July 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 Bankers, F&C Global Smaller Companies, Seneca Income & Growth, Personal Assets, Establishment)

UK (thoughts from Smaller Companies Dividend, Montanaro UK Smaller, BlackRock Income & Growth, Henderson Opportunities, Invesco Income Growth, Aurora, Value & Income, Perpetual Income & Growth, Shires Income)

Europe (thoughts from JPMorgan European, Montanaro European)

Asia (thoughts from Invesco Asia, Aberdeen New Dawn)

Japan (thoughts from JPMorgan Japan Smaller)

North America (thoughts from BlackRock North American Income)

Emerging Markets (thoughts from Advance Developing Markets, Utilico Emerging Markets, Templeton Emerging Markets)

China (thoughts from Fidelity China Special Situations)

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Healthcare (thoughts from Worldwide Healthcare)

Renewable Energy (thoughts from NextEnergy Solar Fund)

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Property (thoughts from Custodian REIT, Value & Income, LondonMetric Property, Ediston Property, Globalworth)

Global *(compare Global funds here)*

The macro backdrop for equities has become more positive in the past few months as liquidity has been the dominant driver of equity markets. The concerns that I highlighted in my year end report mostly remain with us today and could resurface to become more influential in determining market sentiment. However this "wall of worry" is starting to diminish in its influence on investor thinking and with corporate confidence remaining at high levels, helped in part by continued strength in corporate balance sheets, one would hope for some further positive returns from global equities for the balance of the year. From Richard Killingbeck, Chairman, Bankers

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The last year has seen heightened volatility from time to time on the back of geo-political issues, notably in the Middle East and Ukraine, while Greece's change of government also created uncertainty. Perhaps the most significant developments of the last year in relation to financial markets were the collapse of oil prices in the late Autumn and the move to use full blown quantitative easing ("QE") in the Eurozone.

The sharp fall in crude oil prices served to push further out into the future the time at which the monetary authorities in the US and elsewhere (including the UK) would need to start to move interest rates higher. The diminishing threat of higher rates provided a lift to equities globally in the second half of the financial year, and the change of policy in Europe also encouraged investors to look again at European equities on the basis that QE would lift the Eurozone economy out of the doldrums, as has been the case elsewhere where it has been deployed.

Aside from the positive influences on equity performance set out above, it is probably fair to say that economic growth data has been, in the main, lacklustre, certainly relative to expectations from six months ago. The two largest economies, the US and China, have slowed, though expectations are for the US to pick up again through the rest of 2015 as the benefits of lower oil prices on consumer behaviour come through. Japan's economy too, has been under pressure, failing to recover momentum post the increase in sales tax in Spring 2014. This was despite the combination of the Bank of Japan stepping up its on-going QE policy, and further efforts by the government to improve corporate governance and overall competitiveness. More positively, the domestic UK economy has surpassed hopes from a year ago, with unemployment falling significantly, although the country's public finances remain deeply in the red.

Despite a relatively unexciting global macro-economic backdrop, many companies have been working hard to enhance their profit margins, and equity markets have benefited from investors' willingness to pay higher multiples of earnings to acquire shares. It is clear that QE and ultra-low interest rates have lifted financial markets in the last few years and the risk is that this could be the year when the rates cycle turns in the US and potentially elsewhere including the UK. This could cause renewed volatility for both bonds and shares. However, most commentators expect only a slow and modest move up in rates given the ongoing low inflation on a global basis, so there may be less impact on equities than some fear. From Anthony Townsend, Chairman, F&C Global Smaller Companies

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Domestically, the decisive general election result has removed much of the political and economic uncertainty that a coalition government threatened to engender, although the future of the Union and the UK's position in Europe remain concerns. Low oil prices have provided a global stimulus, and Europe itself continues to rebound from its economic nadir of 2014, the threat of a Greek exit from the Euro notwithstanding, while expectations are that the US economy will continue to grow, though figures for the most recent quarter showed a weather-affected fall of 0.7%. Emerging Markets remain a mixed bag, with opinion divided as to the robustness of the Chinese growth story.

Bond yields, having been a one-way bet to zero, especially in Europe, fell too far too fast in the first quarter of 2015 and duly corrected; the speed of the correction is symptomatic of a febrile market. We continue to believe that longer term bonds, as currently rated, look unattractive in the face of potential rate increases and rising inflation. On balance, equities with a defensive bias and 'alternatives' capable of generating real income and capital growth remain our assets of choice. From Richard Ramsay, Chairman, Seneca Income & Growth

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It is clear that unconventional monetary policy has driven asset prices in many areas to more elevated levels, but this outcome should be considered against a backdrop of limited alternatives and positive macro-economic developments, including benign inflationary pressures.

The "elephant in the room" presently is the future direction of US monetary policy. An eventual tightening could trigger some market volatility, as assets prices re-adjust to the new reality. However, the US Federal Reserve will attempt to flag in advance any change in monetary stance.

Following a 30 year plus bond bull market, fixed income assets remain the most vulnerable, especially because of current low levels of liquidity. Geo-political risks will likely remain at the fore, including Greece's future membership of the Eurozone/EU and tension in the Middle East/Ukraine.

The next couple of years will see markets and investors sail into unchartered territory, where market volatility and asset price recalibration could arise, as an outcome of rising sovereign bond yields. From Seneca Investment Managers Limited, managers of Seneca Income & Growth

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After six years of the devil's brew of zero interest rates and quantitative easing there is evidence that bubbles are forming.

William McChesney Martin, Chairman of the Federal Reserve 1951-70, famously said that his job was 'to take away the punchbowl just as the party gets going'. In contrast to this, his successor between 1987 and 2006, Alan Greenspan, has asserted that central banks should concern themselves only with clearing up after crashes rather than trying to identify bubbles in advance. It is therefore ironic that his central bank successors have themselves arguably created the third bubble in 15 years following the dot com boom in 2000 and the housing boom in 2007. Like Greenspan, they are in no mood to identify it - but even if they were they would be as helpless as the Sorcerer's Apprentice to mop up the flood, since the enchanted broom labelled 'interest rates' has lost all its bristles.

Today's bubbles are occurring both in risky assets, like Chinese equities, and in perceived 'safe' assets, like German government bonds. Shanghai-listed stocks are up over 100% during the past year, boosted by retail investors as margin financing has almost quadrupled from the equivalent of $64bn to $280bn in less than twelve

months. Beijing Baofing Technology, for instance, an online audio and video entertainment business, has risen 4,000% since it came to the market only two months ago. We have not seen such flights of fancy since 1999. But flights to safety look just as fanciful. Since 2010 conventional wisdom has held that we are on a path towards normalised interest rates, yet in Europe over the past year some official interest rates have even fallen below zero. In Switzerland and Denmark people are paid to take out mortgages and banks charge you to hold your cash. Savers looking to escape this Alice in Wonderland world may start hiding their notes under the mattress.

The immediate outlook for risk-averse investors is very challenging. Prices today are predicated on interest rates staying permanently low (which cannot happen) while correlations between asset classes have moved closer to one, so diversification gives less protection. In the Bible (Ecclesiastes 11:2) Ecclesiastes, the Preacher, warns us, 'Divide your investments among many places, for you do not know what risks might lie ahead.' Excellent advice as far as it goes, but the Preacher probably never encountered investments as closely correlated as they are today

If interest rates stay close to zero, as seems likely in the near term, low absolute returns are also likely. Conversely, if interest rates start to rise then markets will be extremely vulnerable to a rising cost of capital. From Robin Angus, Executive Director, Personal Assets and Sebastian Lyon, Investment Adviser

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Powerful deflationary pressures continue to sweep around the global economy. Likewise while Japan's aggressive QE programme has pushed the Yen lower and boosted the equity market there are few signs of recovery in this demographically challenged economy. While the Federal Reserve has signalled its desire to "normalise" monetary policy, data releases in the United States over the past few months suggest that the economic recovery is flagging. This is unsurprising given the recent strength in the US Dollar and weakness in the shale oil industry following the collapse of crude oil prices.

