherwise of this is difficult to predict at this stage. China and a number of other emerging markets, whilst still growing, are doing so at slower rates than in the past, although the sharp decline in the oil price should help companies and economies that have a high dependency on oil and significant energy costs. *From Richard Burns, Chairman, Mid Wynd*

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While relatively benign, the outlook is not without risks. Geopolitical tensions will be fanned by competitive currency devaluation and the impact of lower oil receipts in some economies.

In the UK, the coming General Election looks to be a close contest and may well create uncertainty over the relationship with the EU. The Fed will need to communicate the path of US monetary policy with some skill to avoid excessive volatility in the bond market, where rate expectations are currently quite complacent. The rebalancing of the Chinese economy away from a reliance on investment and debt is far from complete and could have ramifications for property prices in the region.

In absolute terms the valuation of equity markets are above long run averages which in itself is a good reason for some caution. *From Keith Percy, Chairman, Brunner Investment Trust*

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The type of spike in volatility that unsettled markets in October 2014 is likely to be more commonplace in 2015. After three years of declining volatility this will be a challenge for investors. However this should not prevent global equities outperforming bonds and cash again in 2015 even if returns are quite muted. After a marked outperformance of the US over Europe in the past year there is a good chance that Europe offers better prospects in the year ahead. The oil price will probably remain under pressure short term but should stabilise during the year as supply is gradually curtailed.

The most positive factor supporting markets will be continued central bank liquidity injections through some form of quantitative easing as recently demonstrated by the ECB's actions. Although the stimulus from the Fed will be lower in 2015 there will be support from the Bank of Japan and the ECB is under rising pressure to act further. The rapid fall in oil prices will support consumer spending.

Corporate earnings are growing around long run averages this year, with solid performances from Health Care outweighing disappointment from Resources, although currency movements are creating some volatility. The US also remains supported by ongoing share buy backs. Revenue growth remains a challenge in the constrained nominal growth environment. Margin upside will be limited outside beneficiaries of lower oil prices.

We continue to favour companies that can grow their businesses and dividends even if economic growth is muted. These stocks can be found globally in industrials, health care and technology, although Europe in particular is now a good hunting ground for undervalued growth companies. Lower oil prices and rising wage inflation provide a better backdrop for consumer stocks. M&A activity and management self-help might well offer good returns in selected UK small and mid-cap companies. *From Lucy Macdonald and Jeremy Thomas, Allianz Global Investors, managers of Brunner Investment Trust*

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The key drivers for positive equity performance remain in place: improving global growth, accommodative monetary policy, and still-supportive valuations. Some of this economic growth has fed through into companies' earnings, the anticipation of which drove much of the valuation multiple expansion over the last year. This kind of environment would typically be positive for more economically sensitive areas of the market. Continued merger and acquisition activity would also be positive for equity markets. Corporate deals soared in 2014 thanks to renewed confidence from company management teams and strong cash flows generation. Looking forward, we will need to see ongoing economic growth and sensible policy guidance from central banks for this to continue.

However, the picture is very different from region to region, and a global recovery is unlikely to be synchronised. The US and UK are moving away from a reliance on monetary policy to a more self-sustaining phase of growth and attention has now shifted to the possibility of interest rate rises. In contrast, in Europe, the economic and company earnings outlook remains less certain. We believe that there are three key areas in Europe where the positive impact for companies is potentially underappreciated: 1) monetary conditions, 2) low energy prices and 3) a weaker euro. In a recent significant move, the ECB announced a quantitative easing programme worth more than EUR 1 trillion, which was cheered by world markets. *From Jeroen Huysinga, Investment Manager, JPMorgan Overseas*

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In the UK, an election is on the horizon and this could cause uncertainty in the short term. However, the domestic UK economy continues to grow and it is too early to assess any impact from the weak growth in the eurozone.

Currencies have been big news recently with the dollar strengthening, the euro weakening and the Swiss Central Bank abandoning its euro peg. At the moment, if history is a guide, the Federal Reserve will be watching but not inclined to act to prevent the dollar from strengthening further. Governments of emerging markets who have currencies pegged to the dollar may be wishing for dollar weakness as their exports become less competitive. Others with unpegged currencies who have borrowed in dollars may wish they hadn't. *From Tom Bartlam, Chairman, Jupiter Primadona Growth*

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The world economy grew at a disappointing and uneven rate in 2014 after six years of monetary stimulus and extraordinarily low interest rates. Stock market valuations however, are near an all-time high with equities benefiting from quantitative easing. Not surprisingly, the value of paper money has been debased as countries have sought to compete and generate growth by lowering the value of their currencies - the Euro and the Yen depreciated by over 12% against the US Dollar during the course of the year and Sterling by 5.9%. The unintended consequences of monetary experiments on such a scale are impossible to predict.

In addition to this difficult economic background, we are confronted by a geopolitical situation perhaps as dangerous as any we have faced since World War II: chaos and extremism in the Middle East, Russian aggression and expansion, and a weakened Europe threatened by horrendous unemployment, in no small measure caused by a failure to tackle structural reforms in many of the countries which form part of the European Union.

However, in a world of zero or even negative bond yields, equities may well remain the destination of choice for investors. Furthermore, the majority of companies are reporting profits exceeding forecasts together with steady earnings growth. In Europe, the combination of a more competitive Euro, an aggressive programme of quantitative easing and the yields available on equities, may well lead to even higher valuations. *From Lord Rothschild, Chairman of RIT Capital Partners*

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UK *(Compare UK funds here)*

The Eurozone area continues to suffer and, as the UK's largest trading partner, its prolonged weakness may restrain growth in the UK, which is otherwise performing well. While tax receipts have lagged expectations, fiscal restraint remains on the agenda, as the consumer attempts to pay down debt. While many investors are focusing on a very difficult to call election which is unlikely to deliver a majority single party government. *From James Henderson and Colin Hughes, Fund Managers, Henderson Opportunities Trust*

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The outlook for global economic growth remains mixed. It now appears that the United States economy has finally established sustainable momentum, underpinned by robust employment growth. Continental Europe remains fragile though, with sluggish demand and continuing concerns about Greece.

