May 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 JPMorgan Elect, Henderson International Income, Henderson Global)

UK (thoughts from BlackRock Smaller Companies, JPMorgan Elect, Fidelity Special Values, Threadneedle UK Select, Merchants Trust, Acorn Income Fund, Invesco Perpetual UK Smaller Companies)

North America (thoughts from Middlefield Canadian Income and JPMorgan American)

Asia (thoughts from Edinburgh Dragon, Schroder Oriental Income, Henderson Far East Income, Witan Pacific, Scottish Oriental Smaller Companies, Weiss Korea Opportunities, Aberdeen New Thai)

Europe (thoughts from BlackRock Greater European)

Japan (thoughts from Prospect Japan, Fidelity Japanese Values)

Healthcare / Biotech (thoughts from International Biotechnology Trust)

Commodities & Resources (thoughts from Global Resources)

Debt (thoughts from P2P Global, ICG Longbow, NB Global Floating Rate, Fair Oaks Income, City Merchants High Yield, Acorn Income Fund)

Property (thoughts from Schroder Global Real Estate, ICG Longbow, UK Commercial Property, F&C Commercial Property, Standard Life UK Property Income, Taliesin Property)

Global *(compare Global funds here)*

We expect growth in developed economies to strengthen in 2015, the US economy remaining the growth leader moving into a mid-cycle phase, with growth modestly above trend but inflation and wages contained. While Europe and Japan should both narrow the growth gap with the US, this expectation remains reliant on aggressive monetary stimulus. In contrast, US interest rates look set to rise later in 2015, leading to increasing policy divergence across developed economies. Meanwhile, growth in many emerging market economies is likely to remain challenged by rising US interest rates, a stronger US dollar and low commodity prices. This environment should be supportive for developed market equities and we remain cautious on emerging market equities.

While investment trust discounts remain relatively tight versus history, the widening we have seen so far in 2015 has introduced some improved opportunities for investing in attractive asset classes and managers with good performance track records at more reasonable valuations. *From Katy Thorneycroft, Investment Manager, JPMorgan Elect Managed Growth*

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Equities have performed well in the period under review, with market valuations and dividend yields broadly in line with historic measures. Low interest rates and inflation internationally provide obvious benefits, but our working assumption is that this is no more than cyclical and will reverse when energy markets stabilise and inflation returns to a more normal level. Absent a major geo-political disturbance we expect the general if patchy recovery from the crisis of seven years ago to be maintained and for equity markets at large to maintain station with this. *From Christopher Jonas, CBE, Chairman, Henderson International Income*

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Six years into the market recovery that started in 2009, we retain our confidence in equities. Our view is supported by improving economic data, reasonable equity valuation levels in a number of regions and the attractive outlook for equities relative to other asset classes. Fixed income markets have come a long way and in many countries now offer negative real yields while facing the prospect of an interest rate hike at some point. The return on cash is low and again in some countries is negative, meanwhile the commodity cycle seems to have turned downwards. These factors increase the chance of equities receiving a larger part of future investor fund flows. That said, beyond the immediate future we recognise that there are signs that we are closer to the end of the current market cycle than the beginning. *From Richard Stone, Chairman, Henderson Global Trust*

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UK *(Compare UK funds here)*

Internationally there are a number of potentially disruptive factors at play, including the stronger US dollar and the prospect of interest rate rises, increased tension in the

Middle East and Ukraine and concern about financial and political developments in the European Union.

Against that background, the US economy is recovering and in Continental Europe the European Central Bank is taking measures to stimulate the economy.

Many emerging markets have suffered as a result of lower oil and metals prices and the rising dollar. In the UK the impending General Election brings considerable uncertainty, which could well affect the equity market. A result which would lead to a referendum on the UK's membership of the European Union could also create instability. Your Portfolio Manager believes that favourable economic factors should support consumer stocks but is wary of exposure to government and corporate spending given the possibility of an indecisive election result. *From Nicholas Fry, Chairman, BlackRock Smaller Companies*

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Global growth forecasts look mixed with the US and UK faring relatively well, but with continental Europe showing some signs of improvement, and lower growth expected in China. The recent fall in the oil price should be a bonus for global growth. Tensions remain around the world in particular in Ukraine and parts of the Middle East. In the UK we have a general election in May with all the inherent uncertainties expected before and after the vote. *From Mike Prentis, manager of BlackRock Smaller Companies*

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A key near term focus for investors in the UK will be the May general election, the outcome of which remains uncertain. Equity market volatility is likely to rise in the lead up to the election, with volatility during 2015 also being impacted by the monetary policy decisions of the major developed central banks, particularly the potential policy tightening by the US Federal Reserve later this year.

The UK economy continues to grow in a non-inflationary way and UK job growth has been impressive; real wage growth has started to pick up, which is a promising trend. The recent dramatic fall in the oil price should be a net positive for economic growth. The cost of production for companies will benefit and lower petrol and heating bills will be akin to a significant tax cut for UK consumers.

UK companies are generally in strong financial health and, for the more domestic among them, 2015 earnings prospects are encouraging given the positive outlook for economic growth. Given the continuing robustness of many UK-focused company balance sheets and managements' focus on cash flow generation, their ability to increase dividend payouts is likely to continue. *From John Baker and Sarah Emly, Investment Managers, JPMorgan Elect Managed Income*

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Despite a period of strong recent performance in the equity market, there are still a large number of companies trading at attractive valuations which don't reflect the positive changes occurring at industry or company level. Compared to last year, more of these positions are found in the small-sized companies category, with fewer cheap

stocks available among large and mid-sized companies. *From Alex Wright, Portfolio Manager, Fidelity Special Values*

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Policy divergence is likely to be a key theme in 2015. In the UK, the timing of interest rate increases will be keenly debated. However, in Europe and Japan interest rates are likely to remain very low, and this should put a cap on any rise in bond yields, particularly in an environment where overall rates of GDP growth are likely to remain sluggish. Investors in the UK will also need to consider the following issues: are earnings expectations reasonable given slower global growth; are the recent measures designed to stimulate the eurozone economy likely to prove successful; and is the slump in oil prices likely to be temporary or ongoing?

Investors will focus increasingly on the UK General Election in May - seldom has the outcome of an impending general election been so uncertain. Given the almost diametrically opposite political philosophies represented by the two major parties, the result will be extremely significant in terms of the economic trajectory of the UK over the next parliament. More pessimistic commentators will also start to focus on what the result might mean for the continuing relationship between the UK and the eurozone. *From Chris Kinder, Portfolio Manager, Threadneedle UK Select*

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The FTSE 100 Index has recently passed the previous all-time high set in 1999 but valuations in aggregate remain reasonable and the UK economy is recovering gradually. In the short term, the general election may lead to a period of uncertainty although the long term effect of a change of government is not expected to be that significant, especially as the portfolio companies have significant overseas earnings. Our fund managers are finding attractive investments across a variety of sectors of the stock market although they also see areas of over-valuation, particularly amongst the more defensive industries. *From Simon Fraser, Chairman, Merchants Trust*

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We continue to favour the outlook for UK smaller companies. After a year of underperformance relative to larger companies the smaller companies sector looks relatively good value particularly when measured on the forecast growth in earnings and not simply the current price earnings ratio. Given that the long term record which shows that smaller companies stocks tend to outperform larger companies we remain positive on return prospects for our Smaller Companies Portfolio. For the Income Portfolio the investment adviser expects defaults in bond markets to remain low. However he remains cautious regarding the outlook for the interest rates. *From Helen Green, Chairman, Acorn Income Fund*