The regional economies in Asia continue to grow but at a slower pace. With global trade subdued the Asian economies that have been historically highly dependent upon trade, such as Korea, are barely growing while more domestically driven economies, such as the Philippines, continue to generate steady growth.

Significantly China's growth continues to slow rapidly. While first quarter 2015 real GDP growth was reported at 7.0% year on year, nominal GDP rose only 5.8% year on year. Factory gate prices continue to fall precipitously (the producer price index is declining at a near 5% annual rate). The property market is of concern with inventory levels in most Tier 3 and Tier 4 cities standing at around three years demand. Nationwide property transactions and completions declined 10% y-o-y in the first quarter while new starts fell by 21% y-o-y.

The People's Bank of China has reacted by easing monetary policy repeatedly over the past six months (both by cutting interest rates and by reducing the Reserve Ratio Requirement) and is likely to continue to ease over the course of 2015. Easier monetary policy, plus the prospect of State Owned Enterprise reform, has sparked life into the domestic equity markets (which are dominated by retail investors) and more recently this excitement has spilled over into the H shares listed in Hong Kong. The good news is that employment levels remain stable as the rapid growth in the

service sector continues. This offsets the slowdown in the industrial sector and leaves [*us*] with a positive outlook for consumption. From Blackfriars Asset Management Limited, Investment Manager, Establishment Trust

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UK *(compare UK funds here)*

With the issues of Greece as a member of the Eurozone, the tensions in the Middle East and continuing instability in the Ukraine all unresolved, there remain considerable geopolitical risks. In the USA, the UK and the rest of the Eurozone the economies appear to be continuing to grow and to be slowly and finally recovering from the 2008 'Credit Crunch'.

Given the election result, the UK has the necessary policies and economy for continued growth. With continuing historically low interest rates, low oil prices, reducing energy costs and little or no inflation, we can expect a year of further growth. From Lord Lamont of Lerwick Chairman, Smaller Companies Dividend

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The debate about the future of the European Union is gathering momentum ahead of the UK referendum. However, we believe that the UK is in a strong position relative to its European neighbours. The UK has a number of advantages, such as a credible strategy to reduce the budget deficit, a revitalised banking system and an independent currency that offers greater flexibility to respond to changing market conditions. Although quoted UK small companies have performed well in recent years, the recent General Election created uncertainty and led companies to postpone capital investment. Improving confidence post the election should encourage companies to invest in their own businesses, which will lay the foundations for continued growth. From Kathryn Matthews, Chairman, Montanaro UK Smaller Companies

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The recent UK general election has removed a major uncertainty for investors, many of whom had feared an inconclusive outcome, which could have resulted in a potentially unstable coalition or minority government. The outright Conservative majority brings with it the prospect of an 'in/out' referendum on the UK's EU membership, and although the run-up to the referendum itself complicates the picture for corporate investment, a settlement of the issue should create a clearer environment for businesses to chart their way ahead.

It is worth remembering that the companies listed on the UK stock market derive around two thirds of their overall earnings overseas, where the outlook has become more difficult to predict with confidence. China's economic growth continues to slow and the US recovery also appears to have stalled. Markets generally have so far taken a sanguine view of these trends, given that they underpin the continuation of loose monetary policy. Encouragingly, European economies have shown signs of recovery, boosted by quantitative easing by the European Central Bank, and a similar picture appears to be unfolding in Japan. Inevitably, however, such policies of providing liquidity to the market will reduce or cease and this creates the prospect of adjustments in equity and bond markets. From Jonathan Cartwright, Chairman, BlackRock Income & Growth

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Eurozone economic activity overall is showing signs of improvement as the European Central Bank starts Quantitative Easing, albeit that factors relating to the Greek economy remain challenging. We continue to focus more on the specific drivers of

individual companies and the ability to determine their future rather than relying on a specific macro outcome. Given that the outlook for both economic growth and interest rates remains uncertain, we seek those companies that can drive returns through self-help and have a clear strategy to deploy the cash flow they generate. From Adam Avigdori and Mark Wharrier of BlackRock Investment Management (UK) Limited, managers of BlackRock Income & Growth

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The UK economy is going through a period of reasonable growth, subdued inflation and low interest rates. It is difficult to think of a better background for equity investing. This is not the view of many commentators who are more concerned with the potential negatives rather than the available opportunities. It is because of their worries that valuations remain undemanding. From George B Burnett, Chairman, Henderson Opportunities

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If last year was challenging then I suspect this year may well turn out to be really challenging. As I write this we have a number of storm clouds appearing such as the consequences of the recent UK election and its impact on both the future of the United Kingdom and our membership of the European Union, Greece's current flirtation with default and Grexit, the speculation over when the US will start raising interest rates and its impact on bond markets and that is without the antics of Mr Putin or Islamic extremists. Notwithstanding all these, there are some positives like continued very low interest rates and the economic benefits of a lower oil price and, of course, unpleasant as market disruptions are at the time, they do throw up attractive opportunities for long term investors. From Hugh Twiss MBE, Chairman, Invesco Income Growth

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The FTSE All-Share Index has risen strongly over the last six years and now stands at an all-time peak level. Although political uncertainty in the UK has been resolved for now, there are other headwinds to withstand in the short term, including weakening demand in the Chinese economy and the political backdrop internationally, but valuations suggest that the long term outlook for returns from investing in the stock market are still attractive. From Ciaran Mallon, Portfolio Manager, Invesco Income Growth

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The anticipated eventual increase in US Dollar interest rates, following a record period of exceptionally low rates, has to date been greeted with equanimity in developed markets because the rise is deferred and is expected to be very gradual; indeed, a number of markets have recently reached new all-time peaks. Several emerging markets, particularly those which link their currencies to the US dollar, have suffered and performed poorly, despite their superior economic performance. China, as already mentioned, has proved the exception.

In view of the scale of the output gap which exists in most economies, interest rates look set to remain relatively low for an extended period. This is particularly relevant to the Eurozone where there is the threat of deflation becoming entrenched. Moreover the whole concept of the Eurozone is being threatened by Greece's potential debt default and the likely shockwaves of such an event.

At current levels of valuation most major stock markets are anticipating a prolonged period of better economic and trading conditions, which looks to be achievable. The UK recovery needs to broaden out to demonstrate that it is not based solely on service industries, government financed property price inflation and excessive consumer borrowing, as in the past.

Currently the optimism permeating the Chinese stock-market is starting to filter through to medium and smaller capitalisations in the domestic market. The Chinese stocks quoted on the AIM market remain at absurdly low levels, some of which are even trading at a fraction of their holdings of net cash, as the result of prevailing worries over perceived corporate governance issues. Hopefully, many of these worries will abate and prove unfounded. From Lord Flight, Chairman, Aurora Investment Trust

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Led by the US economy the world-wide economic recovery continues. Whilst the rate of US unemployment continues to fall from month to month the level of wages has not yet started to rise. Moreover manufacturing industry continues to fluctuate. In that light, the Federal Reserve Board views the economy to be in possession of plenty of spare capacity and remaining fragile. Although commentators opine frequently about the date of an impending rate rise, somehow that date keeps being delayed.