The recent and rapid fall in oil and commodity prices is likely to keep inflation subdued and increase fears of possible deflation. A return to more normal levels of interest rates may also be deferred as a consequence. Falling oil prices should also provide a helpful fillip to economies in the developed world.

The forthcoming UK general election, and the knowledge that, whatever the outcome, government borrowing still needs to be addressed, may well impact market sentiment and temper enthusiasm for corporate investment in the short term. Following a lacklustre year for the sector, valuations on many high quality small and mid-capitalisation shares now look more attractive and offer good prospects notwithstanding the uncertainties on the horizon. *From Crispin Latymer, Chairman, BlackRock Throgmorton*

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Global growth forecasts look mixed with the US and UK faring relatively well, lower growth expected in China, and the Eurozone struggling to grow. The European Central Bank has announced plans to provide monetary stimulus to support Eurozone economic growth. The recent fall in the oil price should be a bonus for global growth, and one which has not yet really been felt. Tensions remain around the world in particular in Ukraine and parts of the Middle East. Closer to home we have a general election in May with all the uncertainty that this will involve before and after the vote. Uncertainty is generally not good for equity markets and especially for small and mid-cap equities.

Valuations are more reasonable than at this time last year as earnings have grown and share prices have on average slipped slightly. Sentiment towards smaller companies remains weak and experience shows this can often be a good time to accumulate positions. *From Mike Prentis and Ralph Cox, BlackRock Investment Management (UK) Limited, Managers of BlackRock Throgmorton*

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The UK equity market has rallied strongly over the past couple of years driven not by an increase in earnings but by a rerating of earnings buoyed by the effects of quantitative easing. As such the price the market is willing to ascribe for security of earnings and dividends is now relatively high but as long as bond yields stay low equities are likely to be valued through the

lens of the bond market. Back in the real world, earnings growth is likely to remain hard won and political risk in the UK certainly complicates the picture but there are some rays of light - lower oil prices should act as a potent stimulus, we should see a period of real wage growth as weaker oil prices bear down on inflation and quantitative easing should also benefit Europe, our largest trading partner, all helping the UK economy to continue to trundle along at a relatively steady clip. No doubt there will be various speed bumps ahead but your Manager [*believes*] globally competitive businesses with robust financial characteristics and experienced management teams offer the best earnings and dividend growth prospects over the long term. *From N A Honebon, Chairman, Murray Income Trust*

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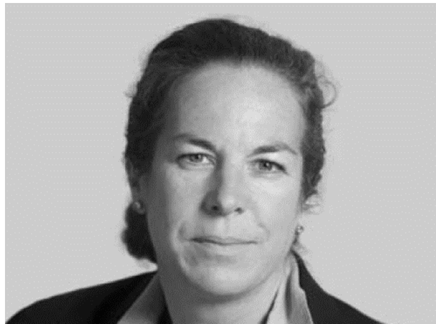

The UK economy remains one of the fastest growing in the Western World, expanding at 2.6% in 2014, and forecast by the Bank of England to grow at 2.9% in 2015. Inflation is low and continues to fall due to the oil price collapse. This decline in inflation supports the case for keeping interest rates lower for longer - the market is now expecting the first rate rise in early 2016 and even this may prove premature. Unemployment continues to fall faster than all expectations, and (finally) UK take home pay has begun to increase in real terms, for the first time since 2009. In the last quarter of 2014 it rose 2% versus 2013, and should continue to rise and support consumer confidence as low inflation persists.

As the Eurozone remains the UK's principal trading partner, it is likely that the economic outlook for the UK will be further improved by the ECB's €1.1 trillion stimulus plan and a suitable solution to the Greek crisis. While we expect the UK general election and the possibility of another coalition government to cause uncertainty and market volatility in the first half of 2015, it remains the fact that corporate fundamentals are healthy, as demonstrated by continuing growth in dividends. Business investment intentions are at record highs and we except growth in corporate earnings will drive markets higher through the remainder of the year. *From Georgina Brittain and Katen Patel, Investment Managers, JPMorgan Mid Cap*

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The Manager has been concerned for some time that the regime of low interest rates prevalent both in the UK and internationally has encouraged investors to seek higher returns in alternative instruments and has pushed many asset prices to levels beyond their fair value. There is potential for this `search for yield' to end badly, exacerbated by the lack of liquidity in many markets and the realisation by these investors that they have bought assets far more volatile than the cash they switched from. While central bankers continue to adopt aggressive policies, with debt worldwide having grown significantly since the financial crisis and valuations far from cheap, the Manager expects the turbulence of recent months to continue. It is anticipated that this will produce some attractive investment opportunities. *From John Reeve, Chairman, Temple Bar investment Trust*

The unconventional monetary policy conducted by central banks over recent years shows no sign of ending. While the Bank of England in the UK and the US Federal Reserve have finished, or perhaps just paused, their bond buying programmes, the Japanese have re-entered the fray with great enthusiasm and, in the absence of improving economic news, the European Central Bank has recently initiated its own programme. The great financial experiment is therefore likely to run for some time and the risk remains of unintended consequences.