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Our outlook remains cautious. We think that the high yield bond market is relatively highly valued and has limited potential for further capital appreciation. The UK economy continues to benefit from low levels of unemployment, continued record-low interest rates and the anticipated pre-election stimulus. As a result, the conditions for investing in the equity of high quality smaller companies appear relatively benign, even allowing for risks, political and economic, on the world stage. *From Ian Barby, Chairman, Invesco Perpetual UK Smaller Companies*

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Liquidity is a major driver of asset prices and the ECB decision to pour over €1 trillion into the European economy via open market asset purchases will offer significant support to stock markets over the next year. Equities, in particular smaller companies, continue to look better value than bonds, which appear to have slipped into a strange

parallel universe, with some investors now paying for the privilege of lending to the German government. With earnings expectations now at particularly low levels, UK smaller companies could even start to see the benefit of earnings upgrades for the first time in a few years. Notwithstanding all the geopolitical and macro-economic issues which are looming large at the current time, including a potentially inconclusive UK general election, we see good prospects for the companies we invest in. *From Jonathan Brown, Portfolio Manager and Robin West, Deputy Portfolio Manager, Invesco Perpetual UK Smaller Companies*

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North America *(compare North American funds here)*

Canada

We believe that Canadian equities stand to benefit from the accelerating growth of the US economy, which is benefitting from the following trends. First, since many other global economies remain dependent on quantitative easing to stimulate growth and inflation, we expect the relative strength of the US will increase demand for US dollar denominated assets. Second, the current US business cycle is anticipated to continue for the foreseeable future as interest rates, inflation rates, and debt levels remain relatively low when compared to previous business cycles. Finally, favourable demographic trends, namely the maturation of the largest population cohort in the US – the millennials, should support consumer spending, household formation, and cause a measurable increase in GDP growth. As a result, we expect increased US demand for Canadian exports, aided by the continued appreciation of the US dollar vis-à-vis the Canadian dollar. We further believe that the prolonged US business cycle will broadly support corporate profit growth in Canada and improve the relative strength of the Canadian dollar versus the British Pound and other global currencies.

The Canadian real estate sector remains attractively valued versus other developed markets. Cash flow and dividend growth are well supported by limited supply, low interest rates and improving growth in Eastern Canada. The real estate sector delivered a total return of approximately 10% during 2014 and Brookfield Property Partners, the Fund’s largest holding, appreciated by more than 30%.

The equity income sector will benefit from global economic stimulus initiative and the continuing strength of the US economy. This backdrop is expected to drive demand for companies with low debt and strong organic growth to support stable and growing levels of dividends for dividend-paying companies over the long term. From Nicholas Villiers, Chairman, Middlefield Canadian Income.

Supported by a low interest rate environment, accelerating US economic growth, and favourable conditions for Canadian exporters, we expect companies in the financial, industrial, real estate and infrastructure sectors to post strong total risk adjusted returns over the next 12 to 18 months. Furthermore, in light of an ageing population with a growing need for income, we remain positive on the outlook for equity income securities and expect North American equities, particularly cyclical investments, to respond favourably if inflation expectations rise prior to the year end. *From Middlefield Limited, managers of Middlefield Canadian Income*

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US

The US equity market continues to provide a range of opportunities not readily available elsewhere and UK investors have tended to underestimate the strength of the US corporate sector. Valuations are clearly not cheap and the impact of the

ending of quantitative easing and the possible increase in interest rates is very difficult to assess. *From Sarah Bates, Chairman, JPMorgan American*

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We believe that US equity markets can continue to march higher from here despite that fact that they have had a very strong rally over the last several years. While earnings growth in 2015 will most likely be lower than the prior years due to weaker global economic growth, with significantly lower oil prices and a strong US dollar the equity market still has some positives. Record high margins continue to increase due to lower interest costs and muted wages costs and the US economy continues to maintain its low growth trajectory. US companies continue to have healthy balance sheets with ample cash reserves which should continue to support dividend increases and share buybacks. We may also see an increase in mergers and acquisitions activity as management teams continue to look at the best ways to grow their businesses.

From a US economic standpoint the slow and steady pace continues to persist while the global emerging markets are decelerating and the other developed markets are struggling to expand. The US employment picture continues to improve as hiring trends continue to drift higher and consumer confidence levels are at the highest levels since the financial crisis ended.

The Fed will no doubt play a part in this year's financial markets. Current expectations are for the Fed funds rate to be increased from the very low levels at which they stand now. If this does turn out to be true, history says that the market volatility will increase as market participants will worry that the current economic cycle has peaked and the higher interest rates will restrict the economy from growing further. This is the inherent tension between the level of short term interest rates and the level of economic growth. *From Garrett Fish, Investment Manager, JPMorgan American*

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Asia *(compare Asian funds here)*

The overriding concern of financial markets remains the heavy hand of policymakers. Europe has started its quantitative easing, but the US could soon tighten rates. The net impact on the global economy is hard to gauge. Meanwhile, a rising US dollar has clouded the timing of the Fed's impending rate hike. Continued dollar strength will hurt exports and constrain inflation, potentially stalling the US recovery. Not surprisingly, Fed chairman Yellen is now treading a more dovish path.

Nonetheless, US policy normalisation will happen, and along with that, repercussions for the rest of the world. For Asia, this may mean capital outflows and higher borrowing costs for companies owing to tighter liquidity and depreciating currencies vis-a-vis the US dollar. Increased uncertainty will undermine confidence and, in turn, curb consumer spending and investments.

The good thing is that Asian governments and central banks are already preparing for the inevitable, aided by benign inflation. Structural reform towards more domestically-based growth is also gathering pace. Over the long term, this will better insulate the region from external shocks.

Current conditions appear challenging for companies. The winners will be the ones in capable hands with good corporate governance that can continue to grow the

business while keeping a tight rein on costs to protect margins; sub-standard ones will struggle to perform.

On a broader level, Asia remains a convincing long-term story, given its growing middle class with rising incomes that will underpin demand for many years to come. *From Allan McKenzie, Chairman, Edinburgh Dragon Trust*

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The first quarter has been marked by yet more loosening of monetary policies worldwide with over 20 central banks cutting policy rates in response to disinflationary forces which remain very much to the fore. Oil and industrial commodity prices remain soggy, as do soft commodity prices which play a more than proportionate role in emerging markets, both as exporters and given the larger share of budget they comprise for lower income consumers.

However, with sovereign bond yields now below core inflation in the G7 group of developed economies, and an estimated 30% of the euro area bond market now on negative yields, the extraordinary efforts of central banks are continuing to distort financial markets. The ECB decision to embark on quantitative easing is the obvious proximate cause, but aided and abetted by the other leading economies of the UK and Japan. Furthermore, with US growth coming in below expectations and a strengthening dollar effectively tightening policy, the Federal Reserve has sought flexibility in the timing of when active rate rises follow on from last year's ending of the asset purchase program.

