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Monthly summary | Investment Companies

6 July 2016

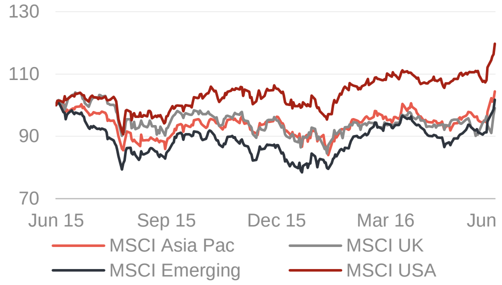
Economic & Political Roundup

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	30/06/16	Chg. on month %
USD / GBP	1.3311	-8.1
USD / EUR	0.9004	+0.2
USD / JPY	103.2	-6.8
USD / CHF	0.976	-1.8
USD / CNY	6.648	+1.0

MSCI Indices rebased to 100

Time period 30/06/15 to 30/06/16



Source: Bloomberg and Marten & Co

	30/06/16	Chg. on month %
Oil (Brent)	49.68	0.0
Gold	1321.9	+8.8
US Tsy 10 yr yield	1.4697	-20.4
UK Gilt 10 yr yield	0.867	-39.3
Bund 10 yr yield	-0.131	n/m

The UK's vote to leave the EU has sideswiped markets as most investors seem to have been anticipating that the vote would go the other way. The main effect has been to weaken the pound, strengthen the gold price and trigger a further fall in government bond yields. The political fallout in the UK has been significant but the vote has also boosted the hopes of anti-EU political parties across Europe.

Please bear in mind that many of the comments included within this note were written ahead of the vote.

Global

May commentators sound notes of caution on valuations. There are worries over threats to free trade.

Graham Meek, chairman of Capital Gearing, sounds a bearish note, highlighting the threat to free trade from the referendum vote amongst other things. Alastair Laing and Peter Spiller, the managers of that fund, say financial markets are as distorted as any time in history and say, given the macroeconomic risks are combined with very high asset prices it seems reasonable to expect better investment opportunities in the future than are available today. Robin Angus and Sebastian Lyon, the executive director and investment adviser for Personal Assets, say, seven years into a cyclical bull market, equities are living on borrowed time and the link between profit and performance is all but broken. They sense a reappraisal of stock valuations has begun.

Global …continued from page 1

Harry Wells, chairman of Establishment Trust, points out that, despite the unprecedented level of interest rates and monetary accommodation, global growth remains elusive. Blackfriars Asset Management, managers of that fund, examine the situation in China and conclude that the economic stimulus there is unsustainable, they do not trust the bounce in commodity prices and believe deflationary pressures remain intense. Richard Ramsay, chairman of Seneca Global Income & Growth, acknowledges that government bonds are expensive but thinks it may be a little while before a bond bear market finally arrives. The managers of that fund are a little more upbeat, thinking that private sector confidence, battered by the events of the economic crisis, is taking a long time to recover but this does not mean that it will not do eventually. Richard Killingbeck, chairman of Bankers, thinks the lack of confidence in corporate boardrooms could persist or worsen as the US Presidential election looms.

UK

Mixed views about the UK market with some believing valuations look high whilst others think they are supported by very low gilt yields. Smaller companies are seen as more attractively valued than large caps.

Schroder Investment Management, managers of Schroder UK Mid Cap, think the new national living wage could boost consumer spending but poses a threat to UK corporate earnings. They also see the chance of overseas investors taking advantage of the weak pound to make acquisitions in the UK. Angela Lascelles, manager of Value & Income, looks at the UK equity market's yield in comparison to the yield on gilts and concludes valuations discount concerns about Brexit and slower growth overseas. Mark Barnett, manager of Perpetual Income & Growth, thinks earnings growth in many sectors may disappoint and, given valuations are not obviously cheap, believes overall returns from equities may be subdued for the time being. Kathryn Matthews, chairman of Montanaro UK Smaller Companies, asks investors to avoid letting politics distract their attention and to take a long-term view of investment in the UK small cap sector. The managers of that fund say smaller companies are trading at a discount to large cap.s, low fuel prices and interest rates are supportive of the consumer and company's balance sheets are in good health. They say there are reasons for cautious optimism. Hugo Twiss MBE, chairman of Invesco Income Growth, says the increased uncertainty in the macro environment is going to mean very low interest rates for some time to come. Jonathan Cartwright, chairman of BlackRock Income & Growth, writing after the referendum result was announced, thinks it is reasonable to expect that the UK will be able to negotiate satisfactory trading arrangements with its European neighbours. Norman Yarrow, chairman of Dunedin Smaller Companies, thinks markets are reasonably fully valued and will remain volatile although he sees more value in smaller companies than larger ones. Peter Jones, chairman of Henderson Opportunities, looks to the longer term when markets have priced in the effects of Brexit and expects well-managed businesses to be more highly rated.

Asia ex Japan

Chinese credit growth is worrying many commentators. India seen as a bright spot in the gloom.

Carol Ferguson, chairman of Invesco Asia, points out that elevated Chinese debt levels are a continuing structural imbalance but, in India, the government is making progress with tackling barriers to growth. Ian Hargreaves, manager of that fund, views a recovery in Chinese property demand as fleeting and says a reacceleration of credit growth in China is unwelcome. By contrast, he believes India is one of the few economies close to the bottom of its credit cycle. Nicholas Smith, chairman of Schroder Asia Pacific, seems cautious. He points out that, for many investors, the point of Asian equities is rapid growth in corporate profits but the region has not provided that for a while. The managers of the fund seem nervous about China's credit growth, warning that it is raising the risks of a more severe slowdown.

Global emerging markets

Emerging economies still growing faster than developed ones.

Carlos Hardenberg, manager of Templeton Emerging, is keen to highlight that there is faster GDP growth in emerging markets than in developed countries, even with Brazil and Russia in recession. The team managing Aberdeen Emerging Markets think Chinese authorities have significant means at their disposal to avert a crisis but caution that the rally in Brazilian markets looks fragile.

China

China – short-term worries about problem loans but long-term opportunity from growth of middle class.

Dale Nicholls, manager of Fidelity China Special Situations, says Chinese banks are understating their non-performing loans and the authorities have sometimes failed to communicate policy changes effectively. At the same time, he is positive about the long-term investment potential created by China's growing middle class.

India

Reasons for optimism, especially in light of banking sector clean-up.

Hasan Askari, chairman of New India, says there is growing optimism that political differences will be set aside in a bid to advance the legislative agenda in India. The managers of that fund take a sector-by-sector look at the Indian economy and conclude there is cause for optimism. In particular, they highlight the RBI's clean-up of the banking sector.