The worriers are not restricted to a bunch of mavericks and permabears. Richard Fisher, President of the Dallas Federal Reserve, has also voiced his concerns: 'Nobody really knows what will work to get the economy back on course. And nobody – in fact, no central bank anywhere on the planet – has the experience of successfully navigating a return home from the place in which we find ourselves. No central bank – not, at least, the Federal Reserve – has ever been on this cruise before'.

Debt remains a problem. In fact, looked at in some ways it is a bigger problem than it was at the peak of the financial crisis. In 'Deleveraging? What Deleveraging?', a recent joint publication by the International Center for Monetary and Banking Studies and the Centre for Economic Policy Research, the authors emphasised that global debt to GDP is still growing and breaking new highs. They highlighted that historically, high levels of debt at best have constrained economic growth. At worst, they have led to financial crises, be they banking, sovereign or currency related.

Equity investors in developed markets, and particularly the USA, keep the faith, trusting that everything will work out fine. Thus, most news is framed positively: low interest rates are supportive to equity valuations, whilst potentially higher rates are equally good news as they signal that growth prospects are good. If the oil price is high, it encourages capital expenditure and job creation whilst if it falls, it boosts consumer spending. Bad news has apparently been abolished and any market selloffs are an opportunity to 'buy the dip'.

The bulls add that the bears should remember that equities always rise in the long term and consequently it is crazy to be out of the market. Gold, they add, is a barbarous relic, governments can print money to pay off any debts they incur and neither deflation nor inflation is particularly likely or worrisome. Perhaps most intriguingly, this relaxed attitude has become entrenched so soon after a financial crisis. At least our financial predecessors were good enough to have a decent mourning period before partying again.

Or perhaps investors really do accept that high and growing government debts genuinely are a problem, that the Euro is looking ever more fragile, that Chinese economic growth may yet disappoint, that the US may be forced to return to bond buying policies and that the Japanese are playing with fire, but that as the music is playing it would be rude to leave the dance floor. If so, surely we have seen this movie before. Not everyone will leave without paying a heavy price.

As we have detailed in previous years we have far more sympathy with the bears in these arguments. Of course our fears may be overdone, or even if we are correct, our timing may be badly out. In a world which increasingly demands near perfect timing, we are constantly asked to identify the catalyst for such market weakness; without a catalyst most investors are highly reluctant to sell. Our concern is that with a catalyst they may find themselves unable to sell.

Those who focus on timing often highlight John Maynard Keynes' alleged aphorism that markets can remain irrational for longer than one can remain solvent. If Keynes did in fact say this, his problem was that he had borrowed money to invest in the stockmarket and thus feared insolvency as and when the bank requested the return of its money. In contrast, an investor holding cash can outlast an irrational market although sometimes great patience and tolerance is required.

While we watch how events develop, we were recently provided with some encouragement from veteran American high yield investor Howard Marks quoting economist Rudiger Dornbusch, "In economics things take longer to happen than you think they will, and then they happen faster than you thought they could', to which Marks added, '…and they go much further than you thought they could'.

If equities were extraordinarily out of favour and cheap our concerns would be much diminished. A significant amount of bad news would be discounted in prices and therefore the expected long-term returns from holding equities would be greater. However, this is not what we see. We think valuations are pretty stretched, particularly so across a broad swathe of medium-sized companies. The search for yield has forced dividend yields down and we must be very sensitive to the risk of disappointment. Comparing an equity dividend with the low rate of interest on a bank deposit or of a government bond is appealing to many, but is racked with risk. A superior equity yield can appear attractive, but is obviously neither guaranteed to increase each year or even remain constant and is attached to an asset far more volatile than the one with which it is being compared. It is highly likely that in the very long run a high yielding equity portfolio will comfortably outperform both bonds and cash, but the very long-

term is often too long an investment horizon for many investors and the interim volatility can test the mettle of the average investor; particularly if he has historically preferred the more serene areas of bonds and cash.

There also seem to be contradictions at work in equity markets. Equity bulls highlight the attraction of equities compared with low interest rates. However, the story implicit in bond yields (low growth and very low inflation) hardly tallies with growing corporate profitability and high dividend growth. On the other hand, if bonds are mispriced and yields are too low, then the yield advantage of equities is temporary.

The oil price fell heavily towards the end of the year to finish far below any forecasts of twelve months earlier. Of course, the commentary that accompanied this fall rationally explained the events away and provided more forecasts, but it is difficult to believe that forecasting such a volatile commodity has become any easier twelve months on. The episode has probably just proved as screenwriter William Goldman once said that 'Nobody knows nothing'. If it is more reflective of an imbalance between supply and demand given a step down in global growth then there is a good chance that oil bounces back. If the conspiracy stories (take your pick)are correct, then the Saudis are aiming to make life painful for the high cost producers for a few months and encourage some of them to leave the market. If that is true, once again we will probably see a bounce back. To believe that the fall is permanent one may need to believe the more extreme argument that the Saudis are concerned that they have too much of a rapidly depreciating asset in the ground and therefore need to pump at any price. Geo-political problems, central bank policy, emerging market problem areas and the growing levels of government debt around the world all suggest the potential for higher volatility and reasons to believe that there will be better times to take on more risk. *From Alastair Mundy, Investec Fund Managers Limited, as Manager of Temple Bar Investment Trust*

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The interest rate environment remains incredibly benign. Our economists are predicting that the Fed will tighten between June and September with the UK following suit a few months later, with oil prices having fallen adding a couple of percent to disposable income. The impact of this can already be seen in consumer spending patterns in the UK. In Europe the picture is more mixed. Economic stagnation in Southern Europe is still ingrained, with the recent election in Greece meaning that negotiations are tense over debt relief and the Euro. China's modest but controlled slowdown and a decent short term outlook in Japan are positives. All of this means that the economic backdrop to markets around the world look reasonably positive.