Equity investors have drawn some comfort from the loose monetary environment, but this has been tempered by fears that, despite the best efforts of policymakers, the global economy remains in the grip of secular stagnation and deflationary conditions. We would not be as pessimistic, and hold to our view that we will see a period of steady low inflationary expansion. Fears of stagnation arise from mistaking lags for longer-term factors. In particular, the recovery of bank lending in a number of markets, especially in Europe, was bound to take time given the level of damage to both confidence and balance sheets wrought by the global financial crisis. Similarly the adverse effects of lower commodity prices have been quicker to hit resource dependent economies (particularly emerging markets where structural weaknesses were already apparent) than for the benefit to come through for energy/commodity consuming companies and consumers.

For the patient, we believe this is a fairly benign environment for Asian markets, meriting a balanced approach for income oriented portfolios between good quality but modestly cyclical companies in sectors such as consumer discretionary, industrials and IT on the one hand, and more defensive yield in areas such as REITs and telecoms. Weakening European currencies and a newly competitive Japan will present challenges for the region's exporters, so selectivity remains key.

Given the size of its economy, events in China may continue to dominate the headlines in the region. While growth would appear to be slowing markedly, domestic Chinese equity markets have continued to surge amid loosening monetary policies and a speculative flurry of margin finance and a surge in equity trading account openings. Driven more by speculation than fundamentals, this is beginning to impact the Hong Kong market via the Shanghai/HK Connect with investors concentrating on arbitrage opportunities between A and H shares (the latter usually at discounts) irrespective of the quality or valuations of underlying investments. It is impossible to say when this phase will pass. *From Schroder Investment Management Limited, managers of Schroder Oriental Income*

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We remain positive on the outlook for the region in the medium to long term but recognise that market direction will be dictated by macro factors on a shorter time horizon. The recovery profile of the US economy and the success of quantitative easing in Europe will be key to determining returns. Asia is the biggest beneficiary of low material and energy prices and this will have a positive impact on economic growth, inflation and corporate earnings in the year ahead. Valuations in Asia are attractive, especially compared to other world markets, and companies are cash rich with significant potential to increase dividend pay outs over time. *From Michael Kerley, Fund Manager, Henderson Far East Income*

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The fall in oil and commodity prices provides a tail-wind for the region and could, in common with most developed economies, create a positive growth surprise in 2015, although more fundamental reforms are needed in order to take full advantage of this one-off windfall. Our new financial year begins with an improved confidence in economic prospects for the region, owing to the direct benefits from lower energy costs but also the greater freedom to cut interest rates arising from the associated decline in inflation.

Investors still face a number of uncertainties in 2015. There is the prospect of the US Federal Reserve starting to raise interest rates in response to a stronger US economy. In Asia, the reform-minded Chinese government is seeking to restore discipline to the banking system without unduly slowing the economy. Japan is continuing with its "Abenomics" policy of seeking to stimulate its economy by devaluing the yen and implementing structural change and there are high hopes that India's new government will deregulate its economy. There are also hopes that the cyclical influences in the region are turning more positive which may help to offset the likely moderate tightening emanating from the US.

Last year, we commented that investor sentiment may have become unduly negative towards the region, coloured by disappointment in 2013. Now, a degree of confidence appears to have been restored, making selectivity at the stock, sector and country level more important although valuations relative to other major equity markets remain lower than historical averages. Trade statistics indicate that the region has become increasingly economically interdependent in recent decades rather than simply relying upon exports to Europe and North America. For example China is Japan's largest trade partner with some 20% of both Japan's exports and imports arising from trade with China. Japan is China's top source of imports and its third largest export destination. Japan and the rest of the Asian region have delivered similar equity market total returns over the past 5 years, which may be an indication that these economic changes are asserting themselves, now that the valuation and development gap between Japan and the rest of South East Asia has narrowed. To date, this improved showing by Japan has yet to attract as much investor focus as the preceding 20 years of Japanese underperformance. *From Sarah Bates, Chairman, Witan Pacific*

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Equity markets continue to face increasing challenges and are likely to be volatile. Political, social and valuation risks are intensifying as the key economic issues of

excess debt, unorthodox monetary policies and low growth remain unaddressed. In this context and amidst rising labour costs, Asian equities have fared well. Consequently, valuations are high and the prospect for short term returns is diminished. Partially offsetting these concerns is the benefit of a lower oil price to Asian coffers, with the notable exception of Malaysia. However, this impact may be transitory with the lower oil price insufficient to compensate for a deteriorating export environment.

In China, the enduring anti-graft campaign is having a chilling effect on commerce amidst the wider transition from an export-to a domestic-led growth model. The leadership also has to contend with the increasing burden of debt, social disharmony and a slowing economy. Recent monetary stimulus suggests that growth challenges are pressing but policies aimed at reducing corruption and increasing the quality of growth need to be endured for China to prosper in the longer term.

The outlook for India and South East Asia is slightly brighter, given the greater number of quality franchises. However, political discord and social tension are both risks to these regions and are arguably underappreciated by current valuations. Nowhere can current valuations be deemed especially attractive. *From James Ferguson, Chairman, Scottish Oriental Smaller Companies Trust*

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Korea

Korean sovereign debt is roughly 36% of GDP by comparison government debt to GDP in the Euro area and U.K. are both at 91%, and the U.S. is around 102% of GDP. Japan is at 227% of GDP, but a considerable fraction of its debt is held by the Japanese Central Bank. Korea's budget deficit was 1.5% of GDP. It has a large trade surplus, and positive net international assets. Although the NPS [*National Pension Scheme*] has large liabilities, it also has large and growing assets. The NPS is increasing the fraction of its assets invested in domestic equities, which should not only support equity prices but will also help its long run solvency. Corporate debt is high, but corporations also have substantial holdings of cash and securities, as well as overseas assets.

Most commentators seem to view the high levels of household debt as being the greatest threat to the Korean economy. While household debt is 156% of average annual disposable income, household assets are around twice as large as household debt. The Korean government limits the loan-to-value ratio of all transactions at no greater than 70%, and regulates the permissible debt-to-income ratio. The Korea's jeonse system of renting residential property makes it very difficult to compare household debt in Korea with that in other countries in which all renters have to make regular rent payments. Only about half of renters in Korea pay a monthly rent (this ratio is rising). The remainder use the jeonse system in which the renter does not pay rent, but instead gives the landlord an interest free loan that the landlord repays at the termination of the fixed term lease. This loan is a significant fraction of the value of the property, and is collateralized by it. The loan by the renter to the landlord is a form of savings: it is an asset that offsets the liabilities of the household.

One way to think about the effect of the jeonse system is to compare a jeonse tenant with a renter who makes monthly rental payments. Let's suppose that the jeonse tenant obtained the entire jeonse deposit by taking out a bank loan. Like the monthly renter, the jeonse tenant must make regular payments, except as interest to the bank, rather than as rent. The interest and rent payments should tend to be roughly equal. The usual computation of debt to disposable income would suggest that the jeonse renter is heavily indebted relative to renters in other countries. This is misleading. The jeonse renter has the same fixed obligations, they are just called interest payments, while in other countries the fixed obligation is called rent. Furthermore, his outstanding

debt obligation can be completely repaid when his lease expires - standard leases are two years. From the viewpoint of the landlord, matters are trickier. When the lease expires he needs to repay the loan to the jeonse tenant, but this is not much different from a term loan that needs to be renewed. Because interest rates have been low, the jeonse deposits have become a larger proportion of the value of the property, which likely increases household assets and household debt. On the other hand the percentage of rental agreements paid for through jeonse leases has been falling, which has the opposite effect. The data is insufficient to determine the net effect, but it is likely that changes in household indebtedness overstate changes in the net financial position of Korean households.