Japan

Negative interest rate policy called into question.

Aberdeen Japan's managers say the negative interest rate programme does not seem to be having a meaningful impact on consumption and investment. The managers of JPMorgan Japan Smaller Companies say the downside risks are greater now than six months ago, citing the strength of the yen, the planned increase in the consumption tax, low growth and low inflation. Harry Wells, chairman of CC Japan Income, focuses on the rising yield on the Japanese market, helped by rising dividend payout ratios. The managers of that fund say the strength of the yen following the adoption of the negative interest rate policy, calls into question the credibility of the government's reflation strategy.

North America

Economy still expanding but the upcoming election creates uncertainty

Andrew Bell, chairman of Gabelli Value Plus, says investors have been cheered by the slowing pace of interest rate rises. The managers of that fund say it is hard to see a US recession materialising over the next year given firm consumer spending, low oil prices and an expansionary monetary policy. Simon Miller, chairman of BlackRock North American Income, says the forthcoming Presidential election adds an element of unpredictability to markets.

Russia

Higher oil prices would help. Hope of positive earnings revisions

Gill Nott, chairman of JPMorgan Russian, sees some upside in Russia if oil prices continue to strengthen. Oleg I. Biryulyov, the manager of that fund, is expecting positive earnings and revisions from the third quarter onwards.

Biotechnology & healthcare

No significant impact from US election

Sam Isaly, manager of Worldwide Healthcare, takes a comprehensive look at the sector. He says he firmly believes that there will not be adverse impact on the revenue and earnings of large cap pharmaceutical companies post the US election.

Regional UK property markets supported by lack of development activity

There is also comment on the Debt, Environmental, Renewable Infrastructure, and Resources sectors. We conclude with a look at the UK property sector where the team behind Picton Property Income say, in many markets a lack of development activity and limited supply should be supportive of current pricing. A point reiterated by many other management teams.

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Global

(compare Global funds **here**)

Graham Meek, chairman, Capital Gearing: Apparently slowing growth in GDP in several key economies, consistently high debt levels, and the feeling that central banks may be scraping the barrel of monetary policy ingenuity, all point to a difficult year ahead for bond and equity markets. Additionally, neither the risk of geopolitical strife in the Middle and Far East nor threats to free trade from upcoming political events in the USA and UK bode well for market progress.

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Alastair Laing and Peter Spiller, managers, Capital Gearing: Financial markets are as distorted as any time in history, as evidenced by one third of all government debt trading on negative yields. That in turn reflects the extraordinary fiscal and monetary policy that has been deployed by governments and central banks. All this is an effort to avoid the natural consequences of the excesses that preceded the Great Financial Crisis. The most significant of those excesses was the level of debt which rose alarmingly in the developed nations up to 2008. For the world as a whole, debt has risen much further as a percentage of GDP since the crisis, exacerbated by an extraordinary expansion in China. The solution to the problem of debt has been more debt.

Against that background, low growth in nominal GDP would cause disaster and central bankers are prepared to take high risks to stimulate growth and inflation so as to avoid the defaults that threaten both corporate and sovereign bonds. It is unclear if the world economy is entering a period of renewed weakness, but if it is, then the central banks will be tempted by the next extension of QE, namely monetary finance. That involves increasing government expenditure on infrastructure, or tax cuts, or simply handing out cash to citizens, financed by printed money. Such a policy would surely succeed in raising both growth and inflation; the difficulty is in calibrating the latter. Governments can always promote inflation if they are aggressive enough, just not 2% inflation.

Whether the economy holds up or not, the yield curve could steepen markedly sooner or later, undermining both bond and equity markets. The latter looks particularly vulnerable as valuations only make sense if current low interest rates persist indefinitely. Implicit in persistently low interest rates is persistently low nominal GDP growth which means current record high levels of corporate profits would prove unsustainable.

As always there are political and macro economic clouds on the horizon. A few potential concerns include a hard landing in China, economic problems in the Eurozone, growing political unrest in the European periphery, Brexit, military tension in the Middle East, and the threat of protectionism growing in the shadow of US politics. Given these risks combined with very high asset prices it seems reasonable to expect better investment opportunities in the future then are available today.

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Robin Angus, executive director and Sebastian Lyon, investment adviser, Personal Assets: The late Yogi Berra said that, "It's tough to make predictions, especially about the future". How right he was! This cycle, since 2009, has been notable for the over-optimism of policy makers, economists and strategists. Falling inflation from the mid-1980s allowed for lower interest rates, encouraging consumers to save less, spend more and take on ever more debt. This peaked in the mid-2000s, coinciding with the top of the US housing market. Consumers then grew nervous and stopped borrowing, leaving governments and companies to take up the slack. Accordingly, growth in GDP and corporate earnings has slowed to a snail's pace. Extravagant baby boomers who were 20-35 years old in 1985 now face retirement - not a time of life to be spending. This may explain why, despite record low interest rates, borrowing has been losing its appeal to individuals. Companies are happier to take on debt but are not prepared to invest when demand has been so feeble, preferring instead to buy back stock to massage upwards their earnings (and sometimes, indirectly, their directors' remuneration).

Seven years into a cyclical bull market, equities are living on borrowed time and the link between profit and performance is all but broken. In the past two years UK company earnings have fallen while 16 FTSE 100 constituents have cut or passed their dividends (in some cases twice). In the United States S&P 500 earnings have fallen for six straight quarters, while the gap between Generally Accepted Accounting Principles ("GAAP") profits and flattering 'adjusted earnings' has been wider only during the recessions of 2001 and 2008. Falling earnings and latterly dividends, with only very modest declines in the stock market from all-time highs, have pumped up valuations even higher. Why? Because investors have felt compelled to pay more for less - not in the expectation of better growth in future but owing to the lack of other options and the stark need for yield.

The world's central bankers, today's reluctant captains of economic policy, are finding it hard to extricate themselves from their unorthodox polices. On the contrary, attempts at normalisation of interest rates have encountered the law of diminishing returns. Recent decisions by the Bank of Japan and the European Central Bank aimed at debasing their currencies have been own goals while the US Federal Reserve's decision to increase interest rates for the first time in nine years is looking like a clamber up the interest rate hill while the prevailing path slopes downwards. Gold bullion remains an essential insurance against central bankers losing control of their monetary policies.