For the pessimists out there the relentless continuous application of quantitative easing must be a concern. Firstly, because it encourages the formation of an asset bubble as investors seek more risky income sources. It is notable for example that Private Equity is back outbidding the listed market for the purchase of businesses with KKR for example buying The Trainline.com just as it was about to list on the LSE and, secondly, in so far as weaning the world economy off QE is difficult and unpredictable. In an increasingly connected world unintended consequences that have not been foreseen may come to pass.

Profit margins for cyclical industries are at levels that were last seen in 2007. Cyclical stocks, have now seen six years of recovery since the nadir of the banking crisis in early 2009 and after so many years of recovery have now delivered an earnings growth track record that make those of our consistent quality growth holdings look quite pedestrian. Some late cycle sectors such as real estate are taking up the running in terms of performance. All this suggests that we are now in the later stages of the up phase in this economic cycle.

The new issues market has quietened down since a year ago although it is still open for business. Acquisition activity remains surprisingly modest from trade buyers looking for growth.

Smaller Company valuations are actually not overstretched right now with the Price Earnings ratio of the Numis Smaller Companies Index as calculated by professors' Dimson and Marsh being just above that of the FTSE All Share Index. The trouble is that markets will be assuming that the economic cycle has in fact not been banished to oblivion and that the next turn in the cycle is downwards. This means that Smaller Companies as a more cyclical sector will gradually de-rate until an actual economic downturn occurs. Whilst no down-turn is currently envisaged our feeling is that it pays in the long run to be vigilant and to remain cautious.

Perhaps a by-product of this is that dividend growth is now starting to tail off with what seems to me to be less in the way of special dividends being paid. This reflects a greater degree of medium term caution from company Finance Directors. *From Harry Nimmo, Standard Life Investments, manager of Standard Life UK Smaller companies*

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

Investors will feel that 2014 has been a dramatic year for many emerging countries, with the positive election euphoria in India and Indonesia being countered by the disappointing political events in Brazil, and the sharp decline in commodity prices which has negatively affected not only major markets like Russia and Mexico but also smaller ones such as Nigeria, Chile and Colombia. It seems very likely that the difficult macro-economic environment that some developing countries now face will persist in the near-term, but there are encouraging signs too: in China, for example (despite 2014 being the fifth consecutive year of slower growth), there appears to be gradual movement towards the implementation of the economic reform that the country is felt to need. *From Coen Teulings, Chairman, Genesis Emerging Markets*

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In the Fund's last Annual Report we noted that we feel emerging markets companies are likely to experience more difficult conditions than they had become accustomed to over the last decade. Many will need to adjust to a new reality of lower levels of profitability in certain industries (due to factors like higher competition, taxes and regulatory pressure); a slower demand environment, reflecting the increased levels of penetration in many markets of basic goods and services over the last ten years; commodity prices which should in general fade to lower long-term equilibrium levels; and strong share price performance and hence rich valuations in certain industries. We also remain alive to the threats and opportunities posed by new disruptive business models, especially after a year marked by the spectacular Alibaba IPO. Evidence of these trends can be seen in a number of markets and sectors, but while some [*areas*] still seem relatively expensive (e.g. India, Thailand, health care and many consumer companies), others appear much cheaper. Russia, Nigeria and banks fall into this latter category, along with resources holdings, which we also believe are notably undervalued. *From Genesis Asset Managers, LLP, managers of Genesis Emerging Markets*

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Latin America *(compare Latin American funds here)*

The unwinding of the commodity boom has severely tested the thesis that Latin America has managed to escape its historic role as a geared play on global economic growth, highly dependent on energy and resource exports to sustain respectable economic growth and viable government finances.

Many of the hoped-for benefits of Mexico's recent reform programme have taken longer to emerge than initially expected. In Brazil, although there have been some changes to key ministries, recent corruption investigations seem likely to cloud the momentum behind much needed structural reforms.

However, despite this uninspiring backdrop, the region contains many dynamic and well managed companies capable of generating attractive shareholder returns, and which are less dependent on the progress of the global economy overall. Current valuations are not demanding and offer value to the long term investor. *From Peter Burnell, Chairman, BlackRock Latin American.*

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Brazil's prospects for 2015 are uncertain. Growth was weak in 2014 and the required fiscal adjustments being implemented by the new economic team are likely to provide further headwinds to growth. In addition, the alleged corruption investigation around Petrobrás and many of the country's largest infrastructure companies are also likely to impede growth prospects. As the slow economic recovery continues [*Mexico*] should finally start to experience some of the positive aspects of the reform process. Oil field auctions will begin in the second quarter of the year. [*In Peru*, w*e see*] the prospect of improving economic growth throughout 2015. However, given the impact of lower commodity prices on their economies, along with growing fiscal costs for companies and individuals, we have low weightings in Chile and Colombia. *From William Landers, BlackRock Investment Management (UK) Limited, managers of BlackRock Latin American*

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Macau

The corruption clampdown in China is likely to continue to affect market sentiment in Macau. But we would caution against losing sight of the city's unique positioning. Macau remains the only territory on Chinese soil in which gaming is permitted. The potential for long term growth remains significant.

