Monthly summary | Investment Companies

17 February 2016

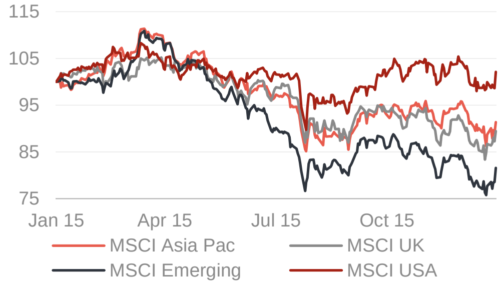
Economic & Political Roundup

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.

Exchange Rate	31/01/16	Chg. on month
USD / GBP	1.4244	-3.3%
USD / EUR	0.9233	+0.2%
USD / JPY	121.14	+0.8%
USD / CHF	1.0231	+2.1%
USD / CNY	6.5760	+1.3%

MSCI Indices rebased to 100

Time period 31/01/15 to 31/01/16



Source: Bloomberg and Marten & Co

	31/01/16	Chg. on month
Oil (Brent)	34.74	-6.8%
Gold	1118.2	+5.4%
US Tsy 10 yr yield	1.921	-15.3%
UK Gilt 10 yr yield	1.560	-20.4%
Bund 10 yr yield	0.325	-48.3%

Global equities

Economic and political headwinds to global equity markets remain. The path of interest rate rises is unlikely to be steep and the eventual peak modest but global equity markets are unlikely to benefit from the same level of accommodative monetary support over the next few years. Going forward earnings and dividend growth will be key.

Richard Killingbeck, Chairman of Bankers, continues to see political and an economic headwinds across the globe but believes that, by taking the medium to long term view, you can escape the "noise" and focus on building on returns. Douglas McDougall, Chairman of the Independent Investment Trust, sees plenty of cause for concern with the world economy. In his view, any one of a number of issues could provide an unpleasant reaction in equity markets, but he is nonetheless struck by the number of interesting new opportunities his team are seeing in the UK market. He says that many of these are strongly cash generative businesses with apparently good growth prospects, which are not especially dependent on the health of either the world or the UK economies for their prosperity. Richard Martin, Chairman of F&C Managed Portfolio believes that, the trajectory of the US interest rate cycle will not be steep and expects the eventual peak to be modest. He also comments that the UK is some way behind the US and may not begin this process until later this year or even into 2017. He observes that the European Central Bank and the Bank of Japan are still conducting quantitative easing but has a sense that accommodative monetary policy may not offer quite the same level of support to global equity markets that it has over the last few years. This does not necessarily suggest a "bear phase" but the key from here will be earnings and dividend growth. He sees potential downside risk to markets should concerns over global growth re-emerge but, on balance, believes equities still offer the best prospects of positive returns.

UK

Divergence in interest rates globally is likely to produce greater volatility in markets. The outlook remains mixed but the normalisation of monetary policy is likely to be a slow and measured.

Jonathan Cartwright, Chairman, BlackRock Income & Growth comments that the momentum behind economic growth appears to be faltering. He comments that a divergence in interest rates is likely to produce greater volatility in currency markets, with the Eurozone area seeking to avoid another recession and emerging market companies feeling the effect of a stronger US dollar on their dollar denominated borrowings. Neil Hermon, the manager of Henderson Smaller Companies says that the outlook remains challenging with mixed economic performance across the globe. However, he believes that the 'normalisation' of monetary policy will be slow and measured and that the collapse of oil prices should provide a boost to global growth overall. He comments that the equity market has gone from being cheap to more fairly rated and is now more in line with long term averages and believes that, for the market to make progress, we need to see earnings growth accelerate. He says that this failed to happen in 2015 when the wider corporate sector saw minimal earnings growth, partly reflecting sterling's relative strength but also weak commodity prices. Andrew Chapman, Chairman of River & Mercantile Micro Cap feels that global instability has been a recurrent theme of late but that the extensive use of Exchange Traded Funds (ETFs) has exacerbated violent market moves, with the resultant volatility staying the hand of the Fed, leaving interest rates at record lows. In the meantime he says conditions remain healthy at the smaller end of the UK market and that the outlook remains positive for UK Micro Caps. Aberforth Partners, managers of Aberforth Smaller Companies comment that if the recent interest rate increase in the US heralds a gradual normalisation of monetary conditions around the world and bond yields are higher in twelve months' time, it is probable that [the value investment style] will have benefited from tailwinds. If, however, the rate increase proves more than the economy can take and bond yields stay the same or decline, then [value investors] will probably face headwinds similar to those of 2015. They say that this is not an outcome they can call. However, the challenge that the interest rate rise in the US represents to the broader investment world's safe and consensual preference for growth stocks is intriguing.