Investors today find themselves in an unenviable position. They can lock in very low returns by investing in high risk bonds and equities, or they can wait for better opportunities and the prospect of improved future rewards while accepting even lower returns in the short term. Our approach has always been to assess the likelihood and the possible extent of the downside rather than make the tempting mistake of extrapolating the upside. Dividend growth, once the engine of share price growth, cannot today be relied upon - equities offer not just capital risk but income risk as well. We sense that a reappraisal of stock valuations has begun. Once it has taken place, we look forward to being more fully invested. To quote Yogi Berra again, "The future ain't what it used to be"."

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Harry Wells Chairman, Establishment Investment Trust: China's credit excesses are "chickens coming home to roost". Continued quantitative easing by the European Central Bank and the Bank of Japan is designed to head off these deflationary threats. No less than five central banks have embraced negative interest rate policies while many sovereign bond yields have entered into negative territory. Despite the unprecedented level of interest rates and monetary accommodation global growth remains elusive. Softer economic data from the United States has cast doubt over the likelihood of the Federal Reserve increasing interest rates further, even though they would perhaps like to do so. Indeed, the first move by the Federal Reserve to increase rates, in December 2015, caused shock in world markets. Any attempt to raise US rates again, without regard to the realities of the world economy may result in renewed US dollar strength. This, in turn, will create renewed stress in emerging markets, given the extent of international US dollar financing. These extraordinary economic and monetary conditions are unprecedented and make it challenging for investors to navigate concomitant volatility and the valuation of assets with any confidence. Stability in equity prices appears in many cases to be determined by the level of dividend income and supportive cash flow. We are also in an exciting era of rapid technological development spawned and accelerated by the digital age, which is potentially massively disruptive for many traditional industries and business models.

Furthermore, certain countries in Asia face specific challenges. Those with good demographics and robust domestic demand profiles continue to grow strongly. Asia remains an excellent long term investment proposition, while valuations, as measured by price to book, seem reasonable being one standard deviation below the long term average even though corporate earnings expectations remain subdued.

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Blackfriars Asset Management, managers of Establishment Investment Trust: The global economy remains in a difficult place. The rapid slowdown in the Chinese economy in the second half of 2015 saw commodity prices resume their decline; The Thomson Reuters CRB Commodity Index fell by one quarter in the second half of 2015 and, despite the recent bounce, currently stands at roughly one third of its 2008 peak. The shipping industry remains in freefall; the Baltic Dry Index (first published in January 1985 at 1,000) fell to 290 in February 2016 - a level never seen before. Although the index has since doubled, daily charter rates remain miles below fully costed break-even levels. It is surprising perhaps that, in March this year, three Chinese Ship operators (Cosco, China Merchants and ICBC Financial Leasing) placed a $2.5bn order for 30 Valemax bulk carriers. With a capacity of 360,000 tonnes, a Valemax is almost three times the size of a Capesize bulk carrier.

Quantitative easing in Japan and Europe has done little, if anything at all, to improve underlying domestic demand. While the United States undoubtedly remains the best of a bad bunch, forecasts of further rate rises in the United States since the Federal Reserve lifted short term rates last December swing from month to month depending on data releases which continue to send mixed message. For example while residential investment grew 14.8% quarter-on-quarter at a seasonally adjusted annual rate in the first quarter of 2016, non-residential investment fell by 5.9% quarter-on-quarter at a seasonally adjusted annual rate.

In Asia it is useful to observe South Korea, a decent sized and relatively open economy that competes with neighbours China and Japan in many industries such as the steel, shipbuilding, autos and electronics. Exports, which have essentially flat lined for the past three years, fell 13.3% year-on-year in the first quarter of 2016. Domestic consumption fell 0.3% quarter-on-quarter seasonally adjusted annual rate and capital expenditure plunged 5.9% quarter-on-quarter at a seasonally adjusted. Growth forecasts for 2016 continue to be downgraded; the Bank of Korea expects growth to be 2.8%.

This Korean "backdrop" gives an interesting read through to China, the most important economy in Asia, and perhaps, at present, the world. The credit boom, and consequent over-investment post the global financial crisis, has been well documented and the chickens are coming home to roost, especially across the heavy industry and commodity sectors. While reported non-performing loans across the Chinese banking industry remain implausibly low, the direction is ominous. Non-performing loans rose 51% in 2015 while special mention loans rose 37%. Domestic bond defaults are on the rise including some bonds issued by State Owned Enterprises (SOEs). In theory these SOEs have the support of local or central government, but in practice it appears that some SOEs are "more equal than others".

For a banking sector that traditionally defined risk in a binary manner (a loan to an SOE was risk free, a loan to a private company or individual was risky) this is a truly terrifying development!

The authorities have reacted to the slowdown in a predictable fashion. Fiscal policy has been eased with infrastructure projects fast tracked and credit growth ramped up. Total Social Financing rose 41.8% in the first quarter year-on-year with over US$1trillion of new credit extended. Unsurprisingly, economic activity has picked up and China was able to report GDP growth of 6.7% in the first quarter - bang in line with the 6.5-7.0% forecast announced at the recent National People's Congress.

[*We are*] equally convinced that this stimulus is unsustainable and, having pressed the pedal hard, there are already signs that the authorities are reigning in credit growth. Total Social Financing in April fell 68% month-on-month and 29% year-on-year. [*We do*] not trust the recent bounce in commodity prices and believes deflationary pressures remain intense. Our exposure to China is limited to cash flow generative businesses operating almost exclusively in the consumer sector. The tertiary, or service, sector in China continues to grow reasonably consistently and there are good investment opportunities.

Elsewhere in Asia, the divide remains fairly simple. Industrialised North Asia (Japan, Korea and Taiwan) remains exposed to flaccid global trade volumes while deteriorating demographics remain a persistent drag on domestic demand. In stark contrast, less industrialised South Asia is enjoying positive demographic trends that are propelling strong growth in domestic demand. The Philippines remains the economic poster boy of the region while Indonesia and India also have excellent stories to tell. All three should post GDP growth of 6-7% in 2016 and corporate earnings will reflect this.

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Richard Ramsay, chairman, Seneca Global Income & Growth: As usual, it is prospects for the global economy that most aptly shape the investment outlook. Indeed, they may be more important than ever, in light of the fact that unconventional monetary policy across the developed world appears not to have had its desired effect of stimulating growth. Furthermore, China's economy has continued to slow and some form of hard landing remains a possibility.

Why both growth and inflation in many parts of the world are still low, given the vast amounts of monetary stimulus injected by central banks, is not precisely clear. There may well be forces at work of a structural nature that have made it harder for ultra-loose monetary policy to rouse economies from their post-crisis funk. Falling population growth, reduced need for capital to start and grow companies, and income and wealth distribution disparities all serve to lower growth potential, making it harder for monetary policymakers. Furthermore, fiscal austerity was supposed to lower real interest rates and in so doing boost private sector confidence. It has done the former but not the latter.