Over the next three years, six new casino resorts will open, boosting the number of hotel rooms from 29,000 to 42,500 - still 110,000 fewer than in Las Vegas. Some 35,000 new foreign workers, or almost 10% of Macau's working population, will be needed to staff these resorts. This new phase of casino developments will be heavily geared towards China's growing middle class - the key to sustainable future growth in the territory. This in turn is expected to drive mass-market gaming, which is significantly more profitable and less volatile than the VIP segment upon which Macau has been overly dependent. *From David Hinde, Chairman of the Board, Macau Property Opportunities Fund Limited – a much fuller analysis of the situation than we can reasonably accommodate here is given in Sniper Capital's manager's report.*

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Qatar *(compare emerging market single country funds here)*

The fall in oil and gas prices will undoubtedly have some impact on the Qatari economy as certain low priority projects may be deferred. However, Qatar is the world's largest exporter of liquid natural gas (LNG) and an overwhelming majority of these exports are secure under long-term contracts so have steadier revenue streams. The government diversification policies over recent years have placed Qatar in an enviable position relative to other Gulf countries with around 50% of GDP now derived from the non-hydrocarbon sector. This, combined with strong population growth, improving demographics and a full infrastructure pipeline, should safeguard Qatar's growth prospects.

The Investment Adviser believes that the recent correction in the Qatari market gives fresh entry points for long term investors seeking robust earnings growth potential and attractive dividend yields. *From Epicure Managers Qatar Limited, managers of Qatar Investment Fund*

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Financials

Sentiment towards the sector was volatile in 2014. In the banking sector the recently completed asset quality review (AQR) has confirmed that European banks have made substantial progress in strengthening capital bases and cleaning up balance sheets. The amounts of additional capital required to satisfy the stress scenario are very small in the context of the European banking system and have been covered in large part since the completion of the AQR. At the same time as strengthening capital bases, banks in Europe and the US have made great strides in rationalising costs and improving the quality of their loan

books. This is having positive effects on profitability and will support dividend growth. Stronger balance sheets, growing dividends and buybacks, growth opportunities in emerging markets, and attractive valuations continue to provide the positive prospects for a re-rating of the financial sector.

This has not been helped by a string of high publicity punitive fines by regulators on a number of banks. It is not possible to say if and when this will come to an end. Although further punitive actions may be a short term risk factor, we believe that the increased regulation and transparency of financial institutions since the banking crisis are reducing the long term risk of poor behaviour and weak governance. Better cultures and management performance are part of the recovery and re-rating story, as well as a driver for a recovery in sentiment for this sector. The Investment Manager's confidence in the outlook is reflected in the Company's low cash position and the use of its leverage discretion to increase exposure to attractive opportunities *From Robert Kyprianou, Chairman Polar Capital Global Financials*

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The sector's performance correlates very strongly, not surprisingly, with the underlying performance of the economies and financial markets in which its companies operate. If expectations for growth pick up, as some leading indicators are pointing towards, than the sector will perform well and should outperform underlying equity markets. Furthermore, if this leads to higher interest rates, then that will be beneficial for the sector as it should lead to higher earnings through margin expansion. Finally some of the negative headwinds of fines and litigation should start to dissipate over the coming year.

Other key drivers include the longer-term impact of technology on the sector. Over recent years there has been a significant shift from customers using branches and call centres to using on-line and mobile banking which is significantly less costly to service. McKinsey have estimated that banks could cut their cost-income ratios by 7 percentage points, largely by reducing and downsizing their branch networks which would provide a significant boost to profitability. As an example, Swedbank, one of Sweden's largest banks and a holding in the Trust has announced a cut in its cost base from 17.5bn krona to 16.0bn krona, largely due to these shifts.

Stress tests are likely to become an annual phenomenon, which should underpin an improvement in sentiment towards the sector, although it still remains very negative towards European banks despite the ECB's asset quality review and stress tests in which the vast majority of banks were given a clean bill of health. There is also likely to be further tweaking of the regulatory framework for banks, which we see as a positive, but which will no doubt continue to generate some uncertainty in the shorter-term and create more headlines despite having no material impact on earnings.

Nevertheless, we consider that the negative sentiment that surrounds the sector is overstated as it is largely focused on a small number of large banks. There are a significant number of other banks and other financial companies that are growing strongly and without legacy issues, at odds with perceptions of the sector. Reflecting our positive view, in August, we took the opportunity to partially drawdown on the Company's borrowing facility with ING, reducing our cash balances in the process and adding to our holdings across the portfolio. *From Nick Brind and John Yakas, Polar Capital Partners LLP, managers of Polar Capital Global Financials*

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Private Equity *(compare Private Equity funds here)*

Economic stimulus is nothing without structural reform. Nor, for that matter, is swingeing austerity. Just when most of the world appeared to be recovering from the economic ills of the past six years, symptoms have returned to many markets that indicate that the medicine administered has proven as unsuccessful as the widespread cure.

Europe, having turned a corner, is slipping into recession once more. Deflation across the Eurozone is a threat, and indeed already a reality in some markets. The UK, which emerged strongly from the downturn, may not be able to escape the pull backwards. Meanwhile, Japan has slipped into recession once more, with its fifth technical recession since 2002 deeper than at first thought. At the end of 2014, the Bank of Japan signalled its intention to lift its bond

buying program to unprecedented levels, while the European Central Bank in January announced plans to buy €60bn a month of sovereign debt and other assets until September 2016 in the hope of rekindling growth. So, just as one large central bank - the US Federal Reserve - seems to be turning off the printing presses, two other central banks appear ready to flood markets with masses of liquidity.

The problem of slow growth is most acute in those two markets, but not confined to them. A large part of the world is now faced with the symptoms of what economists call "secular stagnation" - a long-term reduction in the potential growth rates of developed economies. Meanwhile, large emerging markets, including China and India, have stronger growth but seem unlikely to recapture the heady double-digit or high single-digit rates registered just a couple of years ago. The prospect of anaemic growth leaves policymakers around the world grappling with ways to stimulate their economies, create jobs and increase prosperity for their citizens.