North America

Interest rate tightening should benefit quality stocks

Simon Miller, Chairman of BlackRock North American Income, say that the start of a tightening cycle [of interest rates], even a gentle one, should benefit those quality stocks with high profitability, stable earnings growth and low financial leverage.

Global Emerging Markets

Selective reasons for optimism in 2016. Negative sentiment at a high, which is a strong contrary indicator.

Aberdeen Emerging Capital Limited, managers of Advance Developing Markets, say that, after emerging markets experiencing a third successive year of both absolute declines and underperformance of developed markets, they see reasons for selective optimism in 2016. In their view, sentiment towards emerging markets is as negative as they can recall, which they view as a strong contrary indicator. They argue that valuations are very reasonable, both compared to history, developed markets and in absolute terms. They also comment that, at a bottom up level, discount widening and market volatility have thrown up opportunities for nimble investors in the short term, as well as for the patient ones over the longer term.

Vietnam

Despite the influence of China, Vietnam is beating its own economic drum with growth accelerating in contrast to China's deceleration.

Jean-Christophe Ganz, Chairman of VietNam Holding Asset Management Limited, comments that Vietnam is closely linked to China (geographically, politically, culturally and economically) and, because of this, the recent China developments loom large. However, in his view, Vietnam is beating to its own economic drum: in 2015 its GDP growth has accelerated to 6.7%, in contrast to China's deceleration and to the performance of most other emerging markets. He suggest that, as recent estimates suggest that aggregate global emerging market economic growth is running at about zero, Vietnam is one of the very best growth stories in the world.

UK Property

Contracting UK property yields likely to come to an end. Undersupplied segments will see income growth.

William Hill, Chairman of Ediston Property, believes that the fall in property yields that have characterised the market over the last two years may come to an end and that a greater proportion of total return is therefore likely to come from income. He believes that, with several parts of the UK property market undersupplied, the prospects for income growth are positive. Danny O'Neill, the company's CEO, believes that the economic fundamentals supporting the economy remain relatively positive. He observes that household finances have improved as a result of the low inflation environment and an upturn in real wage growth, which he believes has given rise to improved levels of business and consumer confidence. On the downside, he notes increased uncertainty over the in/ out referendum on EU membership but that recent economic woes in China appear to have lessened the prospect of an immediate increase in interest rates but the resultant volatility in equity markets is a concern. He also believes that global oil price falls and Middle Eastern geopolitical issues have the potential to impact negatively and heighten investor concerns. He is of the view that there is presently enough of a yield gap between gilts and property to provide an adequate buffer to cope with some upward movement in rates, whenever that may occur. There may, however, be some short-term volatility as investors take different positions when rates start to move.

Utilities

US shale oil is entrenched in the global supply chain. The cost of supply is falling but producers will need to be incentivised – many believe this needs a WTI price above US$60 per barrel.

Ecofin Limited, the manager of Ecofin Power & Water Opportunities, comment that opinion differs widely on the short-term outlook for oil prices but that there appears to be a broad consensus that oil produced from US shale basins has now become a lasting feature of global supply. In their view it is cheaper and getting cheaper and it can be mobilised much more quickly than much of the off-shore oil supply. They see that, as global demand grows, US supply from unconventional sources will be required and producers will need to be incentivised by a higher oil price. They say that many believe the WTI price will need to be in excess of US$60 per barrel.