It is hard to imagine this state of affairs changing much, but this is not necessarily a bad thing for investors. While the outlook for profits and dividend growth may be somewhat subdued, this does not mean that equity markets cannot rise. In fact, equity markets in some respects prefer environments in which economies require stimulating rather than restraining. The possibility for equity market valuations to rise is a real one, particularly since they are not currently stretched.

Developed market government bonds remain expensive but may become even more so if economic growth stalls. [*We do*] not like buying expensive assets and hold no developed market government bonds, though concede that it may be a little while yet before the much anticipated bond bear market finally arrives.

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Seneca Investment Managers Limited, managers, Seneca Global Income & Growth: We noted last year that market returns would likely be heavily influenced by macro-economic developments and central bank monetary policy. We were right, though to be frank we felt that they would influence equity markets positively rather than negatively and safe haven bonds negatively rather than positively.

The question now is whether the growth concerns that permeated markets during the period under review will subside or intensify. Economies around the world are on the whole operating below potential and thus still have scope to grow. This is evidenced by consumer price inflation that with the exception of some emerging countries is below the respective central bank target, unemployment rates that to varying degrees still have some way to fall and output gaps that while above levels five years ago are still negative. Recessions normally happen because economies are overheating and central banks are trying to constrain them. This is hardly the case at the moment.

There is no doubt that aggregate private demand in general is weaker than should be expected given the amount of monetary stimulus that has been injected in recent years. Furthermore, more austere fiscal policies at this point in the cycle should ordinarily boost private demand by lowering long-term real interest rates.

Our view is that in the wake of what was the worst financial and economic crisis in the best part of a hundred years, it naturally takes longer for severely battered private sector confidence to recover but this does not mean it won't eventually. Evidence of this can be found in April retail sales in the US, which rose 1.3% compared with the previous month, substantially beating expectations. True, this is only one month of data, but it is the sort of upside surprise we would expect if our thesis is correct.

Given this view of the world, we maintain our moderate overweight position in equities and zero position in developed market safe haven bonds. If we are wrong and growth concerns intensify in the coming months, we have ample scope to move equity weightings higher to take advantage of what would likely be weaker markets.

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Richard Killingbeck, chairman, Bankers Investment Trust: Global stock markets run the risk of becoming paralysed by macro uncertainties during the summer months. In the UK this will be compounded by the "Brexit" referendum which is already having a demonstrable effect on economic sentiment and activity. Corporate activity remains moribund as the continued hoarding of cash on balance sheets is given preference over investment. This lack of confidence amongst corporate boardrooms is likely to set the tone for the balance of the year and could get worse as uncertainties shift towards the Presidential elections in the US.

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UK

(compare UK funds **here**)

Schroder Investment Management Limited, managers, Schroder UK Mid Cap: Uncertainty ahead of June's EU referendum may well weigh further on UK consumer sentiment over the coming quarter. There may be additional pressure on already depressed domestic-focused stocks, which could introduce interesting buying opportunities. We are more positive for the outlook of the British consumer since the introduction in April of the national living wage (NLW) may act as an additional support. We recognise however that the NLW poses a risk to UK corporate earnings, particularly for elements of the leisure sector such as the pubs and restaurants groups, where the positive of rising disposable incomes may be more than offset by the higher costs of serving customers.

Mid cap profits have witnessed more downgrades than upgrades over the past 6 months. However, March saw a welcome improvement in the earnings revision ratio of the FTSE 250 (ex-Investment Companies) Index. The valuations of mid caps overall are presently only slightly below their long-run average, leaving little room for error.

Last year there was a trend for highly rated stocks to become more highly rated. Opportunity lies in the companies with above-average growth potential that have been left behind, on the view that investors are likely to switch towards them, especially if corporate activity accelerates.

Companies are using the low interest rate environment and, in the case of foreign acquirers, weaker sterling, to make acquisitions to supplement organic growth. This is being well received by the market and it is a trend we would expect to carry on. We continue to seek out organic growth and pricing power where possible and avoid companies with too much debt because, in a deflationary environment, the latter can reduce the value of equity very quickly.

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Angela Lascelles, manager, Value & Income: In the UK, the Office of Budgetary Responsibility (OBR) downgraded its forecast for UK economic growth in 2016 from 2.4% to 2.0%. The reduction partly reflects the impact of slower growth in China and other export markets. The reduction in forecast growth caused the Chancellor to revise upwards his forecast of borrowing by GBP38bn. The OBR estimates that government debt has now reached 82% of GDP. The UK government now predicts this will only fall from 2017-18 onwards, two years later than previously estimated. In Europe the political strains caused by the refugee crisis remain acute and economic growth continues to lag behind the US and UK. However investor sentiment was boosted by the ECB's decision to expand its monthly programme of bond purchases from EUR60bn to EUR80bn. In addition the ECB signalled that, for the first time, it would purchase non-bank corporate bonds. In the US, sentiment was also helped by comments from Janet Yellen indicating that the Federal Reserve would proceed cautiously in raising interest rates partly due to the risks posed to the US economy from global developments.

The major issues facing investors in the next few months will be the referendum on the UK's EU membership and the stability of the Chinese economy. Mr Cameron returned from his negotiations to reform the European Community with nothing of significance, so voters are faced with the choice of the status quo at best, with less negotiating power going forward, or the journey into the unknown, though with some comfort from our close links with America and our Commonwealth. Currently, the market seems less worried over the outcome of the vote than the Prime Minister. Concerning the Chinese economy, the lower price of oil, which is still 28% lower in the last year, should encourage growth at a later stage. Currently, forecasts for growth in China seem to be settling above 6% for the next two years. The UK market's yield of 3.8% remains nearly three times the gilt yield and we believe it discounts the concerns about Brexit and the slower growth overseas.

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Mark Barnett, manager, Perpetual Income & Growth: The near term outlook for the UK stock market is likely to remain clouded by a muted macro-economic backdrop in the global economy and increased pressure on profitability in the corporate sector. The multiyear monetary policy of setting interest rates at close to zero has not stimulated capital investment. Rather, companies have contained costs, particularly wages, and have used low financing costs to buy back their own stock. Whilst good for profit margins and shareholder returns in the short term, the result has been a depletion of the capital stock and an implied level of economic growth in the developed world which is below historic averages. Another side effect has been to widen income inequality in many developed market economies, prompting incumbent governments, increasingly wary of more populist movements, to redress the balance - measures have included increasing minimum wages and tackling corporate tax arbitrage. Combined with some natural wage pressure from tighter labour markets in the US, this is beginning to threaten corporate profit margins.