As investors, we have to find ways to generate returns against a backdrop of persistent uncertainty and volatility. In the face of slower growth and stagnation, investors' fundamental quest for yield has fuelled the credit markets. Treasury yields flirt with record lows and high-yield credit can prove to be anything but. While, of course, a lower cost of credit is helpful to private equity managers in reducing the cost of capital for portfolio companies, it also has the effect of pushing up asset prices. As such, private equity is not immune to downward pressure on returns, but private equity managers can be more active in order to create value, including making judicious use of the credit markets as well as financing growth in businesses with clear opportunities to increase operating efficiency and/or market penetration.

Amidst the uncertainty, bright spots remain on the horizon. In the US, growth is on an upward trajectory, joblessness has fallen, consumer spending and business investment are growing and inflation - pushed down in part by low oil prices - is picking up and wages are responding. Normal economic progress, though not boundless growth, is returning. The US experience of quantitative easing shows that such measures can work, but only when allied with financial and structural reform. Certain emerging markets are also showing strong signs of continued growth and undervaluation from a private equity perspective. And globally, oil prices - which at time of writing have slipped to below $60 a barrel - can provide a fillip for growth, particularly in those countries reliant on oil imports for their manufacturing output.

In Europe, a brief honeymoon of improving economic growth has been replaced with a deteriorating outlook. The European Union registered GDP growth of just 0.3% in the third quarter, with its largest actor Germany having effectively ground to a halt since the end of March. ECB President Mario Draghi's planned €1 trillion quantitative easing stands ready to administer emergency liquidity. Yet, without long-term reform, the benefit is likely to be short-lived. The politics of inequality is trumping much of Europe's political commitment for reforming labour markets, cleaning out its banking problems, and dealing with an inconsistent Stability and Growth Pact, which is driving the continent into deflation.

In Japan, structural market reforms, one of Shinzo Abe's "three arrows" of expansionist policies, have been disappointingly slow in coming. It remains to be seen whether the renewed mandate of his government can deliver on this elusive goal.

While the quantitative easing that is expected in both these markets is likely to be helpful for equity markets in the short term, private equity investors, as long-term investors, will need to be particularly careful to invest in areas of the market that are better defended against these largely deflationary effects.

Long-term slowing growth extends to large emerging markets, presenting challenges for their respective administrations. Additional political volatility creates a backdrop of uncertainty for investors, despite the potential long-term attractive characteristics as these economies grow.

China's growth has come off its peak, and while much has been made of attempts to increase the pace of growth, the OECD is predicting that GDP expansion will dip below 7% in 2016, while OECD member growth increases to 3%. Addressing wasteful investment will help, but China's transition to a domestically-driven consumption economy will inevitably mean slower-paced growth in the long run.

One of the hazardous consequences of quantitative easing is the widespread asset price inflation witnessed globally. Stock markets are above where they stood before the crisis, while

bond yields are at some of their lowest levels. Private equity has not been immune. Public market comparables set a high benchmark for valuations, while cheap loans and high-yield bonds enable sponsors to stretch prices further. Furthermore, fundraising has been enjoying its best run since 2008 with record levels of dry powder increasing competition for assets. We expect that run to continue in 2015 as the European Central Bank and the Bank of Japan take on the mantle of providers of liquidity of last resort to the global economy. High valuations and high levels of market liquidity, which increases the risk of overpaying when deploying capital in new investments, provides a welcome boost to sellers of assets and consequently the market as a whole has seen increasing levels of distributions from funds as assets are realised in this favourable environment.

Secondary transaction volume reached another record level in 2014 with $38.5bn transacted, significantly surpassing the 2013 level of $24.5bn . The growth reflected a favourable pricing environment for sellers of secondary interests in funds enjoying helpful exit market conditions. Consequently, in addition to the expected sellers, we saw many institutions making opportunistic use of the secondary market to reduce exposure to non-core managers. Pricing in the market has been robust, with an average high bid of 95% of NAV throughout the year.

The most active sellers in the market are expected to provide significant secondary deal flow in 2015. Despite the Federal Reserve Board's announcement in December 2014 of a deadline extension for banks' compliance with the Volcker Rule to at least July 2016, banks are expected to engage in further selling activity this year. Moreover, pension funds are expected to look to take advantage of a more active secondary market to concentrate their resources on fewer fund relationships. These trends, along with a recovering US economy and further volatility in Europe is likely to mean another active year for secondary deal flow in 2015.

While we see high prices and fierce competition for assets in many markets, we do believe there are broad themes shaping consumption trends globally, including developments in technology and in large emerging markets. These are enduring investment themes which private equity can tap into and ultimately profit from. Among these we see demand for new energy sources, resurgent US manufacturing and the ageing global populations as driving forces for our investment markets. *From Pantheon International Participations*

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Property *(compare Property funds here)*

This reporting period has delivered exceptional performance which is unlikely to be sustained, but with property yields remaining attractive against the risk free rate and interest rates expected to stay low for some time, the outlook for property remains favourable. The approaching UK election and possible EU referendum together with global economic and political uncertainty may act to temper performance and at some point the scope for property yields to compress further will end and some outward adjustment is possible. The Manager is predicting a gradual return to more sustainable levels of performance over the coming five years with rental growth becoming a more important factor in performance, and for total returns to be increasingly driven by income return. *From F&C UK Real Estate*

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We expect to see improved business confidence across both the UK and Ireland for 2015. Commercial property is seeing positive signs of rental growth across selective office and retail catchments which is extending outside the main CBDs of London and Dublin. Investment appetite remains strong across the board with a growing appetite for risk particularly in our target markets where significant pools of capital are looking for a home. The recent Quantitative Easing programme is expected to put further downward pressure on property yields and offer opportunities for lower cost debt funding across our portfolio. *From Charlotte Valeur, Chair, Kennedy Wilson Europe*

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The retail sector has been changing at a rapid pace and change is likely to continue in 2015 as the UK economy continues to strengthen. The outlook for retail spending in 2015 is positive due to a combination of low inflation, reviving growth in earnings and resilience in the labour market, indicating that households' real disposable income should increase over the course of the year.