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Global

(compare Global funds **here**)

Richard Killingbeck, Chairman, Bankers. For the future, I remain cautious! I continue to see headwinds across the globe from both a political and an economic perspective. Some of these, such as low economic growth, disinflation and falling commodity prices have been with us for many months if not years and new ones will emerge in the year ahead such as the UK's membership of the EU. But what I also continue to observe is that by taking the medium to long term view on companies and major economies one can escape the "noise" and focus on building on returns.

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Douglas McDougall, Chairman, Independent Investment Trust. The state of the world economy still provides plenty of cause for concern: China, so long a source of demand for other countries, is wrestling with slowing growth and an urgent need to re-orientate its economy; economic recoveries in Europe and Japan are fragile and dependent on unconventional monetary policies; tightening monetary policy in the USA may well have an adverse impact on the economies of many emerging markets; and there are signs that the momentum in corporate profits may be slowing or reversing. Any one of these issues has the scope to provide an unpleasant reaction in equity markets, but we are struck by the number of interesting new opportunities we are seeing in the UK market. Many of these are strongly cash generative businesses with apparently good growth prospects which are not especially dependent on the health of either the world or the UK economies for their prosperity.

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Richard M Martin, Chairman, F&C Managed Portfolio. The long heralded increase in US interest rates took place in mid-December. The trajectory of the interest rate cycle will not be steep and the eventual peak, in all likelihood, modest. The important point is the change of direction. The Federal Reserve wishes to gradually tighten monetary policy. The UK is some way behind and may not begin the same process until later this calendar year or even into 2017. Whilst the European Central Bank and the Bank of Japan are still in the midst of quantitative easing there is a sense that accommodative monetary policy may not offer quite the same level of support to global equity markets that it has over the last few years. That is not to say that equity markets will move into a "bear phase" rather that the driver of positive returns from equity markets may have to be different. The key from here will be earnings and dividend growth and if individual companies or sectors can achieve this then even though valuations are elevated that should not be a barrier to positive returns.

Though there is potential downside risk to markets should concerns over global growth re-emerge, on balance, equities still offer the best prospects of positive returns. Against this background the proceeds from the Cayenne Trust corporate action will be invested steadily and mainly into existing holdings.

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UK

(compare UK funds **here**)

Jonathan Cartwright, Chairman, BlackRock Income & Growth. After a sustained, if unremarkable, period of economic expansion following the financial crisis the momentum behind economic growth appears to be faltering. Whilst the recent, and long awaited, tightening in US interest rates provides some evidence that the Federal Reserve believes that the US economy can sustain modestly higher rates, elsewhere growth appears to be slowing. Further quantitative easing has been signalled for the Eurozone area. The Chinese economy is in a state of transition as it seeks to move to more domestic consumption and away from government investment in order to stimulate growth. A divergence in interest rates is likely to produce greater volatility in currency markets, with the Eurozone area seeking to avoid another recession and emerging market companies feeling the effect of a stronger US dollar on their dollar denominated borrowings.

In the UK, employment levels and average earnings growth point to a continuing, although potentially fragile, recovery. The prospect of a referendum on the UK's membership of the European Union adds some uncertainty. Although some sectors, including UK housebuilders, show signs of margin pressure, the UK market continues to offer a broad spectrum of strong companies capable of growing their dividends over time.

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Neil Hermon, Fund Manager, Henderson Smaller Companies. The outlook remains challenging with mixed economic performance across the globe. The recent rise in US interest rates has flagged to investors that loose global monetary conditions will at some stage reverse. However the 'normalisation' of monetary policy will be slow and measured. On a more positive note the collapse of oil prices should provide a boost to global growth, although certain oil producing economies are seeing a negative impact on their economic performance.

In terms of valuations, the equity market has gone from being cheap to more fairly rated and is now more in line with long term averages. To see the market make progress we need to see earnings growth accelerate, a situation which failed to happen in 2015 when the wider corporate sector saw minimal earnings growth, partly reflecting sterling's relative strength but also weak commodity prices.