The collapse in energy prices and the relentless drive of digital technology have entrenched low inflation expectations such that, combined with the factors outlined above, companies operating in the global economy face an ongoing lack of pricing power. This in turn has restrained the level of turnover growth in many industries, while any rebound in energy prices or pick up in employment costs may not easily be passed on.

The overall implications for the UK stock market, which is highly global in its make-up, are that earnings growth in many sectors may disappoint. Given that valuations are not obviously cheap, overall returns from equities may be expected to be subdued for the time being. The volatility witnessed since the start of 2016, partly caused by nervousness over financial stability in China, is also likely to remain a feature of the investment landscape for the remainder of the year. The Company's portfolio has changed relatively little in recent months, as the current investments continue to demonstrate the ability to grow earnings and dividends in this challenging environment. In the very short term, the outcome of the referendum on EU membership is playing on investors' minds, with a sharp fall in the currency expected should the outcome be an EU exit. The performance of the UK equity market under this scenario is less certain, laden as it is with large companies that derive substantial earnings from overseas and who would in theory be beneficiaries of a weaker sterling.

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Kathryn Matthews, chairman, Montanaro UK Smaller Companies: The economic outlook for the UK remains encouraging, supported by record low interest rates, weaker Sterling and a benign inflation outlook. Historically, such a backdrop has proven to be positive for smaller companies, which tend to derive a greater portion of their profits from the domestic economy than larger companies.

However, much of the stock market's attention over the coming months will be drawn to the "Brexit" debate in the run-up to the 23 June referendum. The odds of the "Remain" or "Exit" choices remain too close to call: emotions will play an important part in the outcome of what is a complex question. Regardless of the result, we are hoping that the referendum will bring some welcome clarity to the UK's future within the European Union.

It is important that politics do not divert SmallCap investors' attention away from making long-term investment decisions. It is interesting to note that over the past 60 years, during which the UK has experienced periods of political upheaval and economic hardship, quoted smaller companies have outperformed larger companies by 3.5% per annum on average.

The UK SmallCap market remains less well-researched and is becoming increasingly so as competition and new regulations such as MiFID II cause brokers to withdraw from the market. We remain confident that current conditions will continue to offer investment opportunities for those in a position to complete the in-house research and due diligence required.

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Montanaro Asset Management, manager, Montanaro UK Smaller Companies: Mark Twain, the American author, once quipped that "History doesn't repeat itself but it often rhymes". Whilst he was not thinking of UK SmallCap when he said this, the behaviour of the asset class follows his observation with remarkable precision. Research we conducted in 2009 (using data going back to the 1950s) showed that SmallCap outperformed LargeCap during bull markets by an average of 8% per annum. As we updated our analysis to include the current bull market that began in March 2009, we found that SmallCap had outperformed by no less than 8.3% per annum during this period. With such forecasting skills, Mark Twain could have made quite a career as a SmallCap investor.

The primary reason for this outperformance has been the relative strength of the UK economy since the financial crisis. Real GDP growth over the last six years has averaged 2% per annum, broadly in line with the United States and comfortably ahead of Germany (1.6%), France (1%) and Japan (0.7%). Alongside this, employment and consumer confidence, the twin drivers of household consumption, have rebounded. Looking ahead, we expect low interest rates and cheap fuel costs, combined with a positive wealth effect from rising home prices, to continue to support consumers' purchasing power.

In light of this, it is natural to ask where SmallCap is headed from here. According to Professors Dimson and Marsh, at the end of March 2016 the NSCI was trading on a trailing P/E of 13.8x, which compared to a multiple of 17.3x for the FTSE All-Share Index. The last six years of outperformance have therefore not eroded the attractiveness of SmallCap on valuation grounds. A 20% discount is significant and can be attributed, at least in part, to the more robust earnings momentum within the SmallCap market. Reassuringly, it is also a sign that investor exuberance is not yet upon us. The bull market may well have further to run.

Furthermore, small company balance sheets are in good shape: in many respects, balance sheets and cash positions are stronger than ever. Indeed, SmallCap dividends appear safer than those of larger companies, with the dividend cover on the FTSE 250 at 2.2x compared to 0.9x for the FTSE 100 (Source: Financial Times). Rarely have we seen such a flurry of LargeCap dividend cuts than over the past twelve months.

Although markets ended the fiscal year in "risk-off" mode, there are two reasons for cautious optimism. The first is that the recent reporting season suggests that investors are again focusing on company fundamentals, rewarding businesses that deliver and punishing those that underachieve. Secondly, any market weakness in the run-up to the EU referendum on 23 June may lead to an attractive entry point for UK SmallCap investors.

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Hugh Twiss MBE, chairman, Invesco Income Growth: I am having to write this statement just ahead of the EU referendum, the result of which, as I write, is still very unclear. However it finally plays out, it is causing increasing uncertainty, which is likely to continue if the result is to leave. This, together with its possible impact on an already fragile Europe and the prospect of uncertain political changes in the USA, all means that we are probably facing a period of increased uncertainty, the very thing that markets do not like. When combined with slower economic growth around the world, it would suggest that stock markets may not enjoy the experience. However, one consequence is likely to be continued very low interest rates for some time to come.

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Jonathan Cartwright, chairman, BlackRock Income & Growth: At the time of writing, the UK, the European Union and global markets generally are absorbing the historic decision by UK voters to leave the EU. As predicted by many, we have seen substantial volatility in the equity and financial markets since the result of the vote was announced. Following such a momentous decision, it is not yet possible accurately to predict the long term impact on the UK economy. However, the underlying economy is strong.

Companies listed on the UK stock exchange derive around two thirds of their overall earnings overseas. Thus, shorter term shocks experienced domestically as a result of the referendum vote are mitigated for such companies by their overseas exposure. Looking to the longer term, it is reasonable to expect that the UK will be able to negotiate satisfactory trading arrangements with its European neighbours - and more widely.

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Adam Avigdori and Mark Wharrier, managers, BlackRock Income & Growth: The wider macro backdrop continues to be challenging with sluggish economic growth combined with political uncertainty and heightened currency volatility resulting from diverging monetary policies among the G7 nations. The outcome of the EU membership referendum throws an additional unknown into this mix. Our approach continues to focus on the underlying merits of company investments. Despite the uncertainties, companies which have strong market positions and the ability to generate cash and deploy this to their advantage are likely to produce attractive investment returns over time whichever macro scenario unfolds.