A major boost to the US economy is emanating from the huge fall in the price of shale gas, resulting from the success of the fracking industry; this provides the US with a major advantage over the Far East competition where the price is three times higher. On-shoring of the chemicals industry is accordingly occurring. A further notable feature is the construction of seaboard export terminals for LNG with the intention of flooding Europe with cheap gas, thus making this continent less dependent on exports from Russia.

In the Eurozone the outlook is much less healthy having been adversely affected, inter alia, by sanctions against Russia. Only Germany is prospering as a direct result of the weakness of the euro which has aided its export trade. France and Italy are faring less well. Greece is tottering on the brink of defaulting on its debts while other peripheral countries are stagnating and suffering from actual deflation. Signor Draghi has finally resorted, albeit far too late, to the implementation of Q.E, which is starting to have some effect on the markets. My suggestion is that he immediately gives a consultancy to Robert Mugabe to help combat the serious threat of deflation before it takes hold too strongly!

In Asia the various economies continue to expand, albeit not at the rip-roaring pace prevalent prior to the financial crash. The Japanese stock-market, aided by stimulatory measures, is achieving new (but not all-time) highs accompanied by Hong Kong, India and other markets.

During the last six months the Chinese government has not only relaxed the reserve ratio requirements to boost the economy, but has reduced the official rate of interest no less than three times. It is therefore not surprising that the Chinese stock-market should perform so well (indeed at a time of falling property prices) against such a background, in fact more strongly than any other major stock-market. Individuals are opening new accounts with stockbrokers in record numbers having found an alternative outlet to residential property for their savings. Hopefully, this enthusiasm will feed through into the smaller capitalisations, to which the portfolio is exposed and where the valuations are derisory.

Rarely in history has the outlook for the British economy changed so dramatically in the space of one minute, as it did at 22.01pm on 7th May on publication of the exit poll following the general election. Prior to that moment a government hostile to

business had been universally predicted to take office. In consequence of Mr Cameron having gained an overall, if slim, majority there is now no longer the necessity for weeks of horse-trading between the parties, in order to form a government, which would have introduced much uncertainty.

There will also occur less state intervention and less regulation and a lower degree of fear of rising taxation than if the opposition had been victorious. The UK economy should therefore regain momentum in the coming months, as investment programmes are reinstated and consumer confidence continues to rise against a background of record numbers employed, and falling unemployment, despite wages not rising.

Furthermore, as appetite for risk-taking slowly and inevitably increases, investor sentiment is likely to improve, which should benefit at long last the holdings in the portfolio with the most exciting prospects. Needless to say they are the smaller companies, which hitherto have been deemed too illiquid, under-analysed and too risky for the average investor, who has ignored them. From James Barstow, Mars Asset Management Limited, manager of Aurora Investment Trust

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Recent equity market peaks have been powered by the ECB's announcement of the enlarged asset purchase programme of 60bn Euros per month which includes, for the first time, the purchase of sovereign debt, known as QE. Investors have also been encouraged by the announcement of falling levels of unemployment, now below 6%, a zero rate of inflation and real growth in wages. Prospects for rising consumer spending here in the UK look brighter than for the last five years or more and our GDP should continue to grow in 2015. We expect that government spending will continue to reduce as a proportion of GDP. This is necessary due to the enormous overhang of public sector debt which is 80% of UK GDP.

With spreading tensions in the Middle East and the Yemen, the UK market may be volatile over the next few months, but we believe that the investment case remains intact for long-term investors. Equity dividends continue to rise, and in the first quarter of 2015, the adjustment for dividends on the FTSE All Share Index rose by nearly 8%. Although the price earnings ratio is now around 15x, which is just above the long-term average of 14x, the average yield of 3.3% is more than double the yield of 1.6% available from ten year gilts. From Angela Lascelles, OLIM Limited, manager of Value & Income

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The recent performance of the UK equity market has seen further strong positive returns, with the FTSE All-Share Index hitting a new all-time high towards the end of April - and this makes the near term outlook more subdued. The continued re-rating of equities primarily as a result of the policies of central banks has resulted in boosting asset values to the point where the market looks more fully valued than for many years. This high level of valuation coupled with a low level of earnings growth is the primary risk to the current level of share prices. Furthermore the increased probability of a change in monetary policy from the US central bank represents a more difficult back drop for government bond markets which will inevitably have a knock-on impact into equities.

The unexpected outright Conservative victory in the general election was positive for business and for UK plc. Importantly, it removes the uncertainty that would have surrounded a hung parliament and fears of anti-business legislation. However, as a result of this outcome two new political risks have risen to prominence. First, the risk surrounding the successful integration of the Scottish Nationalist Party into the UK parliamentary system and second, the longer term risk relating to the EU "in-out"

referendum. The latter will certainly have an impact on financial markets and the domestic economy in due course. From Mark Barnett, Portfolio Manager, Perpetual Income & Growth

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Recovery is continuing in both the domestic economy and the United States. Unemployment is falling in both countries, disposable incomes are increasing and growth is approaching trend levels. Europe is also showing signs of improvement, though it should be remembered that some extraordinary policy measures, including negative deposit rates and a stimulus programme equating to EUR60bn per month, have been required to get to this position.

The decline in the oil price should act as an additional form of stimulus for most economies. If however the reduced price does not drive additional demand then it may instead prove to be deflationary. That would hinder continuing recovery.

Despite some sector specific exceptions, companies are generally trading reasonably well, though those that are exposed to the decline in commodity prices will need time to adjust to their new environment. Equities appear to be good value relative to fixed interest. This probably says more about the relative expensiveness of some fixed interest rather than the cheapness of equities. Having previously traded at a discount to their international peers, UK equities are now valued more in line with their overseas counterparts, though the yield in the domestic market remains above that available elsewhere. An additional positive is that following a prolonged period of downgrades to earnings expectations investors now seem to be pricing in a more achievable level of profits growth and hence disappointments may diminish. That will be important because European quantitative easing has pushed markets upwards and valuation multiples, especially of higher quality companies, are at levels that will require growth in earnings. From Anthony B. Davidson, Chairman, Shires Income

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Equity markets appear good value when compared to fixed interest. However, it is increasingly accepted that fixed income markets are being driven to uncomfortably high levels by the actions of central banks around the world. Without wishing to suggest when this might reverse it seems fair to observe that the yields on hopefully risk free assets no longer provide a sound touchstone for the determination of fundamental equity valuations.

We are in an environment where creditors have to pay to lend money to the Swiss Government and the Mexican authorities can issue 100 year euro denominated debt. In effect investors who want any semblance of yield or the possibility of capital appreciation are forced to buy equities. This has driven the valuations, especially of high quality companies, to levels that are increasingly difficult to justify unless the current environment is indeed the "new normal" the outlook for corporate profitability. In fact there are some reasons for optimism. The US and UK are still recovering. Growth in both these economies is forecast to accelerate this year. Unemployment is falling and wages are beginning to rise which should be good for demand. Dollar strength will aid companies exporting to the US. The lower cost of energy should feed through to demand and profit growth. There are signs that the European economy is picking up, boosted by quantitative easing, but improving all the same. GDP is now

expected to rise over the next two years. Credit conditions are easing as both demand and availability increase. Eurozone earnings momentum has turned positive for the first time in four years as analysts' forecasts have not been subject to the downgrades that have been so familiar over recent times.

Corporate balance sheets are strong; this gives management teams options. Therefore it would not be surprising to see merger and acquisition activity continue. Shell's proposed acquisition of BG and Heinz's merger with Kraft are examples. If such deals are done for the right reasons they can deliver value.