The supply of new space is limited. In 2008, a record year, over 8 million sq. ft. of new shopping centre space was built in the UK. Levels fell with an all-time low in 2014 and even by 2019 the supply is only expected to have reached around 3 million sq. ft.

Across the sector we are expecting to see a focus in 2015 on improving the customer experience, with seamless multichannel engagement and an increasing sense of personalisation, showrooming and convenience. We recognise that the influence of digital technology will continue to dominate tactical and strategic decision-making across the industry. At Intu, we see the rise of multichannel retail - online, in-store, click and collect - as an opportunity rather than a threat. *From intu Properties.*

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Renewables *(compare Renewable Energy funds here)*

Renewable generation build-out is needed not only to achieve the UK's low carbon targets but also, as importantly, to bolster security of supply. Wind remains the most mature and widely deployed renewable technology available in the UK and electricity production from wind is becoming an increasingly important part of the UK's generation mix. We expect a significant number of further investment opportunities for the Group as utilities and developers continue to seek to recycle their capital. *From Tim Ingram, Chairman, Greencoat UK Wind*

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The regulatory outlook for operational wind farms in the UK remains stable. Renewable developers on the other hand (predominantly wind and solar) face considerable uncertainty as the Renewable Obligation is replaced by CFDs for new projects (March 2015 in the case of solar >5MW and March 2017 in the case of wind). The general election in May 2015 may bring increased uncertainty for developers.

The secondary market for operational UK wind farms is over £25 billion, increasing to £60 billion of assets in the medium term, being the combined value of those assets currently in operation, in construction or consented. Both utilities and developers are looking to sell such assets to recycle capital into assets in development and construction.

Power prices were weaker than forecast in 2014 owing to lower than forecast gas prices. In general, independent forecasters expect UK wholesale electricity prices to continue to rise in real terms (in the short and long term), based on tighter UK capacity margins in the short term and global energy supply and demand in the long term, together with the ongoing phasing out of coal-fired power stations. *From Greencoat UK Wind*

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The period after March 2015, will be interesting for the solar industry as it transitions over to the new regime where the industry will start to use Contracts for Difference ("CfD") for large solar assets and growth in the commercial and industrial market is expected. Experience of other solar markets indicates that even in a changing regulatory landscape, solar markets are highly adaptable.

The regulatory outlook for the industry remains positive, albeit the industry will transition over to the new regulatory regime for newly built projects from April 2015, which naturally creates some uncertainty. It is the view of the Investment Adviser that even with this transition, the UK solar market is viewed as highly attractive by developers, contractors and funders and that the market will see continued growth throughout 2015. The shape of the market may be slightly different with an expectation to see an increase in the number of sub-5 MWp assets due to an ongoing RO Scheme eligibility and fewer large scale (>5 MWp capacity plants) until the next CfD auction at the end of the calendar year.

The UK solar market is unique in relation to established solar markets in that the UK government has explicitly outlined an ambitious plan for growth in the sector, through the publication of the Solar PV Strategy: Part 2 (the "Strategy"). In tandem with the Strategy, the outcome of the consultation into large scale solar was delivered in quarter 4, 2014 (the "Consultation").

The Consultation sought to achieve a market that has balanced growth across all the major investment sectors, domestic, commercial and industrial and agriculturally situated.

Under the Consultation, the Renewables Obligation ("RO") Scheme for solar will close for installations that are greater than 5 MWp in capacity and are grid connected after 31 March 2015 (except in the case where they qualify for a 'Grace Period'). For assets that are greater than 5 MWp in capacity, they are to be replaced by the new support, the CfD, which is proposed to give fully-indexed revenues for 15 years with no exposure to wholesale energy prices. There is no change to support for projects connected prior to April 2015.

In July 2014, the Department of Energy and Climate Change ("DECC") announced its ambition to see the rooftop solar market grow from the current low installed capacity to 11-12 GWp by 2020, creating a potential major new investment market. The single biggest part of this market is expected to be the industrial and commercial market. In respect of unlocking this huge potential, DECC launched a consultation on 25 November 2014, seeking views on whether medium and large rooftop solar installations could be moved without the loss of feed-in tariff ("FiT") payments. The consultation closed on 5 January 2015, and the results are yet to be announced. DECC also announced an amendment to the definition of building-mounted solar under the FiT regime to require that the building must use 10% of the electricity generated.

At the same time as the launch of the rooftop consultation, DECC released the results of a previous consultation on the introduction of a grid delay grace period for projects qualifying for the RO Scheme Obligation, with DECC deciding in favour of the introduction of a 12 month grace period for projects greater than 5 MWp which have a Distribution Network Operator ("DNO") confirmed connection date before 31 March 2016. *From Bluefield Partners as managers of Bluefield Solar Income Fund*

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

The oil price more than halved during the six month period under review, and with Saudi Arabia apparently determined not to forego market share we may have an opportunity to discover what the cost price of shale oil really is. Lower oil prices will put money into consumers' pockets and boost the majority of corporate profit margins, but they also add to the deflationary pressures that so frighten the world's central bankers. The US Federal Reserve appears to be in no hurry to raise interest rates, while increases in the Bank of Japan's QE programme and Mario Draghi's first 1 trillion tranche of European QE further entrench a loose monetary policy that promises to sustain an asset price bubble.