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Norman Yarrow, chairman, Dunedin Smaller Companies: The prospects for global economic growth remain uncertain, with China central to the outcome. The Chinese authorities have tilted policy away from reform and towards fiscal stimulus and for the time being this looks set to support growth. In the UK, although the recovery is continuing, it remains fragile and the timing of interest rate increases keeps moving further out. The uncertainty caused by the referendum on EU membership has been unhelpful in the context of both investor and corporate sentiment.

With so much uncertainty, stockmarkets are likely to remain volatile and, at current levels, equity valuations appear reasonably full, especially when expectations of slower corporate profit growth are taken into account. Smaller companies are, however, more attractively valued at the current time although investors are paying a premium for quality businesses

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Peter Jones, chairman, Henderson Opportunities: In writing this section shortly before the Brexit vote, I am of course acutely aware of the potential market impacts that might arise after 23 June. Whatever the outcome, one source of market uncertainty will be removed and one might expect volatility to reduce somewhat, although nervousness around growth in China and the oil price may well remain for some time. Macroeconomic conditions are beyond our control and, in any case, we always aim to invest in companies with strong management teams that will cope in innovative and productive ways with whatever market conditions their businesses encounter.

As the causes of uncertainty recede, we might reasonably expect the market to better reward the performance of well-managed businesses, with good results reflected in equity prices.

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Global Emerging markets

(compare global emerging market funds **here**)

Carlos Hardenberg, manager Templeton Emerging Markets: While 2015 was a challenging time for investors in emerging markets, outflows from emerging markets tapered off in the first quarter of 2016, with flows turning positive in March as investors focused on the attractive value apparent in those markets. In our opinion, the long-term investment case for emerging markets remains positive as economic growth rates in general continue to be faster than those of developed markets; emerging markets have much greater foreign reserves than developed markets; and the debt-to-GDP ratios of emerging market countries generally remain lower than those of developed markets. Even with major economies like Russia and Brazil in recession, emerging markets' growth in 2016 is expected to be 4.3%, more than twice the rate of the 2.1% growth projected for developed markets.

Though investors have been concerned with China's growth rate slowing down, we believe that the fundamentals of China's economy remain positive, and it is still one of the largest and fastest-growing major economies in the world, even with a moderation in its growth rate. China is in the midst of a transition from an export-driven to a consumer-led model, which could impact some industries but also create new ones. Market volatility is likely to continue in China and other emerging markets but, in our view, periods of heightened volatility represent potential investment opportunities.

Elsewhere, we remain optimistic about investing in the South Korean market over the long term. The country's well-established export sector spans a range of industries from shipbuilding and construction, through car manufacturing and consumer electronics to advanced technology, with levels of expertise placing the country's businesses among leaders globally in many fields. At the same time, a well-developed and sophisticated domestic consumer economy has developed, which is receiving further impetus from government moves to stimulate spending, encourage entrepreneurship and increase economic participation rates, particularly among women.

[*Brazil is*] a country with a large and growing consumer base. Stock markets usually run ahead of the real economy, so, in our opinion, the market had already priced the economic recession. During a recent visit to Brazil, our team met a number of companies which are surviving in the face of the negative growth rates and are actually looking forward to a strong revival as industries consolidate and the market share of well-positioned companies improves. Thus, we view the situation in Brazil as an opportunity to buy stocks at attractive prices, especially stocks of well-managed, high-quality companies that have been affected by broad-based selloffs amid indiscriminate negative sentiment.

Emerging market countries account for nearly three quarters of the world's land mass and four fifths of the world's population, present considerable potential in terms of resources and demographics, and are in a strong position to benefit from technological advances. It is also important to remember that emerging market countries represent a large share of world economic activity and equity market capitalisation.

The largest risk which we see to emerging markets' performance in 2016 would be from unforeseen events, either geopolitical or financial. While most known risk factors are generally already discounted into market valuations, investors tend to have a disproportionately negative reaction to surprises, and often emerging markets bear the brunt of a "flight to safety" on these occasions. While heightened market volatility can be unsettling, we aim to look beyond the short term to find and invest in well-managed growth leaders at what we believe are attractive valuations. As we look forward, it is important to note that times of stress in financial markets can offer the largest upside potential in the medium term.

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Aberdeen Emerging Markets: After a healthy recovery from the January lows, investors seem to be deliberating whether or not fundamentals justify a continuation of the upward trend. We believe the backdrop of a weaker US dollar, rising commodity prices and positive political developments could help in this regard. We would also argue that valuations do not yet represent a reason for the rally to stall. The [*MSCI Emerging Markets*] benchmark currently trades on 11.9 times forward earnings, 1.4 times book value and offers a dividend yield of 2.8%. Analysts' forecast for earnings growth are, for once, conservative at just 7.1% for 2016 according to Bank of America. We believe this provides an undemanding base from which positive surprises could result, especially if emerging market currencies remain stable or strengthen. The latter, we believe, would be justified based on declining current account deficits and inflation in emerging markets. JP Morgan's Emerging Market Currency Index remains 22.5% below its five year average despite gaining 6.9% since January. Sentiment indicators also remain generally supportive of emerging markets. The recent rally has seen the first meaningful inflows to the asset class for some time, but these flows are thus far negligible when compared to the outflows of the past four years.

Despite these positives, the real economic challenges facing both emerging markets and their developed counterparts remain and it is still unclear if policymakers' actions, largely involving further monetary easing or delaying expected tightening, will achieve the goals of stability followed by growth. In the short term at least, investors appear to have taken comfort from such measures. However, the recent referendum result in the United Kingdom illustrates the significant impact that decisions in one country can have on global markets, including those in which the Company invests.

Within the emerging world itself we remain of the opinion that the Chinese authorities have significant means at their disposal 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. The recent Brazilian rally in particular looks fragile, having been triggered by the expectation of political change. In markets such as India and Mexico, the macroeconomic outlook is robust but valuations are commensurately higher. In Eastern Europe, highly attractive valuations, moderate growth and the potential for further stimulus are an appealing combination.

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Alexander Zagoreos, chairman, Utilico Emerging Markets: The markets remain outside normal historic parameters with negative interest rates in a number of countries and Quantitative Easing ("QE") still being implemented in Europe and Japan. The normalisation of monetary conditions will result in sharp volatility as global markets react to decisions in the main being made by central banks. The USA is looking to edge towards normalisation. Given this backdrop, it is encouraging that most emerging market economies continue to achieve positive GDP growth.