In the short run, markets are often driven by swings in sentiment; in the long run, market returns tend to reflect fundamental values. When growth is driven by increased competition, markets do not perform well. However, when growth is driven by lower input prices for existing producers, and an increased supply of well trained workers, that would be expected to raise profits and drive share prices higher. As long-term investors we are very pleased with the outstanding performance of Korean students on the international PISA tests of mathematics, reading, science and problem solving ability. They score among the very top performers in every category. The high performance on problem solving ability should translate into a large supply of workers with managerial potential, and consequently higher performance by the Korean firms who can avail themselves of those highly skilled workers. The only country that does better on problem solving is Singapore, and wages there are roughly twice the level of South Korea and its population is a small fraction of that of Korea. When those improved fundamentals are accompanied by improved shareholder rights we would expect them to eventually generate higher equity values. It is impossible to know when markets will recognize these superior fundamentals, but we believe they eventually will be reflected in equity valuations.

Stepping back, 2014 was an important year because a powerful activist entered the market: the Korean government. President Park has vowed to reform the chaebol system. The NPS has been empowered to improve corporate governance and increase dividend payout ratios. Consequently, we continue to be bullish on the long-term prospects for Korean preferred shares. *From Weiss Asset Management LP, managers of Weiss Korea Opportunities*

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Thailand

The legitimacy of the military's rule has rested upon it swiftly restoring order and facilitating the re-drafting of the constitution, before returning control to the people by calling for elections. Hence, it is key that the political process remains on schedule. The first draft of the new constitution is expected to be completed by spring of this year, and may be put to a national referendum. Elections may then take place in the first half of 2016. The amendments to the constitution are designed to prevent the abuse of power by any single party. However, political watchers are critical, and say that its main purpose is to block the Puea Thai party from regaining its dominance.

In the meantime, Yingluck [*Shinawatra*] has been impeached and banned from politics for five years. She now faces the prospect of a lengthy trial for the charge of

criminal negligence over the rice-subsidy scheme. The programme cost taxpayers US$18 billion and the accusation is that it was aimed at buying the rural vote. It is possible that Yingluck may decide to join her brother Thaksin in exile to avoid prison. There remains the risk that supporters of the Shinawatra family and the Puea Thai party may instigate protests and provoke civil unrest. However, with the threat of further military crackdowns, the party may decide to work within the framework of the new constitution and possibly put forward another Shinawatra family member to stand for elections. A new political environment with elected representatives from both the Democrat and Puea Thai parties sharing power in a constructive way would be the optimal outcome for long-term stability.

On the economic front, cheaper energy should continue to provide relief to consumers and businesses, while allowing the government to cut fuel subsidies and boost infrastructure spending. If the junta can successfully execute its multi-billion dollar infrastructure programme, that should also help to lift the economy. *From Nicholas Smith, Chairman, Aberdeen New Thai*

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In comparison to 2014's stellar run, Thai equities could well post more modest returns in the months ahead. The economy should certainly improve. Forecasts are for growth of between 3-4% this year, albeit relative to 2014's low base. However, pressure on exports, commodity prices, manufacturing and domestic consumption may continue to generate considerable headwinds. Meanwhile, uncertainty over the path of the global economy and the prospect of further policy surprises from major central banks could curb risk appetites. Foreign investors have been net sellers of Thai equities for several months. While they are bound to return at some stage, the presence of uncertainty regarding the constitution's key terms and an unelected government remains a key deterrent in the medium term.

It is doubtful the military would test the electorate's patience by clinging to power indefinitely. We expect the new constitution to be drafted and elections held by the first half of 2016. In the meantime, the administration is likely to push ahead with key policies, such as crucial infrastructure investment, in an effort to defend its legitimacy. Separately, the case against Yingluck Shinawatra has the potential to reignite simmering political discontent. However, it is far more likely that she will be allowed to follow in her brother's footsteps into exile, rather than face possible incarceration.

There are still plenty of reasons to be invested in Thailand. The central bank's March interest rate cut suggests a focus on reviving the economy, while the liquidity boost should further inspire domestic investors, particularly given low deposit rates. Elsewhere, tourism, long a pillar of the economy, is slowly but surely staging a comeback, while the plunge in oil prices is a windfall, given Thailand spends close to 10% of its GDP on energy imports. Already, it has enabled diesel and LPG subsidies to be repealed. The still healthy current account surplus should widen further, which is reassuring for the Baht, if normalizing US monetary policy exerts pressure on regional currencies. *From Aberdeen Asset Management Asia Limited, Investment Manager, Aberdeen New Thai*

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Europe *(compare European funds here)*

The Eurozone region has started 2015 with a number of reasons to be positive. In addition to QE, recent Euro weakness, particularly relative to the US dollar, has improved the competitiveness of many European exporting companies. Furthermore, the recent sharp drop in the oil price will reduce input costs for many companies and should also boost consumer spending. Corporate earnings for Eurozone businesses

still remain at very depressed levels compared with their US counterparts and closing the gap could drive the next phase of share price gains.

Given the above, current valuation levels suggest that European equities remain attractive and that opportunities continue to be available in companies with good pricing power and encouraging earnings prospects. However, although prospects are brighter, the likelihood of a rise in US interest rates later in the year and ongoing political uncertainty in Greece and Ukraine, could yet create volatility in European stock markets. *From Carol Ferguson, Chairman, BlackRock Greater European*

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The European economy now appears to be recovering, driven by supportive action in terms of QE, the weaker Euro and lower oil price. QE is injecting €60 billion a month into Europe and this will not only apply downward pressure on government bond yields, but will also have a beneficial impact on borrowing costs for European companies. The cost of debt for companies has fallen markedly over the last six months and we believe that companies will take advantage of the favourable financing conditions to issue more and cheaper debt, both to refinance existing debt and/or to acquire other businesses. Moreover, an economic recovery should drive consumer demand and earnings higher, which also should be supportive for markets. As the recovery continues to gather momentum, and as the ECB rolls out its QE programme, we believe that European equities can rally further. Markets are likely to remain volatile though, given the political uncertainties in Greece and Ukraine, and this should open up opportunities to acquire undervalued stocks. *From Vincent Devlin and Sam Vecht, managers of BlackRock Greater European*

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Japan *(compare Japanese funds here)*

As widely expected the ruling LDP coalition won a convincing victory in the Lower House election and Prime Minister Abe lost no time in announcing new tax reforms, including additional cuts in corporation tax. From April 2015 corporation tax will be cut from 34.6% to 32.1%, followed by a further reduction to 31.3% in April 2016.

A draft of the Japanese Corporate Governance Code, which is due to be implemented in June 2015, was also announced. The code follows a number of other shareholder-friendly measures in 2014, including the Stewardship Code and the Ito Review, and is designed to stimulate corporate entrepreneurship and increase corporate value.

Japanese companies remain financially strong and as at the end of September aggregate cash levels reached Yen233trn. In addition to cash flow being used for increased shareholder returns, total M&A activity also rose in 2014 and in the second half of the year there was a noticeable increase in the number of domestic deals.