If corporate confidence improves, M&A will increase, especially as little or no return can currently be generated from cash and the cost of debt is historically low. This is a trend which will help smaller companies in particular as mergers and acquisition activity tends to be focused in this area.

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Andrew Chapman, Chairman, River & Mercantile Micro Cap. The UK remains amongst the top performing economies in Europe, and indeed globally, which attests to the judicious balance between prudent fiscal policy and accommodative monetary policy. In a defining event for the future of the UK - the general election - the result was a surprisingly conclusive backing of the prudent fiscal policies advocated by the Conservative Party. The decisive majority result has given a firm mandate to continue with the current approach, resulting in materially reduced uncertainty compared to a prior expectation for protracted coalition negotiations. It is therefore unsurprising that the domestically oriented (smaller cap) indices have outperformed over the period compared to the more globally oriented FTSE 100.

Global instability has been a recurrent theme of late, with another Greek crisis averted after protracted negotiations but a new crisis emerging with the implosion of the Chinese equity market bubble. Volatility was also aggravated by the change in direction of the renminbi as investors mulled the latest twist in the global currency devaluation war which is ultimately a zero sum game that is unlikely to confer lasting benefits to anyone. Ultimately however it is the extensive use of Exchange Traded Funds (ETFs) which exacerbated violent market moves, with the resultant volatility staying the hand of the Fed, leaving interest rates at record lows. In the meantime conditions remain healthy at the smaller end of the UK market, given that the lack of ETFs resulted in less disruption in the evaluation of exciting growth companies. With continued domestic and stock-specific growth, the outlook remains positive for UK Micro Caps.

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Aberforth Partners LLP Managers, managers of Aberforth Smaller Companies. If the recent interest rate increase in the US heralds a gradual normalisation of monetary conditions around the world and bond yields are higher in twelve months' time, it is probable that [*the value investment style*] will have benefited from tailwinds. If, however, the rate increase proves more than the economy can take and bond yields stay the same or decline, then [*value investors*] will probably face headwinds similar to those of 2015. The outcome is not one that the Managers are able to call. However, the challenge that the interest rate rise in the US represents to the broader investment world's safe and consensual preference for growth stocks is intriguing.

Closer to home, the outlook for the UK's corporate sector is undeniably cloudy. Demand is challenged by the uncertain pace of growth in much of the world, while costs are, at last, coming under pressure from wages rising above the rate of inflation. Sliding commodity prices - particularly that of oil - offer some mitigation, but a squeeze on margins is plausible. It should not come as a surprise if the profit growth expected by the market for small companies in 2016 - currently around 9% - once again proves too ambitious. In mitigation, balance sheets do not appear stretched across the investment universe in general. Moreover, another year of above average dividend growth from small companies looks likely.

For the Managers, the most encouraging factor is that of valuation. The investment universe continues to offer up numerous attractively valued investment opportunities. Indeed, the consolation of a year in which growth stocks have led the Numis Smaller Companies Index (ex Investment Companies) higher is that the valuation gap between growth and value has widened.

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North America

(compare North American funds **here**)

Simon Miller, Chairman, BlackRock North American Income. The Federal Reserve has kept investors guessing about the eventual timing of the first interest hike in nine years, having held rates at the near-zero levels set during the financial meltdown in 2008. Federal Reserve officials have been carefully monitoring the U.S. economy for an economic upturn. At their meeting on 16 December they announced the first rate increase since the middle of 2006. The start of a tightening cycle, even a gentle one, should benefit those quality stocks with high profitability, stable earnings growth and low financial leverage.

Global Emerging Markets

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

Aberdeen Emerging Capital Limited, managers of Advance Developing Markets. In the Company's annual report published a year ago, we stated our belief that "positive surprises in terms of growth, reform or political change" would be required to prompt a turnaround in the performance of emerging market assets. Sadly, what occurred instead in 2015 was continued deterioration in most of these factors, with the trend for weaker currencies, energy and commodity prices prevailing and further political and governance issues generating volatility and weighing negatively on sentiment. Investors responded by withdrawing a record USD 73 billion from dedicated emerging market funds over the year according to EPFR data.