Less positively, with the Eurozone already experiencing deflation there are increasing concerns that the fall in the oil price may not be accompanied by an increase in demand. In such a scenario the benefit of cheaper energy may be outweighed by the impact of deflation. However, the market is currently pricing in an increase in inflation across the region. Falling commodity prices and currencies have prompted interest rate cuts in a range of countries from Australia and Canada to Denmark. Expectations for interest rate increases in the UK have been pushed out to 2016 and whilst the US is still likely to increase rates sometime this year it will be difficult for them to do so at a time when most other regions are reducing rates. This points to the second significant risk, namely that the benefits of European quantitative easing are diluted as countries around the world seek to counter the threat of deflation by devaluing their currencies.

China's growth is slowing, its economy is having to transition. Chinese demand for commodities is reducing and that can be seen in commodity prices that have been falling for some time. This decline in demand may serve to push deflation across the emerging markets, and this would surely impact the developed markets as well.

Clearly a Greek exit from the euro has the potential to cause uncertainty. There will be pinch points as the staged repayments and renegotiations progress. It seems more likely than not that all parties involved will ultimately come to a sensible agreement. However, the process of reaching a settlement has the potential to cause significant volatility in markets.

The risk from geopolitical events seems to be rising. This could create additional volatility during the year. However, investors should take care to look at individual company valuations rather than relying on aggregate valuations. There is a very broad spread of valuations across different market sectors accompanied by wide ranging variances in expectations for earnings growth, and in some cases contraction.
From Ed Beal, Aberdeen Asset Managers Limited, manager of Shires Income

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Europe *(compare European funds here)*

Although the increase in the benchmark index was considerably less than over the previous year (7% v 17%), our optimism about the overall outlook for Europe as expressed in last year's Report and Accounts was well founded and, we believe, continues to be so. This is particularly the case given the markets very positive start to the calendar year following the European Central Bank's commitment to address the threat of deflation with its quantitative easing programme. The large fall in the world price of oil has also acted as an economic stimulus which if sustained, together with increased levels of bank lending to consumers and businesses, are expected to help improve confidence, boost demand and stimulate investment in the forthcoming year.

However, as I have often said in this report, 'bull markets climb a wall of worry'. Happily, therefore, we can see causes for concern. The popularity of anti-austerity parties in countries on the periphery of the Eurozone are likely to continue to increase,

following the election of the left wing Syriza party in Greece and the surge in support for the SNP in the UK. The election in Spain towards the end of this calendar year will be an interesting contest in this regard. The situation in the Ukraine continues to fuel widespread concern. The possibility of additional economic sanctions against Russia would have negative consequences for EU corporate profits. Nor will European markets avoid the volatility likely to result from monetary tightening by the US Federal Reserve while monetary easing continues in Europe, China and the Far East. The sort of liquidity imbalances between east and west that caused havoc in 2007/8 have changed in character but not necessarily in potential effect. From Andrew Murison, Chairman, JPMorgan European

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The combined effects of lower oil prices, a weaker Euro and falling interest rates should be positive for the European economy. There are tentative early signs that Europe has turned the corner and that a recovery is underway. Therefore, conditions are in place for European corporate profitability to surprise on the upside which in turn suggests that a positive year lies ahead for our investors. We expect 2015 to be a constructive year for the shares of European smaller companies, driven by stronger earnings growth than expected. Nevertheless we do note that valuations are no longer categorically cheap.

According to the UK's Investment Association, recent outflows from European smaller company funds exceeded those experienced throughout the whole of the Global Financial Crisis of 2007 and 2008, a sign perhaps that investors have thrown in the towel on this asset class. This augurs well. Historically, periods of capitulation have laid the foundations for a rise in share prices. After a pedestrian year, we look forward to a more rewarding period for investors in this coming year. From Andrew Irvine, Chairman, Montanaro European

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Asia *(compare Asian funds here)*

In the region generally, growth is expected to slow. Inflation should remain subdued and some of the region's imbalances have been reduced, allowing interest rates to continue to fall. As growth slows, the potential for reforms to improve the allocation of resources and increase economic efficiency assume greater importance and we have seen equity valuations driven higher on optimism surrounding reforms. In some markets this optimism may have run ahead of reality making re-ratings unsustainable unless supported by a commensurate improvement in earnings.

We have identified two potential risks for Asia. First, there has now been a long period of rising leverage, which so far has been helpful in driving growth. This could become a headwind in the medium term as marginal returns on incremental debt deteriorate. Second, a substantial increase in US interest rates would have a negative impact on liquidity conditions in Asia. However, with the likelihood that the US economy will grow at around 2-3% annually, it seems unlikely that US interest rates will rise significantly over the near term.

Against this backdrop, average valuations of 13.7 times 2015 expected earnings for the region look reasonable relative both to recent history and against other equity markets. As growth stabilises, liquidity is eased and reform programmes begin to

have an impact we should expect to see many attractive opportunities for investment.
From Carol Ferguson, Chairman, Invesco Asia

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Asia's economic growth appears to be bottoming, supported by easier monetary policy across the region. Growth, however, will likely remain at a lower level than that which has prevailed in the decade after 2000. This is chiefly because the credit cycle in Asia is more advanced and there is unlikely to be a significant pick up in Asia's exports growth, as there is little to suggest a strong rebound in global growth in the near term. This moderate outlook for growth appears adequately reflected in consensus revenue growth estimates and lower commodity prices and a slowdown in wage inflation should help to stabilise margins and support earnings. Consensus earnings growth forecasts for the Asia Pacific ex-Japan region are currently around 5.7% for 2015.

With the strong performance of Asian equity markets over the past year, market valuations have increased to 13.7 times consensus 2015 earnings. While still attractive relative to developed equity markets, this valuation level is towards the upper end of the range established in the last five years. In this sense Asian markets have, to some degree, already priced in an improvement in earnings momentum. Chinese equity markets are a good example of this. Chinese policy-makers have needed to strike a difficult balancing act between the need to control runaway credit and investment cycles with the need to prevent growth from slowing too much for the sake of social stability. Twelve months ago, Chinese equities were trading on low valuations pricing in this challenging economic environment. Since then Chinese equities (both onshore and in Hong Kong) have rerated significantly. This reflects solid progress in various areas of reform particularly in tackling corruption, state-owned company inefficiency, financial sector and capital account liberalisation. It also stems from a belief that the Chinese authorities will be more aggressive in supporting economic growth through fiscal and monetary policy. However, the government has yet to face head-on the excesses of the credit cycle and the economic losses that are likely to be associated with them. Thus, while we do not completely discount the government's chances of successfully reinventing the Chinese growth model, there is considerable uncertainty over the medium term path for economic growth. Real interest rates remain relatively high in China and it may well be that interest rate cuts fuel further increases in equity valuations. However, as valuations rise, we need to be mindful of a deteriorating medium term risk/reward outlook in Chinese equities.

As valuations in Chinese equity markets continue to expand, the relative attractiveness of the Indian equity market increases, in our view. The recent correction of India's equity market, caused by investors adjusting down their expectations about reform progress to more realistic levels, may still have further to run. Given where we are in the economic cycle, we expect some recovery in GDP growth from its current 4% level to a level closer to its historical long term rate of 5-6% over the next two years. This rebound should be achieved even with limited success on the reform front. In our view, accelerating growth combined with the current correction in the market will render attractive opportunities going forward.