So far Abenomics has had a degree of success such as weakening the yen, higher stock prices and better performance by businesses. It is quite possible that Abe will use the public support gained in the election in December 2014 as a driving force for implementing reforms especially for the third arrow of "growth strategies" where so far there has been slower progress. There is a clearly a need for structural reform so that the benefits of Abenomics spread outside from the main urban areas and to small and mid-sized companies. *From John Hawkins, Chairman, Prospect Japan Fund*

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Prime Minister Shinzo Abe's decision to postpone a second increase in the consumption tax is a positive both for economic growth and the market. Employment conditions are becoming increasingly tight, nominal wages are rising steadily and spending by the older members of society, who hold the bulk of the country's financial

assets, is robust. In addition, the Bank of Japan's recent move to expand its quantitative easing programme has reaffirmed its commitment to achieving sustainable inflation. Meanwhile, corporate tax reform and asset reallocation at the Government Pension Investment Fund (Japan) should turn out to be major supports for the market. The apparent lack of momentum behind the structural reforms pledged in the third of the three arrows of Abenomics poses a risk, and sentiment has flagged to some degree over the last year as a result of the slow progress. However, structural reforms are beginning to be implemented at the micro level. For example, Japan's new stewardship and corporate governance codes, in addition to the introduction of the JPX-Nikkei 400 Index, are focusing the minds of Japanese corporates. Many companies are actively taking steps to raise corporate value by boosting shareholder payouts and improving their return on equity, which can only add to the attraction of the Japanese market.

Although the Japanese economy entered a technical recession following the consumption tax increase, corporate earnings have continued to grow. The earnings revision index in Japan has been in positive territory since late-May of last year, whereas the relevant indices for most other regions remain negative. Company guidance continues to look on the conservative side and the yen has weakened significantly more than many companies assumed in their projections. Combined with the recent oil price decline, moderately stronger external demand and the prospect of corporate tax cuts from April 2015, we are likely to see upward earnings revisions in coming months.

From a valuation perspective, Japanese stocks are still historically cheap. The market trades on a prospective price-to-earnings discount to other developed markets and even has a higher prospective dividend yield than the US market. It is indeed rare for Japan to offer such a discount and this appears to present a good opportunity for investors to capture positive returns in the Japanese market.

Considering the coordinated pro-growth policies and the fundamental changes in corporate behaviour that are occurring, and the fact that Japan is among the few major markets to offer a valuation discount, the mid-term outlook for Japanese equities is attractive. *From David Robins, Chairman, Fidelity Japanese Values*

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Since the end of October, authorities in Japan have delivered three policy initiatives: a boost to QE by the BoJ; asset reallocation by the Government Pension Investment Fund ("GPIF"); and the deferral of the second sales tax hike. These recent developments notwithstanding, slow progress in areas such as labour market reforms and Trans-Pacific Partnership negotiations have fuelled scepticism about Prime Minister Abe's third arrow. However, we are seeing positive developments on the ground in terms of micro-level reforms. The new JPX Nikkei 400 Index has spurred companies to boost shareholder returns and to improve capital efficiency. By investing in assets that track the index, the BoJ and the GPIF are also supporting steps to improve returns on equity. The Stewardship Code is forcing institutional shareholders in Japan to actively engage with investee companies and hold boards

accountable, and all listed companies will have to comply with a new corporate governance code, which is due to be introduced this year.

Despite lingering concerns about macroeconomic headlines, Japanese companies' earnings results highlighted solid fundamentals in the corporate sector. TSE1-listed companies (excluding financials) posted a 5% increase in sales and 11% growth in recurring profits for the six months to October 2014. In addition to the benefits of a weaker yen, restructuring and cost saving measures contributed to the improvement in earnings. Moreover, lower oil prices and a weak yen create further upside in corporate earnings, while consensus earnings estimates remain somewhat conservative.

More than ever, there is a broad-based commitment to reforms and, with returns going up, we can also expect valuations to rise. It is also important to note that Japanese corporate fundamentals are relatively insulated from the recent turmoil in the eurozone. Your Portfolio Manager believes that Japan could offer attractive investment opportunities in companies with long term growth potential. In addition, he also believes that there are abundant stock-picking opportunities given the diverse earnings growth drivers, ranging from a cyclical upturn in demand to a shift from stakeholder-oriented to shareholder-centric management. *From Shinji Higaki, Portfolio Manager, Fidelity Japanese Values*

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Healthcare / Biotech *(compare Healthcare / Biotech funds here)*

The biotechnology sector has had a strong run in recent years. This has generated both interest and concern from the investment community. Some believe that stocks are overvalued, future earnings are unpredictable and pricing power may evaporate. Taking each point in turn: the sector price / earnings ratios (P/E) for profitable companies are not stretched, with forward P/E at 20x to buy a compound annual growth rate of 17% for years 2015 to 2018. We think this is not expensive and certainly not in bubble territory.

Secondly, sales and earnings are both predictable and visible. Often new drugs are launching into markets with known pricing and an established patient population, but with better efficacy and safety levels. Once launched, sales should continue until its patent expires. We assess competitive products that are being developed and may impact the sales of current products and adjust the portfolio accordingly.

Finally the pricing debate. It is fair that investors are concerned about this topic. This year we have seen an increase in focus on the importance of reimbursement, specifically where similar products compete in a specific disease area. Gilead and AbbVie have been battling it out with insurance companies in the US over the inclusion or exclusion of their hepatitis C (HCV) drugs on the insurance company's formulary lists. However, despite such attempts at bringing costs down, Gilead's HCV franchise has sales projections of $15.3bn this calendar year, and actual results of $10.3bn for 2014. Sales of Gilead's Harvoni and Sovaldi have created substantial cash which could be used to acquire small innovative companies that may contribute towards future growth of the business. It is interesting to note that although new drugs are introduced at great cost, many drugs go off patent each year, resulting in savings of an equivalent amount to the new spend. In addition, this does not take into account the long term savings from curing diseases that without treatment or a cure create long term treatment costs for the healthcare services.

We remain excited and positive about the sector going forward. Each year brings a scientific breakthrough, either through individual drug success stories such as Biogen's recent Alzheimer's data or through the advances of new technology platforms such as gene therapy, cell therapies and gene editing. We are optimistic

that the sector's performance will continue, not just for the next year but for the longer-term. *From SV Life Sciences Managers LLP, Investment Manager, International Biotechnology Trust*

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Resources *(compare Natural Resource and Commodity funds here)*

The sector has now entered into its fourth year of a bear market which is undoubtedly one of the severest over the past four decades. The worst affected have been the pre-production development companies, which are in the process of developing new projects, necessary to replace declining reserves that are steadily being mined out by the majors. In many cases quality projects are being developed, but the smaller companies are struggling to raise equity capital, putting undue pressure on their share prices. Market capitalisations are unduly depressed in relation to the value of resources in the ground for better quality companies.

Although the gold market has faced the headwind of a strong Dollar the price has proved resilient, with strong support evident below $1200. This masks the performance in most other currencies in which gold has provided protection. The severing of the Swiss Franc/Euro link caused a sharp drop in the Euro, but proved beneficial to the gold price in Euros. Russians fortunate enough to have some gold exposure were fully protected against the slump in the Rouble, again underlining one of gold's main functions as a currency hedge. The weakness in commodity related currencies such as the Australian and Canadian Dollars has provided some protection to the mining companies.