With emerging markets experiencing a third successive year of both absolute declines and underperformance of developed markets, some commentators have called into question the traditional aggregation of such a diverse group of markets into a single asset class. We disagree and see reasons for selective optimism in 2016.

Sentiment towards emerging markets is as negative as we can recall, even during the depths of the global financial crisis, which we view as a strong contrary indicator. Valuations are very reasonable, both compared to history, developed markets and in absolute terms. In China, while one may question the authorities' methods, we believe a soft landing is being managed. Those same authorities have significant levers they can still pull to avert a crisis, which cannot be said of other emerging markets including Brazil and South Africa, where a turnaround seems dependent on reform or a strong pick-up in global demand and thus export prices. The Chinese market itself is set to grow within an emerging market context, as an increasing number of companies are included in Chinese indices over the coming years. In markets such as India and Mexico, the macroeconomic outlook is robust, although valuations in those markets are commensurately higher. In Eastern Europe, highly attractive valuations, moderate growth and the potential for further stimulus point to better times ahead for investors.

At a bottom up level, discount widening and market volatility have thrown up opportunities for nimble investors in the short term, as well as for the patient ones over the longer term. The same type of inefficiency at a stock specific level is what has enabled many of our underlying managers to perform admirably in what has been a challenging environment, and we are confident that they will continue to do so.

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Vietnam

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

Jean-Christophe Ganz, Chairman, VietNam Holding Asset Management Limited. Slowing Chinese growth has hit the emerging world particularly hard, given the supply-chain, commodity sector, and financial linkages involved. Meanwhile, partly as a result of this slowdown, many markets have reacted to the initial lead from the Chinese authorities, who reduced the value of the Renminbi versus the US Dollar, by ca. 5.5% in total since the initial move in August, and by a further ca. 2% so far in January 2016 at the time of writing.

Vietnam is, of course, closely linked to China - geographically, politically, culturally and economically. Because of this, the recent China developments loom large. However, Vietnam is beating to its own economic drum: in 2015 its GDP growth has accelerated to 6.7%, in contrast to China's deceleration and to the performance of most other emerging markets. Recent estimates suggest that aggregate global emerging market economic growth is running at about zero, making Vietnam one of the very best growth stories in the world.

Vietnam, for its own part, continues to move in the right direction with the bulk of its economic policymaking decisions. These include: (a) the raft of new free trade agreements, which Vietnam stands to benefit from directly in terms of long term export performance, and indirectly from their implications for reforms at home, both acting to raise the country's long term sustainable growth rate by in excess of 1% p.a.; (b) the steady if slow recovery from its recent non-performing loan problems of the past five years; (c) its improved attention to infrastructure development and its willingness to involve the private sector in it; and (d) the attempt to improve the rate of privatisation of state-owned enterprises.

The most important weaknesses it needs to improve are (a) a willingness to allow, indeed force, the disposal of bad debts to new owners from both the government's bad debt warehouse (the Vietnam Asset Management Corporation, VAMC) and from the banks themselves; and (b) a more vigorous and effectual approach to privatisation that generates dramatic change in the outlook for drearily-run state-owned enterprises.

These two efforts alone would truly amount to a new revolution for Vietnam's economy and make the overall Vietnamese investment case unambiguously superlative.

The Impact of China's Troubles On Vietnam

...to assess the impact on Vietnam of the economic and financial situation in China. We see three main considerations to weigh:

#1: The direct trade effects of slowing economic growth in China:

Though Chinese government pronouncements are still proclaiming a GDP growth outlook of 6.5% (already itself a notable slowing from the average of the past decade) the growing opinion is that the true outcome for the coming year or two - even if the official data is fiddled with to hide the truth - will be significantly worse than this. Somewhere in the 2-4% range is more likely, and possibly worse still. A source of particular worry is the Chinese economy's high level of total debt. At USD 23tn-29tn (depending on the data source), it is a high 230%-290% of its GDP, with over half of it owed by non-financial corporations. A sizable ratio when compared with other countries. As of last year, China is the world's largest economy on the basis of purchasing power parity, and the world's top exporting nation. It is unavoidable that a slowdown will affect most other nations' growth negatively. This will be seen in both slower Chinese demand for imports and increased competition from Chinese exports in global markets.