Elsewhere, we believe that opportunities can be found in South Korea. The market now trades at a significant discount to its long term average valuation level, while at

the same time there are recent signs of an improving economy. Housing transactions are starting to pick-up, which we expect will underpin future consumer confidence and spending. Increased spending is evident in the retail sales annual growth rate which rose more than expected to 1.6% in April 2015. Furthermore, the market's dividend payout ratio is beginning to rise which should provide further support. From Ian Hargreaves, Portfolio Manager, Invesco Asia

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There is continuing attention focused upon an expected increase in US interest rates later this year and importantly how such a programme affects the risk of capital flight from emerging markets. There is however a silver lining as such a move by the Federal Reserve also means that the American economy is well on the road to recovery. This is good news for Asian exporters and a number of these leading names are held within the Company's portfolio. In addition, improving government finances and policies which are becoming clearly stated mean that the region is better placed to withstand any short-term turmoil than has been the case in the past. In the longer term, Asia's appeal remains undimmed. Beijing, despite ongoing concerns over its decelerating economy, has sufficient resources to avert a hard landing and oil prices are expected to stay low for some time, giving policymakers the latitude to enact supportive measures. Coupled with young populations, rising wealth and pent-up demand for consumer goods, these factors should underpin the region's growth prospects for the foreseeable future. From David Shearer, Chairman, Aberdeen New Dawn

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Although central banks' ultra-accommodative policies have been a vital pillar of support for markets so far, investors are bracing for the normalisation in US interest rates. Asian equity markets will no doubt be tested when the Fed eventually lifts rates for the first time in almost a decade. An extended sell-off, however, is unlikely as the move has been largely priced in. Unless there is a significant jump in US interest rates, which seems unlikely, a modest and gradual rise in borrowing costs is not expected to spark further rounds of monetary tightening in the region. With deflationary threats surfacing in the wake of declining oil prices, there is, instead, more leeway for interest rate cuts.

At the corporate level, the operating environment could remain challenging for some time, given the patchy regional growth. Domestic demand has been constrained by elevated household debt, while China's economic slowdown has hurt exports. Earnings growth is expected to be modest against this backdrop. However, balance sheets and cash flow generation are still healthy. Lower commodity prices and benign inflation should also help steady margins. Many of the Company's holdings, characterised by their broad regional exposure, established franchises and solid finances, are well-positioned for a cyclical upturn over the long term. Meanwhile with the Asian markets trading at an estimated price-to-earnings ratio of around 13 times for 2015, valuations do not seem demanding compared to developed markets. From Aberdeen Asset Management Asia Limited, managers of Aberdeen New Dawn

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Japan *(compare Japanese funds here)*

The Board shares [*the managers'*] confidence in the outlook for Japanese earnings. Valuations, meanwhile, are not unduly stretched and companies are beginning to respond positively to the emerging higher requirements for Corporate Governance in Japan, which should ultimately lead to much better returns on capital. The overall economic and financial background remains constructive and both government and

municipal pension funds are showing an increased appetite for equities. From Alan Clifton, Chairman, JPMorgan Japan Smaller

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North America (compare North American funds here)

The recent first quarter U.S. economic growth figures were weaker than expected but most commentators have concluded that these represented a temporary weakening of the economy. In recent years first quarter growth has often disappointed only to rebound later in the year. The unemployment rate has also dropped to a pre-crisis low. Fiscal challenges are also abating and even if, as is widely expected, the Federal Reserve start tightening in 2015, monetary policy should remain highly accommodative. The timing and pace of any rises will remain dependent on the economic data. From Simon Miller, Chairman, BlackRock North American Income

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Emerging Markets (compare Global emerging markets funds here)

We remain positive on the prospects for growth in emerging markets for the rest of 2015, but wary of the continued challenges presented by global factors. Asia looks set to remain the engine for emerging markets' premium growth, with acceleration in India and policy stimulus in China offsetting weaker growth elsewhere. The recent trend of outperformance in Asia has led to the region dominating the emerging markets index with over 68% now represented by Asia.

Latin America looks increasingly marginalised, but should not be ignored. Sentiment there is sufficiently negative that small surprises to the upside on the economic, political or corporate fronts will likely be greeted with a meaningful market rally. We are of the opinion that there will again come a moment when a contrarian stance will be warranted.

With developed European economies showing tentative signs of emerging from their torpor, and QE likely to assist further in this, peripheral emerging markets in this region may begin to perform better. We remain cautiously optimistic. From Advance Emerging Capital Limited, managers of Advance Developing Markets

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The USA is looking to exit Quantitative Easing and edge towards normalisation. Japan is expected to continue QE, whilst Europe has just started QE and is expected to continue to do so for some years. These combined initiatives are expected to be positive for asset classes and equity markets. The liberalisation of the Chinese financial markets may deliver a positive impact on Chinese and Asian equities. Given this backdrop, most emerging market economies continue to achieve positive GDP growth and their outlook is positive. From Alexander Zagoreos, Chairman, Utilico Emerging Markets

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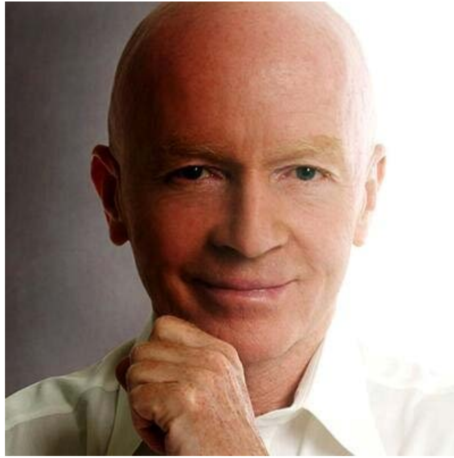
High economic growth rates remain a key attraction of emerging markets. Even with major economies like Brazil and Russia slowing down, emerging markets' growth in 2015 is expected to be comfortably in excess of that achieved by developed markets, with China and India driving Asia to particularly strong growth. In addition, what also makes emerging markets attractive to us is the fact that, in general, they have much less debt and hold significant foreign reserves compared to developed markets.

The direction of policy across most Asian countries appears favourable for economic growth. The Chinese authorities are continuing the major programme of reforms laid



out in late 2013 and in India Prime Minister Modi is starting to introduce ambitious reform measures in line with his election manifesto. Positive structural changes are under way in many other markets across the region while free trade initiatives, most notably the planned Association of Southeast Asian Nations Economic Community and the Trans Pacific Partnership could provide a further boost to growth.

In Latin America, while Brazil has been facing a difficult economic situation due to the reasons discussed above, taking a longer-term view, the currency devaluation could boost competitiveness going forward and moves to root out corruption could lead to improved corporate governance and economic performance. Moreover, significant benefits could arise should the government adopt more favourable policies and reforms.

Central European emerging markets and Turkey could benefit from economic recovery in the Eurozone area. Elsewhere in the region, economic sanctions and anticipation of prolonged political confrontation led us to trim our holdings in Russia during the year. From Mark Mobius, Ph.D., manager, Templeton Emerging Markets

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China *(compare Asian single country funds here)*

As mentioned at the start of this report, I believe the Company's share price has been held back by general negative macroeconomic sentiment towards China. When looking at China, overseas investors are bombarded by headline grabbing stories about slowing GDP, rising debt and falling property prices. Yet in 2014 the Shanghai Exchange was the world's best performing market. So is this negative sentiment justified and what have investors been missing?

To answer the question, yes, some of the negativity towards China's markets is justified - China clearly has challenges but if you scratch below the surface great opportunities still exist for individual companies in the right areas.

First, GDP is slowing, but China is now a $10 trillion economy and it is unrealistic to expect consistent high single digit growth rates over the long-term. It is generally accepted that growth will slow to around 7% in 2015, but that still represents around US$700bn of growth, or roughly 25% of the entire UK economy. In conjunction with this, the economy is shifting towards a consumption-led model, which lends itself to lower, yet more sustainable growth rates. This is still a ripe environment in which the strongest companies can grow.