Most corporate merger and acquisition activity in the junior sector has taken place in the gold industry, where rationalisation and consolidation have gathered momentum. Over the past six months over seventeen acquisitions or mergers have taken place, all at reasonable premiums to the prevailing share prices. Larger producers are finding it more effective to acquire ounces in the ground through the market, rather than through lengthy and costly exploration programmes.

The overall outlook for the world economy remains muted, but some stability appears to have returned to the resource sector, as commodity prices are finding support at levels which are close to the marginal cost of production. Apart from the few companies with robust project economics it remains difficult for most companies to raise equity capital, and many are struggling to survive. *From David Hutchins and Kjeld Thygesen, RDP Fund Management LLP, managers of Global Resources Investment Trust*

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Debt *(compare Debt funds here)*

Technological advances have created efficiencies in all aspects of our day-to-day interactions and continue to challenge more traditional businesses. The world of high street banking is facing increased competition and may lose its market share to more convenient and innovative online lenders. With the financial crisis behind us, banks have managed to stabilize their overall profitability while facing increased regulatory costs and reducing the availability of credit to the market. The industry of online lending has challenged this traditional borrowing and has created a new generation of financial services that market participants expect to become a trillion dollar market in the not too distant future.

As online platforms become more accepted and continue to take over the traditional bank lending market, more investments will flow into platforms which in turn will further improve their financial technology and lower their origination costs. Two

distinct lending models have emerged, the "Balance Sheet Model" (Platforms which generally fund their originations via debt and/or equity on their balance sheet and assume the credit risk of the originations thereby earning net interest and fee income) and the "Marketplace Model" (Platforms which generally act as a marketplace between borrowers and lenders and earn origination/servicing fees and do not assume credit risk), in both instances unlike traditional 'brick and mortar' lenders, online lenders have low overhead costs, attractive margins and scalability.

In the last year alone, the industry experienced a successful platform IPO, saw the first rated securitisation transaction, and witnessed numerous banks collaborating with platforms directly. The online lending industry has already gone through a period of discovery and early adoption, proving itself as a sustainable non-bank alternative model that offers transparency, convenience and innovation.

Despite the rapid growth of online lending in 2014, the Board believes that we are still very much in the early stages of the industry's development. The proportion of the global market share for consumer, SME and trade finance loans to which online originators cater could potentially rival traditional lenders and is likely to be very large from where we stand today. The Board is confident that 2015 is destined to be another year of industry growth and opportunity. *From Stuart Cruickshank, Chairman, P2P Global*

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Currently the absolute supply of financing to all elements of the capital structure is high, with a large amount of capital available to chase market opportunities.

In the senior debt market, we have seen increased competition over 2014 and market pricing tighten for UK real estate senior debt. According to De Montfort University research, pricing had tightened by 25-30bps between December 2013 and June 2014 and, based on what we have seen in the market, this trend continued into the second half of the year, resulting in a contraction of margins of circa 50-75bp during the year. This has resulted in typical margins in the range 200-250bps being offered in the first quarter of 2015. However, at the prime end of the market, especially for large assets, we are seeing intense competition amongst UK and international lenders, resulting in margins as low as 140bps but typically in the range 150-175bps. With five year GBP interest swap rates of circa 1.25%, total interest costs are in the range 2.75% to 4.0% - historically cheap, even at the less prime end of the spectrum.

The mezzanine and whole loan markets are also seeing polarisation. Typical "market-bid" mezzanine debt can be found in the range 7-9% total IRR, especially for larger assets with whole loan financing, such as in support of loan buy-backs, priced in low double digit IRR returns (10-12%) with, typically, a 9% pa coupon.

2014 also showed a significant increase in the sale of commercial real estate loan books, with circa €30bn of UK real estate loans sold, according to research by Cushman & Wakefield - over double that recorded in the previous year. As these loan portfolios are realised by the purchasers over the coming years, this will contribute both to the volume of property sale transactions and lending volumes. *From ICG Longbow*

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We continue to believe that the fundamentals for investing in the loan asset class remain favourable.

Most companies in our investable universe continue to exhibit strong earnings, free cash flow, and solid liquidity and leverage profiles. Furthermore, with minimal maturities over the next three years, we see very few catalysts for a sharp increase in the default rate during 2015. We expect the US default rate by issuer to remain below 2% and Europe in the 3%-5% range.

Performance will continue to be coupon driven with downside risk again coming from any exogenous shocks which could return us to a "risk off" environment and create further outflows from the asset class. These flows could be reversed as we move closer to interest rate rises, particularly in the US. *From Neuberger Berman Europe Limited, managers of NB Global Floating Rate*

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We expect a supportive default environment in the US loan market and technical factors to continue to hold loan price volatility high.

The relative value of US senior secured loans is attractive given the strong economic environment in the US and recent technical pressure on loan prices due to retail fund outflows. We expect defaults in the US loan market to continue to be significantly lower [*than in Europe*] given GDP growth, higher consumer confidence and spending, healthy interest coverage and potential for rate hikes to be delayed or lower than expected as USD strength and low oil prices impact inflation.

There is a reduced universe of control CLO investors as business development companies exit the market and captive funds concentrate on CLOs managed by their affiliates.

Implementation of risk retention regulations in the US in 2016 is bringing issuance forward, increasing issuance volume and thus strengthening the negotiating position of CLO investors. *From Fair Oaks Capital, managers of Fair Oaks Income Fund*

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We think that, although the demand for income will remain an important factor in total returns across bond markets, duration is once again likely to be the dominant factor. In this context the economic backdrop remains relatively supportive: inflation is low while economic growth is generally weak and this should allow central banks to remain accommodative for some time to come. However, with a large part of the investment universe already reflecting this benign outlook the opportunity for disappointment is, in our view, not insignificant. *From Paul Read and Paul Causer, portfolio Managers and Rhys Davies, Deputy Portfolio Manager, City Merchants High Yield*

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Normalising output growth and the emergence of long-awaited wage growth in the UK indicates that UK yields could rise and the Bank of England may eventually raise rates faster than suggested by previous forward guidance and current market expectations. It is expected that geopolitical tensions and political uncertainty surrounding elections both in the UK and Eurozone will make for periods of heightened volatility. Full-blown quantitative easing from the European Central Bank (ECB) in order to stave off an extended period of deflation in the Eurozone now seems almost inevitable.

Default rates look set to remain below historical average levels as issuers continue to take advantage of cheap financing, with default risks likely to remain company specific. It is anticipated that M&A activity will increase in the coming year as

corporations take defensive action to mitigate competition and maintain revenue growth. New issuance will likely continue to be well absorbed and used to finance such activity, rather than to fund organic growth in the current economic environment. The trend of issuers re-leveraging balance sheets to facilitate shareholders returns remains a concern for creditors. *From Paul Smith, Premier Fund Managers Limited, manager of Acorn Income Fund*

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Property

Global

There are two likely economic scenarios we anticipate as we head into 2015. Following the Federal Reserve's guidance on interest rates, the announcement by the European Central Bank and the elections in Greece, the most likely scenario, in the short term, is that the global economy weakens. This will put pressure on central banks to keep interest rates low and to continue their policies of quantitative easing. Due to its resilient income stream, this is likely to lead to a continued demand for property from investors searching for yield.

On the flipside, a strong economic growth scenario will most likely lead to interest rate rises. As long as these rises are the result of sustainable economic growth, then the property sector should see increased occupier demand as companies look to expand. This in turn will lead to rental growth and should offset any increased borrowing costs property firms may be exposed to. Companies with property in secondary locations may struggle, as occupier demand is likely to be stronger in major cities and prime locations which are normally held by the larger quality names in the sector.