Vietnam looks very resilient here, relative to most other markets. It is a massive net importer from China, not net exporter: imports equal to roughly 25% of her GDP, exports about 8%. If the imports from China were to get cheaper (a possibility in such a scenario), that would be helpful to Vietnam. The export number of 8% of GDP is on its own quite significant, and there could be some vulnerability here; however, these export items are mostly soft commodities with low elasticity of demand. A slowing of global growth would see weaker demand conditions in other major export markets, presenting greater challenges for Vietnam. However, it is worth noting the recent strong performance of Vietnamese exports - up 8% YoY in 2015, despite declines in most other Asian countries including China. This demonstrates that Vietnam is improving its market share from a very low base, a trend that we expect to continue.

Our conclusion is that Vietnam's economic growth should remain broadly strong, with one of the very fastest growth rates in the world, even if China slows dramatically. That's not to say that 2015's 6.7% GDP growth will necessarily be maintained or increased, but we'd be surprised if the "floor" scenario for Vietnam is less than 5%. Even that rate would represent a very good growth scenario, in a world where overall global emerging market growth is already hovering at little more than zero.

#2: The effect on Vietnam of a weaker renminbi:

With the renminbi down some 6% versus the US dollar since August, we have the benefit of hindsight to see what the impact on Vietnam of this has been - if the renminbi falls, the Vietnamese dong may fall too. At heart, Vietnam and its investors see the country as an export manufacturing alternative or supplement to China, and therefore are sensitive to the relative costs of operating there. Additionally, there are major Vietnamese industries such as steel that the government will be very keen to protect from the threat of cheaper Chinese imports. A weaker currency protects a nation's cost competitiveness, but it has three relevant negative effects: (a) it makes dollar GDP less than it would otherwise be, essentially making the country's people poorer; (b) it makes generating returns harder for dollar investors such as VNH; and (c) as a "surrogate share price of a country", a weak currency is generally negative for investor confidence. We need to plan for a return of dong weakness versus the dollar - the first time since 2011 that this has been a major factor. Good investor returns are still possible, because there are companies that can be expected to benefit from a weaker currency. And it is worth remembering that relative to other Asian emerging market currencies over the past few years, the dong has held up very well:

#3: The effects of a falling Chinese stock market, lower capital flows into emerging markets, and a higher cost of capital:

It is rational, under the economic scenario we described, to expect continuing weakness and volatility in the Chinese stock market. This certainly can pose a problem for Vietnam, given the heightened correlation between the Chinese and Vietnamese stock markets observed over the past year:

This correlation may or may not hold, and there are arguments for considering it fundamentally unjustified. For example, the different stages of economic development, and completely different stock market profiles - Vietnam market cap is USD 55bn versus Shanghai/Shenzhen at USD 6.7tn; the Vietnam trailing P/E is 11x versus China at 28x. Despite these significant differences in the two markets, a strong recent correlation is an immutable fact.

A troubled China is not the only bad news bedevilling major emerging markets. From Russia to South America, negative developments have led to a halt in net capital inflows into emerging and frontier markets as a whole. In 3Q2015 this net flow of equity and debt was zero. The good news is that Vietnam is not primarily a "hot money" destination. The foreign ownership in its stock markets is mostly in the form of dedicated country funds and other long-term institutional holders. The foreign direct investment component (USD 14.5bn in 2015) of inward capital flows remains large, and inward remittances (USD 12.5bn in 2015) are also sizable and steadily growing. Importantly, most of these inflows are from countries other than China. Certainly a more difficult environment for foreign capital inflows into emerging markets is not helpful for Vietnam, but it seems to be very resiliently positioned in this regard. It's also worth noting that Vietnam's inward flows of FDI and capital generally are mostly not from China.