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Asia ex Japan

(compare Asia ex Japan funds **here**)

Carol Ferguson, chairman, Invesco Asia: Over recent years, Asian equity markets have had to contend with slowing growth in the region. This is partly due to subdued global economic growth which has resulted in a fall in demand for Asian exports. It also reflects the reorientation of China's economy away from investment as the primary driver of its GDP growth. There are signs that lead indicators are once again stabilising as previous Chinese government stimulus measures take effect and, more generally, central banks across the world continue to provide monetary policy cushioning. However, it is worth noting that elevated Chinese debt levels are a continuing structural imbalance with implications for global growth.

GDP growth in India has been slow to materialise but we are nevertheless positive about opportunities. The Modi government appears to be making some progress by gradually implementing measures to tackle barriers that have inhibited India's natural growth drivers. As is typical with India, the market is at times disappointed by the pace of reforms.

The UK vote on the renegotiation of its relationship with Europe is likely to accentuate market uncertainty in the short term. Against this volatile and uncertain backdrop, Asian equities appear relatively good value compared to other global equity markets. The current 30% discount to global equity markets in Asia is wide by historical standards. In absolute terms this development will probably exacerbate the current weak earnings momentum in Asia although this may be ameliorated to some degree by weakness in Sterling for UK-based investors. Your Portfolio Manager and the Board believe that that stock selection is crucial in this kind of market. There are stocks with attractive growth prospects in the region whose valuation multiples offer good entry points for long term investors.

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Ian Hargreaves, manager, Invesco Asia: Asian markets have been stuck in a trading range now for several years. It has been a tug-of-war between low valuation (both relative to Asia's own history and relative to other global markets) on one hand and weak earnings trends on the other. This reflects the lower rates of economic growth in the developed world post the Global Financial Crisis with its negative implications for Asian export growth and, importantly, the structural slowdown in China. There is little to suggest that these trends are going to change significantly in coming years. The rational response from the market has been to rerate companies that have been able to surprise on growth or where there is a decent level of earnings certainty. The challenge arising from this is that valuations of these stocks are frequently above levels that feel comfortable.

The signs of economic stabilisation in China that we discussed in the interim report have become more apparent in the first quarter of 2016. The recovery in property sales that first began back in May 2015 has been central to this and is now being reflected in improving trends across a range of economic indicators. As we had hoped, this has led to improved performance in the more cyclical areas of the market such as materials. We view the recovery in Chinese property demand as fleeting and not the beginning of a new sustained uptrend.

The improvement in the Chinese economy has also been accompanied by a reacceleration in credit growth. This unwelcome development stems from the government's commitment to maintain real economic growth of at least 6.5%. The Party identifies the need to minimise unemployment as critical to maintaining confidence in the economy. However, given the peak in the working age population, this level of growth is no longer necessary to maintain full employment and can only be achieved through increased leverage. Ultimately this is an unsustainable policy and is a medium term risk for Asia. However, other than the sizeable increase in leverage since 2009, China does not yet share some of the key characteristics that have marked out previous emerging market crises. These include large current account deficits (China is in surplus), dependence on large scale foreign borrowing to fund domestic credit (China foreign debt to GDP is only 10%), a high loan to deposit ratio (China has only recently surpassed 100%) and an open capital account (China's is relatively closed). Thus, while this policy will ultimately lead to a high fiscal cost as a result of bad debt resolution, China does not yet appear vulnerable to an uncontrolled liquidity shock that could reverse the credit cycle.

Turning to India, we concur with consensus that this economy is better placed than others in the region. It remains under-developed and is one of the few economies that appears close to the bottom of its credit cycle.

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Nicholas Smith, Chairman, Schroder Asia Pacific: Given the upcoming referendum on the UK's membership of the EU, sterling could continue to be an important part of near-term changes in the Company's NAV. That aside, however, Asia's challenge is finding a new growth path. Many of the factors behind its past success - for example labour cost advantages, China's transformation into an economic powerhouse, and positive demographics - no longer underwrite strong stock markets. Share valuations may be below their historic average, but for many investors the point of Asian equities is rapid growth in corporate profits, and the region has not provided that for a while.

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Schroder Investment Management Limited, managers of Schroder Asia Pacific: Equity markets have been supported by consensus thinking which appears to incorporate a list of positives, although whether they are internally consistent is open to question. One strand is the view that the Federal Reserve has become notably less hawkish on interest rates, due to the previous tightening impact of the stronger dollar and the (probably related) fact that there are fragilities surrounding the global economic picture, most notably in a number of emerging markets.

However, almost in the same breath, the optimists cite signs of a stabilisation in Chinese growth (amid more credit expansion, resilience in foreign exchange reserves and a pick up in residential real estate activity), the easier credit conditions engendered by the weaker dollar, and the recovery in manufacturing sentiment indicators seen across most developed markets and emerging markets.

There are important internal inconsistencies in the above. To hope for both a more dovish Federal Reserve and accelerating global growth is probably wishful thinking, unless of course non-US economic activity can decouple from a slowing US. We view this as a low probability event. We can accept that the recent equity recovery has been underpinned by the reduction in a number of "tail risks" but suspect that the picture remains of equity markets trading in a volatile but essentially sideways pattern for some time yet. This reflects the conflicting pressures of debt constraints to developed market growth, fading confidence in the policies of central banks outside the United States, normalisation of rates by the Federal Reserve, and equity valuations globally that are neither unduly cheap nor particularly expensive.

This short-term lack of a positive inflection point in global activity coincides with the longer-term framework within which we are operating; that is continued low inflation, debt constraints to growth in the developed world, and a more secular slowdown in the trend of emerging market expansion. The latter is exacerbated by the unwinding of the overinvestment and credit expansion post the Global Financial Crisis, for which China remains the poster child.

Valuations round the region are, at least on the surface, cheap relative to history and compared to other markets. However, we see a challenging environment for corporate profits amid continued competitive pressures and beggar-my-neighbour monetary policies from major trading partners/competitors. China remains a key source of event risk. The current bout of investor complacency fails to adequately reflect the fact that there is a renewed surge in credit growth which, while supporting near-term activity, is raising the long-term risks of a more severe slowdown, a surge in bad debts, and loss of control of the currency. The Chinese authorities still have the tools to handle a transition to a new growth model, but the more it is delayed the more difficult the adjustment will become.

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Richard Titherington and Ayaz Ebrahim, managers, JPMorgan Asian: Looking ahead, we are hopeful that Asian equity markets will produce positive returns as markets anticipate a pickup in US growth in the second half of the year, underpinning the global economic and equity markets. In addition, while China's aggregate economic growth is unquestionably slowing in the medium term, driven by structural and cyclical factors, the broader picture is more reassuring.