Whatever macroeconomic back drop materialises, investors will need to be selective as to the companies in which they invest. Market dynamics will impact different sectors to varying degrees and only those companies with strong and experienced management teams will have the ability to weather the negative macro headwinds. For example, the lack of supply in the Singapore office sector has resulted in fundamentals favouring landlords, as demand increases but residential prices are expected to decline over the next 12 months. We believe that our focus on bottom up fundamentals enables us to identify those companies which can create value irrespective of the drivers of the markets in which they operate.

The US listed property sector delivered strong returns in 2014, but the key question now is whether this momentum can continue. Undoubtedly a large number of US property companies are trading at fair value, but we still believe that there is upside potential on a selective basis. Real estate fundamentals remain solid and the initial outlook for 2015 appears to be positive across most major property types. San Francisco, Seattle and New York City continue to experience growth on the back of demand from the technology, media and telecommunications (TMT) sector, which is showing no signs of slowing down.

We expect the eurozone economy to continue to grow in 2015, although growth will be modest and uneven. France and Italy need to implement further supply-side reforms to improve their competitiveness, tempering growth prospects and political uncertainty in Greece have depressed business confidence. However, there are also several positives. Consumers are benefiting from the fall in energy and food prices, exporters should start to gain from the euro's depreciation, the eurozone's big banks have been re-capitalised and Portugal and Spain are now seeing growth in employment. Defensive companies in Europe, looking to provide a sustainable and growing yield, should continue to do well. The main upside risk in the short term is that the inflow of capital from Asia and the USA could trigger a widespread fall in property yields, which would push annualised total returns higher for a limited period.

The main downside risk is that the sovereign debt crisis could re-ignite, either because the Greek government decides to re-negotiate its debts, or because deflation in the eurozone becomes entrenched.

Although the global economic outlook is not substantially improved from 12 months ago there are markets - such as the UK - which have shown marked improvement. The low yield, low growth environment should support the real estate sector as investors continue to chase yield. This, twinned with increasing allocations to real estate globally, should prove beneficial to companies which own assets in prime locations.

Occupier demand is growing and this is driving rental growth in major global gateway cities such as London. As capital values reach levels that they experienced prior to the global financial crisis, it will be the occupier market - leading to rental growth - which should be the major driver of performance. *From Schroder Real Estate Investment Management Limited, managers of Schroder Global Real Estate*

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UK

Over the year to December 2014, transaction volumes in the commercial property market increased by 18% over the previous year to circa £60bn - the second highest volume recorded after 2006.

Driven in part by the weight of money seeking to invest in UK property, the recovery in capital values accelerated in 2014, with the IPD UK quarterly capital values index increasing by 12% over the year, producing total property returns for the year of circa 18%. Industrial and office sectors outperformed retail on the back of stronger capital and rental value growth. Notwithstanding the strong growth in 2014, we believe that capital values remain supported on the whole by economic fundamentals, with the recent strength of the UK economy and employment figures filtering through to rental growth, which began in London offices in Q1 2013 and has since spread across all regions, whilst property yields continue to show a historic spread over UK gilts.

Future expectations are that the rate of capital growth will fall significantly over coming years, as property returns become driven largely by income and rental growth, with Capital Economics projecting total returns averaging 9.3% pa for the years 2015-2019. *From ICG Longbow*

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The economic fundamentals supporting the UK economy remain robust. Along with economic stability, business sentiment and consumer confidence remain at high levels and this can only be helped by the fall in oil prices and the resultant impact on inflation.

In terms of the UK commercial property market, it is expected that careful choices of location and a continued focus on property fundamentals will be the defining characteristics contributing to returns over the next year. Prime assets and good quality secondary assets in stronger locations are likely to provide the best opportunities in the robust economic environment anticipated in 2015. With capital growth not forecast to be as strong in the next three years as in 2014, income will also play an increasingly important role in generating positive returns. *From Christopher M.W. Hill, Chairman, UK Commercial Property Trust*

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Although there are some political and economic concerns that will feature in 2015, the recovery continues to materialise strongly in the UK commercial real estate sector with prices maintaining reasonable acceleration and rents gathering further

momentum. In the favourable environment of improving confidence and reducing void rates, investors are allocating more capital to the sector and consequently, given the increased weight of capital, risk appetite is increasing.

In terms of outlook, we can expect positive total returns in the region of 7% per annum for investors on a three year hold period due to the strong income component and further modest capital appreciation. The sector remains attractive from a fundamental point of view with strengthening economic drivers and a limited pipeline of developments. Eurozone deflation and the forthcoming UK general election are immediate risks, although there is a reasonable buffer in pricing to compensate, particularly as the prospects for any rise in interest rates seems to have abated for the moment.

As we move through the cycle, rental growth momentum is increasing as capital growth momentum decelerates and it is the improvement in levels of rental growth which will provide upside for many investors. Having witnessed muted rental growth for a prolonged period, the UK's regional office markets should benefit from the broadening economic recovery and resultant improvements in occupier demand. The continuing reduction in the availability of Grade A stock combined with a limited number of speculative development completions will also contribute to rental growth.

The retail sector continues to face a series of headwinds that may hold back recovery in weaker locations due to oversupply and structural issues, but the prospects for retail within London and other stronger retail locations are expected to improve further as the economic recovery gains more traction and shoppers take some confidence from continuing low interest rates and falling oil prices.

Many commentators expect the distribution sector to continue its good performance with strong occupational demand underpinned by the structural shift to internet retailing and limited availability of the right buildings in core locations applying upward pressure to rents.

Opportunities are arising in the transactions market for good quality secondary buildings where these assets can be repositioned as prime. There is also likely to be a further rebound for secondary asset prices due to the elevated margin in pricing between prime and secondary reducing as risk appetite increases. In the long term, however, poorer quality secondary assets remain unattractive at a broad level, although there will be opportunities for experienced property investors to reposition assets or generate reasonably good returns on a comparable basis from some of these poorer quality secondary assets.

We expect location choices and a continued focus on property fundamentals to be the defining characteristics contributing to returns over 2015. Good quality stock will continue to attract strong competition which will drive further yield compression Prime/good quality secondary assets as well as selective poorer quality secondary assets in stronger locations are likely to provide the best opportunities in the robust economic environment we anticipate over 2015. *From Robert Boag, Fund Manager, Standard Life Investments Limited, manager of UK Commercial Property*

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Although there are short term uncertainties, including the General Election in May and the possibility of a referendum on the UK's membership of the EU, the Board believes that the outlook for UK commercial property remains positive. The sector should benefit from the strengthening economy and, with interest rates remaining low, investor demand in the asset class is expected to continue, particularly from overseas investors. The Managers expect London and the South East to continue to out-perform the wider market, but to see good performance from some of the stronger regional markets. The quality and security of the income stream will be key to

delivering good performance. *From Chris Russell, Chairman, F&C Commercial Property Trust*