The global cost of capital - for both equity and debt - is on the rise because of the new US interest rate cycle, the negative issues in giant China, and the tarnished outlook for emerging market assets in general - much of this self-inflicted. This upstream current of higher costs of capital will inevitably apply to Vietnam too, although the country has the potential to differentiate itself from its peers through its improved governance and more enlightened economic policymaking.

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UK Property

(compare UK Property funds **here**)

William Hill, Chairman, Ediston Property. The Board believes that the fall in property yields that has characterised the market over the last two years may come to an end. A greater proportion of total return is therefore likely to come from income. With several parts of the UK property market undersupplied, the prospects for income growth are positive.

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Danny O'Neill, Chief Executive Officer, Ediston Real Estate, managers of Ediston Property. As we start 2016 the economic fundamentals supporting the economy remain relatively positive. GDP growth, while fragile, remains around trend levels, providing a reasonable backdrop to a supply-constrained property market. The economy is experiencing a period of benign inflation, interest rates remain low and the country enjoys high employment. Household finances have improved as a result of the low inflation environment and an upturn in real wage growth and have resulted in improved levels of business and consumer confidence.

On the downside, there is increased uncertainty over the in/ out referendum on EU membership. Recent economic woes in China appear to have lessened the prospect of an immediate increase in interest rates but the resultant volatility in equity markets is a concern. Global oil price falls and Middle Eastern geopolitical issues also have potential to impact negatively and heighten investor concerns. The potential impact of a rise in UK interest rates has been subject to significant commentary, given the historic relationship of UK gilts to property yield. We are of the view that there is presently enough of a yield gap between gilts and property to provide an adequate buffer to cope with some upward movement in rates, whenever that may occur. There may, however, be some short-term volatility as investors take different positions when rates start to move.

One of the most encouraging dynamics of the current property cycle is the limited supply of new property throughout the UK. The lack of development since 2008, particularly in regional locations, has arisen as investors shied away from risk and banks withdrew funding for speculative projects. As a consequence we are witnessing historically low vacancy rates across the UK and the potential for rental growth is positive.

The combination of positive economic and supply-demand conditions, along with the sizeable weight of money that has flowed into the sector, may have created another record year for investment volumes in the sector in 2015. Prime yields in London have surpassed those at the peak of 2007 and, in many cases, this also applies to numerous regional locations with the phenomenon applying across all use classes. We are, however, now witnessing yield compression slowing and it appears we are moving into a different phase of the market where 'market' yield improvement ends and returns reduce to healthy positive single-digit territory, supported by a generous income yield relative to other asset classes.

As investors adapt to this new dynamic there should be reassurance that the market still offers prospects for healthy positive returns. UK institutions invested more money into UK regions in 2015 than they did in 2014 and, logically, this is in expectation of better returns in these areas than from London at current price levels. We too have witnessed more competition for assets in the regional markets, with some headline-grabbing yields being paid by UK institutions and US equity funds, supported by higher levels of gearing. This is, however, not reflective of the whole market, as we believe value can still be acquired in locations where rental growth should be achieved in the coming cycle.

With a limited supply pipeline and a low interest rate environment, we remain optimistic about the market's prospects in 2016 with the likely prospect of acquiring good-quality assets in a slightly less-crowded marketplace. However, we do continue to try and identify what the catalysts for change may be and whether the market is ignoring them or not. There is some aggressive pricing being paid for assets and there is a risk of that pricing getting ahead of itself and to a level for which rental growth will not sufficiently compensate. We have witnessed a number of real estate analysts calling the 'top of the market', which may in itself have a negative impact on sentiment. However, it does not follow that every peak has a sharp drop at the other side.

There are clearly positive attributes to the sector. There may well be a yield price correction at the prime end of the market, or in a particular sub-sector or location where things get 'too hot', but the market is generally well-placed to deliver returns closer to income levels.