Second, debt levels have risen significantly, and history teaches us that this should lead to non-performing loan ("NPL") issues down the road. However, I do not think this will lead to a credit crisis of the type witnessed in the West in 2008. A key characteristic of a credit crisis is the drying up of liquidity, but strict government imposed rules mean China's banks have some of the lowest loan-to-deposit ratios in the world, while their largest shareholder is the government, which can direct liquidity to where it is needed. Also, one of the big differences is the level of consumer credit. Debt has risen in China but mostly at the corporate level (including State Owned Enterprises), not at the consumer level. Mortgage penetration is very low, and the deposit requirements for mortgages are relatively high versus Western standards. However, I do think NPLs will become a greater issue for banks going forward.

Third, after years of gains, falling property prices have been perceived by some as the beginnings of the bursting of a bubble. To me, a key aspect of a bubble is rapidly declining affordability. Property prices have moved up strongly in the past decade, but so have incomes. In fact in many cities we argue that affordability has actually improved in the last decade. We should also note that the largest gains in property prices have been in the first tier cities while gains in the lower tier cities have been much more muted. Ultimately it will come down to supply and demand. Supply has increased significantly, but has already begun to adjust since last year. I believe there is still a reasonable case to be made on the demand side. We must keep in mind that the debt increases have been mostly at the corporate level and the consumer balance sheet remains in very good shape.

Finally, many of the structural drivers of demand, such as urbanisation and general upgrading, remain in place. I think the pick-up in market volumes that we have seen in recent months reflects these underlying demand trends. I am not saying that there are not pockets in China with serious overbuild issues - the country is large and there will always be failed projects - but it is not as bad as often made out. For example, so called "ghost towns" dominate the media. I have visited many of these, and while there are some areas with serious problems, on the whole I can say that the problem is generally overstated.

I continue to believe the course is set for an unprecedented reform programme that will open up the Chinese economy and its markets, but we must monitor progress in terms of implementation. There are many ongoing economic and social reforms that address issues such as reducing government intervention, allowing markets to determine prices and improved welfare. These changes tend to take baby steps forward, so can often slip under the radar, but in aggregate they are really changing the investment landscape in China to one where private entrepreneurs and companies can thrive.

E-commerce - China's shift to online represents one of the biggest commercial opportunities most investors will see in their lifetimes. Admittedly this is a global trend, but it is occurring even faster in China, partly because traditional bricks and mortar retail infrastructure has not been built out to levels common in the West. Internet usage in China has only just surpassed 50% of the population so there is still good growth potential for e-commerce. There are also attractive businesses springing up related to internet security and data storage that investors cannot ignore.

Consumer - Chinese wages continue to see solid increases and the growing middle class want to spend on goods, services and travel. All this is happening against the backdrop of a government looking to shift the economy to a consumption-led model, so we can expect further policy tailwinds to support this consumption trend. One example is the government's drive to increase the urbanisation rate, which will boost consumption - ownership levels for rural consumers of everyday goods like white goods and cars tend to be far lower than their urban cousins. Much has been made of the recent anti-corruption crackdown, and this has had an impact at the luxury-end, but I believe that this should have little impact on the underlying drivers behind mass market consumption.

Healthcare - As people get wealthier they want to get healthier. China's per capita expenditure on healthcare is well below that of developed nations, but we are seeing this pick up. China's low cost advantage also makes it attractive as an R&D outsourcing centre for the large Western pharmaceutical companies. In addition, the government has pledged to change the social security system (called hukou) so that more than 100 million people can get better healthcare access by 2020.

Infrastructure - Infrastructure assets are sought globally for the stable cash flows they generate. In China we find that many of these assets tend to be ignored and undervalued as they may not offer the growth potential or thematic appeal of some of the smaller private companies. In addition, reforms focusing on more market based pricing and incentivising management have the potential to drive returns higher. One example of this is the railways where some passenger lines have not seen tariffs rise in almost 20 years.

Overall, I acknowledge there are macro challenges, but find these are often overstated for the sake of a headline. The economic model in China is changing and slower growth is the "new norm", providing a good environment for innovative companies to operate. Reform is a broad concept, but it is a key driver of progress in China and it will create investment opportunities across an array of industries. From a stock picking perspective, the opening up of the A-Share market is really exciting and I look forward to continuing the search in this market for the many opportunities it offers. At the heart of it all, I still believe stock prices follow earnings and cash flows - and I see strong opportunities for growth in both.

At the time of writing this report it would be remiss of me not to comment on the recent rally we have seen. This rally has been driven by increased liquidity and improved sentiment after the authorities granted greater access for mainland investors to buy Hong Kong listed stocks via Stock Connect.

I still believe that China offers some of the most attractive long-term structural growth opportunities in the Asia region, but I can foresee some consolidation and continued volatility given the speed and size of this rally. From Dale Nicholls, Investment Manager, Fidelity China Special Situations

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India *(compare Asian single country funds here)*

Since the Company's year end on 31 March 2015, the Indian stock-market has turned more circumspect following the celebratory rally of the past 12 months. While investors still seem genuinely encouraged by Prime Minister Modi's restructuring efforts thus far, they also recognise that economic headwinds and structural shortcomings persist. The BJP's election defeat in Delhi, its first major loss in state elections since it came to power, was also a reminder of the uncertain state of politics in India and how conflicting interests can derail the reform agenda. Whether the new government is able to garner enough support to push through further reforms, such as rationalising the tax system by implementing a nationwide goods-and-services tax or speeding up the approval of infrastructure projects with the Land Acquisition Act, remains to be seen. Retooling the economy is expected to be a long-term undertaking.

At the corporate level, earnings growth remains muted and this is reflected in the stock market, with share prices having fallen since the review period ended. This is not necessarily a cause for worry. The best of Indian companies have always thrived in the worst of circumstances and any market correction would be an opportunity to add fairly-priced stocks. Long term, India's prospects remain undiminished. From Hasan Askari, Chairman, New India

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Sentiment toward Indian equities has turned decidedly more cautious recently. The market's stellar run over the past year was largely based on expectations following Modi's decisive election win. Investors launched a lengthy celebration of anticipated reforms, long-awaited infrastructure development, a surge in investment, and accelerated economic growth, before most of it actually happened. Modi has made considerable inroads during his first year in office; the recent passage of two key bills is particularly encouraging. However, India is no quick fix and Modi's approach is characteristically slow and steady.

Meanwhile, little has changed for India Inc. Businesses have yet to see a material upswing in earnings and many are keeping the lid firmly shut on capital expenditure. More recently, the finance minister's revelation that the minimum alternative tax (MAT) would be retroactively applied to foreign fund managers registered in India, potentially raising as much as US$6.4 billion for the government, caused a series of market tremors. It also provided a stark reminder to foreign firms of the risks of swimming in India's murky regulatory waters. Given these factors, returns could well be more modest over the medium term.

We are relatively sanguine about short-term market fluctuations, which provide an ideal opportunity to stock up on high-quality companies at attractive valuations. The country offers a multitude of well-run, shareholder-friendly firms, with solid balance sheets and excellent growth potential. For long-term stock-pickers, India remains an exciting investment destination. From Aberdeen Asset Management Asia Limited, Investment Manager, New India

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Russia *(compare European single country funds here)*

The lack of a lasting resolution to the conflict in Ukraine and the risk of further sanctions remain barriers to an improvement in investor sentiment towards the region. The price of oil is a major determining factor for the Russian economy, and it is difficult to predict its development, but at current levels GDP growth is likely to be subdued.