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The property market is delivering a strong performance, driven by strong investor demand and intense competition for stock which is bidding up prices, particularly but not exclusively in London. Although there are macro-level uncertainties that could affect property market performance, including the UK general election, a possible EU referendum and global political, economic and financial developments, the short-term outlook appears positive. The asset class remains in favour with a wide range of investors and market sentiment has shifted in favour of interest rates staying lower for longer, potentially allowing property yields to compress further. At some point interest rates will start to normalise and, while this could affect investment performance through yield adjustment in later years, a growing economy, capacity constraints and improved rental growth may help to mitigate the impact. We forecast that total returns will remain positive both in real and nominal terms over the medium-term to 2019. We continue to expect London and the South East to out-perform and for good quality offices and industrials to out-perform retail property outside London. There is likely to be a disparity in performance at the asset level and we continue to stress the importance of focusing on local market conditions, the qualities of the asset and the potential to protect and enhance the income stream over time. *From Richard Kirby, Investment Manager, F&C Commercial Property Trust Limited*

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A recovery is continuing to come through strongly in the All Property commercial real estate sector with prices maintaining reasonable growth and rents gathering further momentum. In the favourable environment of improving confidence, reducing void rates and falling bond yields, investors are allocating more capital to the sector and consequently, given the increased weight of capital, risk appetite is increasing. Our view remains that poorer quality secondary and tertiary centres remain unattractive in general although there will be opportunities for repositioning assets or generating reasonably good returns on a comparable basis from some poorer quality secondary assets. This is likely to involve a reasonable amount of hard work and effort from investors on the asset management side and the risk of an extended void period continues to be elevated for these types of assets.

In terms of outlook, we expect positive total returns of around 7% per annum on average for UK real estate on a three year holding period due to the strong income component and modest further capital appreciation. The sector remains attractive from a fundamental point of view with strengthening economic drivers and a limited pipeline of future new developments. Rising interest rates are an emerging risk although there is a reasonable buffer in pricing to compensate if the market prices in a further acceleration of rate rises. The retail sector continues to face a series of headwinds that may hold back recovery in weaker locations due to oversupply and structural issues but the prospects for retail towards the South East and Central London are expected to improve further as economic recovery gains more traction. Opportunities are arising to purchase reasonable quality secondary buildings where

these assets can be repositioned as prime. There is also likely to be a further rebound for secondary asset prices due to the elevated margin in pricing between prime and secondary which could reduce as risk appetite improves. We expect locational choices to be the defining characteristics contributing to returns over 2015. Prime, good quality and selective poorer quality secondary assets in stronger locations are likely to provide the best opportunities in the robust economic environment we anticipate over 2015. *From Standard Life UK Property Income.*

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Germany

2014 proved a bumper year for residential investments in Germany, with transaction volumes reaching €12.9 billion according to JLL. Portfolio transactions represented over 60% of this volume. Berlin remained the most popular investment destination with transaction volumes of close to €2 billion. The city has accounted for over 30% of German transaction volumes in 2012 and 2013 reflecting the relative liquidity of the market compared to the other large German cities. The 2014 total did, however, represent a reduction in both value and volume of transactions when compared to 2013 although we do not believe this represents a cooling in the market. Rather, we believe it is indicative of an increasingly tight market and bodes well for further price increases. Of note is the increasing predominance of German buyers. A conspicuous presence in the market in 2014 has been the Berlin city government, which has purchased back a number of portfolios it sold when it was trying to reduce (its now falling) debt burden.

While office and commercial construction is widespread in Berlin, new supply of residential property is nowhere close to addressing the current or predicted demand from investment buyers/owner occupiers or tenants. According to the Berlin-Brandenburg State Statistical Institute (BBSI), housing completions reached a mere 4,647 in 2013 and are estimated to have grown to just 8,000 in 2014. This is at a time when the population of Berlin is expanding, due to a positive birth rate, accelerating immigration and growth in household formation as household sizes shrink. JLL estimate that a minimum of 20,000 new completions are required annually just to meet current demand. This supply is unlikely to be met any time soon given the glacial pace of planning decisions currently being experienced in Berlin.

Meanwhile, as we stated earlier, Berlin's economy continues to perform well, boosted by non-residential construction and improving trends in both the public and private sectors. Unemployment declined again to 10.5% in 2014 (a decrease of 0.7% year-on-year) according to BBSI. Although higher than the German average, the unemployment rate is declining faster than in the rest of the country, incomes are growing more strongly and hence individual purchasing power is closing the gap with the rest of the country. Purchasing power now stands at 93.8% of the German average, according to the BBSI. Berlin's real GDP grew by 1.2% in the first half of 2014 (BBSI) and is expected to have accelerated in the second half. This growth is being supported by Berlin's position as the start-up capital of Germany, particularly in the technology sector, which has been one of the principal drivers of rapid job creation in the city. Tourist arrivals continue to set records, approaching 12 million arrivals in 2014. Berlin has overtaken Rome in terms of the number of tourists and is now the third most visited city in Europe, rapidly closing in on Paris, the second.

These demographic and economic trends, combined with a shortage of supply in the residential market, are having an inevitable impact on rents in Berlin. According to data from CBRE, residential rents in Berlin grew by 6.6% year-on-year in 2014 following growth of 6.9% in 2013. Although Berlin has experienced rapid rental growth over the past few years, it has come from a very low base and rents in the city remain attractive when compared to other large German and European cities. Rents in the

central districts of Berlin are closer to those prevailing in Warsaw than the likes of Munich, Paris or London.

The ECB's recent Quantitative Easing (QE) programme is likely to add fuel to the fire of a robust German economy, as well as helping to boost the prices of property and other real assets. Although many countries in Europe are desperate for any counter-cyclical economic fillip QE can bring, the programme seems somewhat pro-cyclical in the German context, where wages are rising and unemployment has fallen to a post-reunification low. The export sector, in particular, should benefit from a weaker Euro and the attraction of positive yields in the residential sector, especially to institutional investors, should be greater as positive yields in the government market evaporate. According to a recent FT article, there were no government bonds offering a negative yield at the start of 2014 whilst $1.2 trillion worth existed at the end of the year.

In our interim update, we alluded to the risks to German economic activity. More recently, those risks have receded somewhat and economic activity has recovered. The ECB's actions have lowered prevailing interest rates but have weakened the Euro. The risk of a Greek exit from the Eurozone could possibly have some detrimental impact on the Berlin residential market. In addition, the prospect of the US Federal Reserve entering a tightening cycle and thereby denting the appetite for residential property globally remains a risk.

Another risk arises from the security situation in the Ukraine. The precise motives of Russia are somewhat unreadable and the outcome uncertain. Poland and the Baltic states are experiencing a frisson of anxiety about Russia's broader intentions. Germany's vulnerability arises from its dependence on Russia for oil and gas and from the fact that sanctions and a low oil price are curbing Russian demand for German exports. On the other hand, capital flight from Russia is partly manifesting itself in demand for German property.

In light of the trajectory of rents, in particular in the Berlin market in recent years, the Company is alert to the potential for greater political intervention in the market. Two pieces of legislation are proposed.

First, the so called 'Mietpreisbremse' or rent-brake which proposes a cap of 10% rent increases over prevailing rents for vacant apartments. The final definition of prevailing rents is awaited. Exemptions from this cap, where rent increases arise from refurbishment, are also yet to be properly defined.

Second, the city government is implementing restrictions on the splitting of freeholds in 'preservation' areas of Berlin. It is not beyond the realms of possibility that new rules are made retroactive. Moreover the possibility of further re-zoning to create more of these areas cannot be ruled out. Surging rents in a city still dominated by renters was always going to elicit a political response. *From Taliesin Property.*

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