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Utilities

(compare split capital funds **here** – Note: all the utilities funds have a split cap structure and reside within the split cap sector)

Ian Barby, Chairman, Ecofin Power & Water Opportunities. In the opinion of the Investment Manager, world equity markets are likely to continue to be volatile in the face of uncertainty about the outlook for world economic growth and interest rates and as investors react to individual items of economic and political news. The Investment Manager believes, however, that much of the sell-off of unregulated power utilities and companies, such as regulated pipelines, that are perceived to have an exposure to energy commodity prices - as well as of companies in the energy sector itself - is cyclical, and not secular, in nature and driven primarily by the precipitous decline in the oil price over the past eighteen months.

Many industry analysts believe that when the surplus of oil production over demand is resolved by market forces a significantly higher oil price will be required to incentivise the production that will be needed to meet demand.

Over the longer term, the Company's Investment Manager believes that structural changes taking place in the global utilities sector, the need to replace ageing plant and to build new energy infrastructure and the growing importance of renewable energy generation - as well as the world's huge infrastructure needs - will give rise to opportunities to earn superior equity returns.

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Ecofin Limited, Investment Manager, Ecofin Power & Water Opportunities. Opinion differs widely on the short-term outlook for oil prices and the future structure of the global oil and gas industry. There appears to be a broad consensus, however, that oil produced from US shale basins has now become a lasting feature of global supply; it is cheaper - and getting cheaper - than much off-shore oil and it can be mobilised much more quickly. As global demand grows, US supply from unconventional sources will be required and producers will need to be incentivised by a higher oil price - a WTI price which many believe will need to be in excess of US$60 per barrel.

With respect to the outlook for the global economy, the IMF is forecasting an acceleration of growth in 2016; from 3.1% in 2015 to 3.6% in 2016 for the global economy; from 2.0% to 2.2% for the advanced economies and from 4.0% to 4.5% for the developing economies. Most private forecasters are in agreement that growth should be stronger in 2016 but they, like the IMF, caution that large downside risks remain including the risk that China's growth slows more than expected as its transition to a more balanced economy falters, consumer spending disappoints in the developed economies, problems return in the Euro area and that weak commodity prices and tightening financial conditions stifle growth in the developing economies. In the financial markets, the principal development is likely to be a divergence in monetary policy as the US Federal Reserve raised policy interest rates on 16 December, 2015, the United Kingdom's moving closer to a rate hike and the European Central Bank is continuing its policy of quantitative easing. Overlaying all of this is geopolitical risk as the U.K. is likely to hold its referendum on leaving the European Union in 2016, Germany and France approach elections in 2017 and Europe struggles with a continuing refugee crisis - not to mention the geopolitical risk associated with the Middle East.

In the global utilities, infrastructure and energy industries, the outlook remains for more structural change against a background of very large investment requirements. The world's power generation mix is changing: traditional coal-fired generation is in decline due to environmental considerations; gas is increasingly the fuel of choice and the construction of wind and solar renewable energy plants is growing dramatically, albeit from a small base. These developments are creating attractive opportunities among companies that have shown they can respond quickly to change and in the renewable energy sector. They will also require massive new investment in transmission networks for both gas and electricity. Government energy policies, however, remain a work-in-progress as governments struggle to balance the trilemma of energy security, energy costs and low emissions - often summarised as "safe, cheap and green." Many of these developments are disruptive of the traditional corporate structures and strategies of the utility sector and, as a result, the outlook is for an increase in corporate activity - that is, mergers, acquisitions, spin-offs and restructurings - and for a broad dispersion of investment returns in the sector.

In the infrastructure sector, investment requirements and the returns of operators and service providers are closely associated with economic growth, and specifically traffic volumes and industrial production. An acceleration of growth, particularly in Europe, should, therefore, be beneficial for the sector. Finally, although the dislocation brought about by the collapse in the oil price has had far-reaching effects, the investment requirements in the infrastructure sector in the United States are still substantial. The resilience of oil and gas production from unconventional sources has proved a point - namely that such production is now a permanent and flexible part of global oil and gas supply. As a result, we believe selected energy infrastructure investments are still attractive - such as regulated pipelines which are a business leveraged to volumes, not prices. We also believe that the fall in the oil price and weakness in energy commodity prices in general have given rise to a number of attractive opportunities in the power sector for investors with a longer-term view.

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