Despite these matters of concern, the resilience of the Russian corporate sector can be illustrated by its ability to adapt to changing economic conditions and to maintain impressive dividend distributions by historical standards. Moreover the economy has shown some signs of stabilising from the start of 2015 and should this trend continue, there is hope that in time investor interest will return to the region.

[*We believe*] equity markets in Russia still provide a good long term investment opportunity, although the path to recovery is not a straightforward one and requires the resolution of substantial geopolitical and economic issues. From Lysander Tennant, Chairman, JPMorgan Russian

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Instability of the oil price and complications in the global political background make life for Russian equity investors extremely eventful. Unfortunately extreme external factors, such as the price of oil, interest rates and geopolitical events including a forthcoming review by the European Union of the existing economic sanctions regime, may prevail in the short term and seem likely to overshadow corporate activity.

However for the medium term (over next five years) and long term (10+ years) horizon, economic reforms and corporate capital allocation decisions seem likely to dominate as key factors for investment returns. We are reasonably optimistic about the outcome over the medium and longer term.

We anticipate that the earnings spiral is likely to bottom out in the second quarter of 2015, and we should start to see some positive economic and corporate profit forecasts in the second half of 2015.

We believe that while the long-term fundamental case for the Russian equity market is still intact and continues to provide ample opportunity for active fund managers to add value, short-term performance will be influenced by a number of tough economic and political challenges. From Oleg I. Biryulyov and Sonal Tanna, Investment Managers, JPMorgan Russian

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Heathcare *(compare Healthcare & Biotech funds here)*

The macro environment for the healthcare sector remains quite positive. The Affordable Care Act in the U.S. continues to provide increased healthcare coverage to uninsured Americans and the utilisation of services and the consumption of pharmaceuticals has increased commensurately. Importantly, the increased size of the population now covered is proving profitable for healthcare companies despite some concerns to the contrary. Innovation has re-entered the medical device arena, particularly in the cardiovascular space, which has rekindled investor interest in an otherwise dormant sector. Overall, pricing for medical devices has stabilised and M&A in the orthopaedics sector is accelerating. Most noteworthy, however, is therapeutics where pharmaceutical and biotechnology companies have been in an unprecedented novel innovation cycle over the past three years. One particularly exciting area of the therapeutic field is immuno-oncology. New drugs are being approved at record rates and review times for new drugs that are saving lives are the shortest they have even been. While valuations have risen, growth rates have accelerated more, thus we view the healthcare sector as attractive from a valuation perspective. Finally, we expect continued M&A activity as the smaller biotechnology companies remain prime engines of innovation. From Samuel D. Isaly, OrbiMed Capital LLC, Portfolio Manager, Worldwide Healthcare.

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Renewable Energy *(compare Renewable Energy funds here)*

The UK solar PV market experienced an acceleration of growth during 2014, with 2.3GW of additional capacity installed, a yearly increase of 79%. This growth in capacity was only exceeded by China, Japan and US during the same year, according to the International Energy Agency, positioning the UK as the Country with the 8th largest installed solar capacity at 5.1GWp. In addition, the announcement of regulatory changes that will see a phase-out of the ROC regime for solar installations larger than 5MWp and the introduction of new auction based mechanism (Contract for Differences) caused a further acceleration in the rate of new installations in the quarter ended March 2015. As a result, the updated total installed capacity of 5.7GWp, positions the UK at the 6th place in the global ranking for installed solar capacity, and 3rd in the European ranking behind Germany and Italy.

This exceptional growth represents a significant step forward in the UK solar roadmap, which in early 2014 targeted a total solar installed capacity by 2020 of 10-12GWp, with scenarios allowing for up to 20GWp. The Investment Manager believes this supports the case for a positive outlook for the UK solar sector in the next year, given the current momentum of the solar industry, the active project development

market and the continuous appetite demonstrated by the equity and debt capital markets for these assets. From NextEnergy Solar Fund

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Debt *(compare Debt funds here)*

The low default outlook for both the corporate bond and loan markets remains supportive. Volatility in government bond markets in recent weeks may yet spread to other areas of the corporate bond market given outflows from open ended bond funds. It provides a useful example of the dangers of investing in markets in which Central Banks encourage investors to herd into certain investments, regardless of valuation. We expect volatility to remain a feature of the investment landscape in coming months.

We expect yield (income) to be the dominant strategy in the future with limited opportunities for capital appreciation. From John Pattullo & Jenna Barnard, Fund Managers, Henderson Diversified Income

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Property

Looking ahead, we anticipate the strength of the occupational market and the consequential rental growth is likely to support the rise in market pricing, and so justify continued investment into the market. In the current low-return environment, some commentators might justify current market pricing by reference to the margin over 10 year gilt yields, which is circa 400 basis points, well ahead of the long run average. However, we believe it is important that investment decisions are fundamentally grounded in occupational demand, rental growth and an appropriate return for the risks of long term property ownership. From Richard Shepherd-Cross, Custodian Capital Limited, Investment Manager, Custodian REIT

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Commercial property values are now growing steadily in most areas of the United Kingdom, not just the hotspots in Central London. The total returns on the IPD Annual Index in 2014, at 17.7%, were the highest since 2005, with office and industrial property each returning 23% and retail property on 14%. The Scottish property market, however, has been under political pressure. Stamp duty on Scottish commercial properties changed on 1 April. It is now higher than in the rest of the United Kingdom on properties over GBP1.9m and lower on the rest.

After underperforming for some years, risky, shorter-let, "recovery stock" office and industrial properties led the market higher as they were seen to offer the best odds for short term capital growth, especially by aggressive overseas buyers. London office and retail rents are still rising, but Central London valuation yields are wafer-thin.

Two years into economic recovery, rental values are now improving across most regions and property types. Office and industrial/warehouse rents and tenant demand are growing as expected across much of Southern and Middle England. Average retail rental values stabilised in Spring 2014 and are now edging ahead. Intensive competitive pressure in retailing is still depressing retail rents where local spending power and population are in decline, usually in conurbations outside Southern England. But rents are growing again in some prosperous smaller towns, suburban high streets and edge of town locations throughout the United Kingdom as real

consumer incomes move ahead. Medium term retail rental growth outside London will benefit from the rates revaluation, which will take effect in 2017, based on rents today rather than at their peak in 2008.

The internet continues to change established shopping patterns, but the more savvy retailers are turning it from a threat into an opportunity and many high streets are benefitting from new openings by convenience and discount stores, cafes and bar/restaurants. Leisure property capital and rental values are also rising, with strong operators such as Greene King (now including Spirit), Marstons, Mitchells and Butlers, Prezzo, Restaurant Group and Wetherspoons competing for new units both in and out of town. Household spending on eating out, for example, is estimated to be rising by 7% p.a. Leisure property is also rapidly gaining acceptance as a serious institutional investment, with health and fitness and cinemas leading the way in 2014 in the IPD rankings for net new investment. Voids and overrenting in the IPD Monthly Index are at their lowest levels since 2008, which augurs well for continuing rental growth in most sectors.

Demand for scarce investments with long index-related leases in most sectors is very strong, as insurance companies and pension funds seek to match their long-term annuity and inflation-linked liabilities with realistic returns from well let property instead of the "return-free risk" offered by index-linked gilts on negative real yields. But capital and rental values are falling for large supermarkets (the worst performing sub sector in IPD last year with a 6.2% return), in view of the rapid structural change highlighted by Tesco's and Morrison's troubles in particular. Consumers' preferences are moving rapidly towards more frequent trips to smaller, more convenient supermarkets combined with growth in on-line shopping for bulkier items.