Commodity prices have not participated, and in the face of a slowing China, with all the consequential knock-on effects in Australia, South Africa and Brazil, it is not easy to be positive in the short term. There are always exceptions, and the renewed threat to the euro, together with the sudden move by the Swiss Central bank on 15 January 2015 to decouple the Swiss franc, has renewed interest in gold, a key long term component of our portfolio. Negative interest rates reduce the opportunity cost of holding gold and, the Swiss franc aside, it is hard to maintain faith in currencies awash with artificial surplus liquidity.

The medium term is a different matter. There the case remains as compelling as ever, world population growth and increasing urbanisation underpinning a demand for commodities that can only expand. The current period of financial retrenchment at producing companies, combined with the supply constraints that threaten all but bulk commodities, will make the recovery even more dramatic when it does arrive.

Of course the exact timing of this turn is hard to predict, depending as it does on a number of major macro political and economic events. *From Geoff Burns, Chairman, City Natural Resources*

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The stronger dollar is a major headwind for all commodities and resource equities but we believe that this is masking nascent supply constraints that have been built up by underinvestment over the last four years of falling prices. Margin expansion is being witnessed in producing mines and developers are also reporting significant savings when building projects. The Company's focus remains on those companies with tier one assets and sound balance sheets. Four years of falling prices and investor desertion have left the sector starved of capital and valuations correspondingly depressed, but this is the opportune time in the cycle to invest. *From Will Smith / Ian Francis, Investment Managers, City Natural Resources*

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Technology

The technology sector overall has benefited from the continuing pervasiveness of the internet, but in many cases this represents revenue shifts within the sector, as new companies challenge legacy suppliers. While we cannot see any mega trends which will make easy wins in the technology space in the short term, we remain convinced that entrepreneurially managed small companies continue to have the ability to exploit opportunities, and offer much greater scope for profitable investor returns than large companies. The TMT space remains ripe for entrepreneurial opportunity as technology continues to open up new markets. The price for higher potential upside is poorer liquidity.

The recent weakness of sterling relative to the dollar will drive stronger growth in UK profits in 2015. More mature companies have become more expensive than we have experienced in recent years, and takeovers have been focussed on these more mature companies. Consequently, there is the temptation to move to higher risk earlier stage companies where there remains such a shortage of capital. This, combined with macroeconomic uncertainties, tempers our enthusiasm, but that is more than offset by the difficulty of finding more attractive investment opportunities elsewhere, and the realisation that some of the best returns over the years have come from microcaps scaling up their businesses. *From Julian Cazalet, Chairman, Herald Investment Trust*

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For the first time since 2000, there are anecdotal signs that there is an IT skills shortage in London. Too many people were sucked into the industry in the late 1990s, and then a big shift occurred as outsourcing to India became the fashion. This trend seems to be at least in part reversing, and the financial sector is recovering to more normal levels of investment. There are even signs that there is less of a race to offshore manufacturing. It seems that, thanks to working tax credits and immigrant labour, the UK has become more competitive in terms of labour costs, while inflation in Chinese labour costs is conspicuously making China a less desirable outsourcing country.

If the regulatory changes have proved one challenge, the accountants have proved another. There is now a great deal of disclosure in company accounts, in the UK and the US, which takes effort to fathom out. Whilst we are all in favour of success being rewarded, we dislike the trend to issuing shares at below market price. In the UK there has been a surge in the issuance of nil cost options, and in the US RSUs (restricted stock units). Whilst at one level aligning managements' interests with those of shareholders is a good thing, at another level it makes it very difficult to determine the real costs to the company. When options were only issued at market price, adding back share based payments to give an adjusted EPS was not too much of a stretch. With nil cost or discounted share issues, share based payments have become a very real cost, and an adjusted EPS figure which adds back the non-cash element is misleading in terms of company valuation. The second murky area is amortisation. Amortisation of goodwill is a non-cash item, and it is again misleading that the same term is used for amortising capitalised research and development costs. The latter is a real cash cost. In short, the adjusted EPS that companies are inclined to put in the headline results announcement has become a very flawed measure. It is the policy of the Board to discourage the approval of share issuance at any price below the market.

There has been a benign environment for salary inflation outside company boards since the financial crisis, and even since the "TMT" bubble of 1999-2000. Anecdotally we now hear of higher staff churn, skill shortages and poaching. This is particularly challenging in Silicon Valley with Apple, Google, Facebook and others driving a hot market. Furthermore there is an appetite for smart developers to move to start-ups where they dream of millions from stock options. In the UK the market for IT services has conspicuously warmed, as the financial sector

has increased investment to cope with revised risk and regulatory challenges. At least sterling weakness offsets some of this cost creep in the UK.

We are often asked about "Silicon Roundabout" and the growth of the sector in East London. We are frustrated by the sloppy terminology, which does not distinguish digital media which is largely the application of technology, from the development of real technology. The latter has a greater focus in Cambridge, Oxford and in the financial sector.

After the strong performance of 2013 the market consolidation in 2014 is quite healthy, because fundamentals have been sound. The sector continues to have anomalous valuations, some of them conceptual, while the more sensibly valued are being picked off by trade and private equity acquirers. In an uncertain political and economic world we treat fashion cautiously. We continue to be excited by the opportunities. *From Katy Potts, manager, Herald Investment Trust*

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