UK Property simply offers outstanding value at a yield premium of 4 points over conventional gilts and 7 points over long-dated index-linked gilts. Long term property investors can lock in an average real yield premium at all-time high since index-linked gilts were first issued in the UK a generation ago. Property's prospects are also highly competitive with UK equities at almost double their running yield, with voids and tenant defaults declining and rental income from property portfolios growing again - the usual cyclical pattern at this stage of an economic recovery.

British and Irish banks continue to dispose of property owned by distressed borrowers and by sales of non-performing loan portfolios, formal Receiverships and "consensual sales" under the threat of Receivership. Most banks are also lending freely again on commercial as well as residential property. Reasonable quality property is still available from these bank-driven sales, but the prices are rising and the competition for larger lot sizes and portfolios is fierce, with US hedge funds competing at a premium for larger packages. Individual properties and small groups for sale between GBP2m and GBP10m still offer the best value, in the gap between private and institutional/overseas demand.

Average property capital values should continue to rise in 2015, giving average total returns of 10%-12%. Average rental values should also show useful real growth throughout 2015 as employment continues to grow and the economic recovery spreads to the parts of the United Kingdom furthest from London.

2014 was the best year for the British economy since the 2008 crash, with growth at almost 3%. 2015 may be slower. House prices in London have boiled over after their very rapid rise but most house prices elsewhere are benefitting from cuts in stamp duty. Consumer incomes are now clearly growing again in real terms, with average earnings growth around 2%, usefully above both the Retail Price Index at 0.5%, and the Consumer Price Index in negative territory. Falling commodity prices, especially oil, will give a welcome boost to British real incomes in 2015. The UK service sector is buoyant but manufacturing output, construction and investment remain patchy and

the trade deficit, at 6% of GDP, may become a serious concern if our public sector deficit also stays high and Britain has to continue borrowing large sums from abroad for the foreseeable future. Abroad, the IMF is warning of several years of slow growth - the USA is performing reasonably, and the Eurozone GDP is edging ahead, but Greece and Russia are in serious trouble and China, India and Brazil continue to disappoint.

There is still no sign of the Bank of England Monetary Policy Committee raising interest rates, with market expectations delayed well into 2016. With ultra-low interest rates right across the yield curve in most developed economies, rises in short rates here may be small and slow unless sterling comes under sustained pressure. Meanwhile property's exceptionally high yield premium over both short and long-term interest rates provides solid medium-term protection against interest rate rises. Buying pressure from many new as well as established investors should keep prices rising throughout 2015. Affordable and rising real rents, and the specific property locations and types which deliver them, remain the key to high long term real returns when bought at realistic yields. From Matthew Oakeshott, OLIM Property Limited, managers of Value & Income

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The retail sector is experiencing a seismic change. The recession and technological advances have changed consumer mind-sets and, as a result, shopping patterns are rapidly evolving: omni-channel shopping, instant gratification and greater shopping convenience are increasing consumer expectations of retailers - online retail is becoming ever more relevant.

These changing dynamics convinced us a few years ago to invest heavily into distribution and, more recently, into convenience retail at a time when others remained entrenched in legacy asset classes, which may not be as relevant in the future.

Recent events have shown that very few retailers have a fit for purpose logistics infrastructure. With customer loyalty at risk, distribution and fulfilment investment is now becoming more important than stores.

Demand and supply imbalances mean that large, well located and modern distribution assets are highly sought after investments. In addition, "last mile" facilities which enable same or next day home delivery are becoming an essential part of the retailers' infrastructure.

Changes in consumer shopping habits are having a dramatic impact on retailers' demand for new space, accelerating 'right-sizing' strategies, as "expensive" marginal stores are closed and critical locations are turned into showrooms. The grocery sector, in particular, has been heavily impacted with rents and yields rarely justifying the underlying trading metrics.

Retail assets that offer convenience, are well located and let on sustainable rents remain attractive. We believe that convenience retail assets will remain relevant in an omni channel world and so will offer good rental growth prospects. The significant growth predicted for click and collect will, in particular, benefit convenience retail. From Andrew Jones, Chief Executive, LondonMetric Property

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The volatility and uncertainty over recent years in the UK real estate market has been replaced over the last 12 months with a macroeconomic picture that is more positive than it has been for some time.

Rental growth is highly correlated to GDP growth but tends to lag the economic turning points by some 12 to 18 months. This lag is now unwinding with tenant take up reducing vacancy levels to a point where rents are now rising outside London. This is also against a back drop of relatively low development activity which is likely to keep vacancy rates at low levels. With this outlook returns should remain positive and possibly be enhanced by a further fall in yields. However, it is likely that the next phase of the property cycle will be characterised by a greater proportion of returns coming from income and the ability to grow rents. From William Hill, Chairman, Ediston Property

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We believe the property sector remains attractive, underpinned by strengthening economic drivers and a limited development pipeline. Positive returns are expected to continue in 2015 with yields potentially falling further as accumulated cash is invested and further flows into the sector are absorbed. Rental growth is likely to make a larger contribution to returns as the cycle moves forward. The latest Investment Property Forum Consensus Forecast suggests total returns of between 10%-12% in 2015 and indeed the year may surprise on the upside. We would then expect returns to moderate with the dominant feature being income yield rather than further capital growth.

A risk for the sector would be the potential for institutional investment to push yields to unsustainable levels but there is no sign of that yet. Indeed a lot of stock which has come to the market has not sold as investment discipline seeks to dominate undue pressure to invest. One question the market is debating, is when will interest rates rise and will the market be able to cope with such rises? We would suggest that with rates so low there is a healthy buffer that will allow the market to accept increased rates without too much trouble, over the short term. The past year has witnessed Government borrowing rates reduce to historic lows, with the 10 year gilt yield hitting its lowest level in history in January 2015. From Ediston Properties Limited, Investment Adviser, Ediston Property

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Romanian Property

The Romanian real estate market demonstrated significant signs of recovery in 2014. In fact, it was a record (post-crisis) year in terms of commercial investment volumes and office take-up which reached a total of c.EUR1.1bn (c.EUR1.3bn in total) and 315,000sqm respectively.

The improved market sentiment has been supported by the attractive country macro fundamentals which resulted in Romanian Real GDP expanding by 2.8% in 2014 and a forecast of further expansion in the medium term.

Romania's accession to the EU has made additional European funds available to the country. Together with the commitments of the national government to further incentivise investments in Romania, it is estimated that more than EUR43bn will be made available by 2020 to enhance growth.

2014 was an active year for the banking sector, with a clear pick-up in appetite for real estate financing. Good quality projects are in demand, though banks still remain cautious in terms of pricing and LTV

Prime office and light-industrial yields [*have contracted*] to 7.75% (c.50bps annual contraction) and 9.75% (c.50-75bps annual contraction) respectively. Current prime

yields in Romania still remain higher compared to most prime markets in the SEE in spite of their continued contraction and favourable market conditions.

The average office vacancy in Bucharest decreased during the year. Vacancy for prime office properties in central locations, similar to the ones we hold most of in our portfolio, is estimated at c.6%. Vacancy for light-industrial properties varies significantly depending on quality and location of the facility. Most of the new light-industrial properties are pre-let and build-to-suit to the specifications of the tenant, resulting in very low vacancies.

Demand for Class "A" office space was driven by companies from the IT&C, the manufacturing / industrial / energy and services sectors, with a number of multinational corporates consolidating and expanding their operations in the market. We anticipate for the real estate market to continue to improve in the foreseeable future. New schemes, projected to be completed over the next 2 years, are not expected to fully satisfy the anticipated demand for new Class "A" office space as the overall market and country sentiment continues to improve. We believe that rents will gradually start to increase, supported by the growing demand for quality space, and yields to continue to contract, helped by financing becoming more affordable and available. From Globalworth

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