The stabilisation of China's real estate market, resilient middle-class consumption and the rise of the service sector contribute to a positive outlook. These positive themes are to some extent offset by Beijing's planned rationalisation of over-supplied heavy industries and a more aggressive curtailment of subsidy lending that will likely drive an increase in state-owned enterprise redundancies. However, while such structural reforms may further dampen near-term growth, they help reduce longer-term systemic vulnerabilities.

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China

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

Dale Nicholls, manager, Fidelity China Special Situations: Some of China's old growth drivers are struggling and headline growth is undoubtedly moderating as China's economy matures. Debt levels also continue to expand at a significant pace and, in my view, banks are probably understating the true extent of their non-performing loans. The longer this rapid growth in debt continues the greater the longer term risks for the economy.

Policy and communication have been dominant swing factors for markets over the review period and have had a significant impact on market confidence in China. There is room for improvement here and it will take some time for investors to regain confidence in the authorities' ability to manage China's financial system. In the middle of last year, the government cracked down on margin finance (investor's borrowing money from financial institutions to invest in the market). While it is sensible to regulate margin financing, there were questions as to why it was able to grow to such a level in the market (around10% of market-capitalisation in the middle of 2015 was assumed to be from margin finance) and why the consequent market intervention was so aggressive and wide reaching. In the fourth quarter of 2015, the authorities relaxed the exchange rate mechanism. They went from focusing on a tight band against the US dollar to adopting a broader band against a basket of currencies. While this was a positive step towards liberalising China's foreign exchange markets, the poor communication about this change and its aim left many confused. I hope that these are just 'teething problems' for the authorities as China looks to liberalise its capital markets.

Reform in China will be key to the future success of the economy and markets. Despite the strong blueprint laid out in the third plenum, reform, particularly of state-owned enterprises ("SOEs"), has generally been slower than expected. However, we have seen some steps in the right direction, with improved management incentive schemes to align management and shareholder objectives, and an increase in public listing of assets and merger and acquisition ("M&A") activity among SOEs. Meanwhile, increased policy discussion about addressing "supply side" issues related to excess capacity in industrial sectors is clearly a positive, especially in areas such as steel. Execution, though, needs to be followed closely. Many companies in these industries have heavy debt levels, so the challenge of taking capacity out of these sectors and the non-performing loan problem at banks is closely related.

Despite this rather subdued message, what is often lost among the dramatic headlines is the long-term investment potential offered by China's growing middle class and the associated multi-year growth in domestic demand. Indeed, consumption continues to expand at a robust pace and the economy is rebalancing towards a higher quality and more sustainable growth model. This has been reflected in the strength of the so-called "new economy" in areas such as online sales and travel.

Relative to the developed world, many consumer products and services in China remain vastly underpenetrated, which offer significant structural growth potential. In particular, rising internet and mobile usage is redefining the landscape, particularly in rural markets where traditional bricks and mortar enterprises have lagged. This provides a solid backdrop for further growth in consumption, internet penetration and e-commerce in China.

Recently, we have also seen some improvement in areas that have been a drag on growth, such as property and trade. There has been improved pricing in some of the "old economy" industries such as steel. There are some opportunities to be found in more cyclical sectors, especially where we are seeing signs of supply adjustment combined with very low valuations.

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India

(compare Asian single country funds here)

Hasan Askari, chairman, New India: While India is more insulated from external events than most of its regional peers, its markets are still affected by global events. Given the largely listless world economy and widespread investor sensitivity to fluctuating commodity prices and central bank rhetoric, further market volatility is likely.

Indian companies remain fundamentally sound; however, earnings continue to be affected by sluggish demand. Share prices are unlikely to re-rate significantly until consumption and private investment recover. Nevertheless, the budget's focus on farmers should encourage rural spending, while the boost in funds allocated for infrastructure development bodes well for the materials sector in particular.

Elsewhere, the banking sector remains under considerable stress from the increase in non-performing loans. While this is largely confined to PSUs the repercussions are more widely felt. To its credit, the RBI has the issue firmly in its sights. Notably, it has taken steps to recapitalise PSUs, while encouraging indebted corporates to manage their obligations more actively. However, there is still some distance to cover to stabilise this sector. Meanwhile, progress on a unified GST remains crucial, both for Mr Modi's credibility and India's economic evolution. Encouragingly, there appears to be growing optimism that political differences will be put aside in a bid to advance the legislative agenda this year. Were this to happen it would augur well both for Indian equities

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Aberdeen Asset Management Asia Limited, managers, New India: **Information Technology** - as developed markets slow, growth in the software sector has slackened in tandem. Despite this, some companies continue to win contracts in a competitive marketplace and deliver steady cash flows, backed by healthy balance sheets. India's best IT outsourcing companies count among them, given their software engineering expertise, attractive cost structures and professional management.

Energy - for decades, India has largely been remiss in supplying reasonably priced energy and power to its people, with the pace of reform slow and arduous. Recent progress, however, seems more promising. We saw a big step forward when Modi took advantage of the steep correction in oil prices to deregulate diesel, raise natural gas prices and revive direct benefit transfers for liquefied natural gas.

While we are heartened by the developments, we remain sceptical about the sector. It suffers from cyclical earnings that typify a highly regulated sector, which are compelled to subsidise customers at the expense of profitability. There is still a worrying lack of clarity in how the subsidy burden should be shared. In the recent budget, lower oil and gas subsidies have increased the risk of the burden falling more heavily on state-run upstream companies. That has further vindicated our longstanding view on the sector and avoiding investing in these companies.

Financials - While the banking sector is competitive and fragmented, it remains attractive because it services an expanding pool of middle- and upper-class consumers. We favour banks that have entrenched deposit franchises and the ability to manage risks through the credit cycle.

Public-sector banks are dominant with a 70% share, and they have been the key casualties of a slowing credit cycle, with an increase in slippages in asset quality and restructuring. Some relief has come from the government, which will inject 250 billion rupees into state-owned banks to cover bad loans.

Meanwhile, the RBI faces a fine balancing act of cleaning up troubled spots in the banking system, while allowing sufficient liquidity to support growth when credit demand strengthens. It has reduced the risk weightings on mortgage assets for local banks and non-banking financial companies, freeing up capital for expansion.

On a less positive note, the RBI has become more prescriptive in requiring banks to write off loans since the December quarter. Implementation, however, was patchy, causing discrepancies among lenders.

Consumer Discretionary - we like the automotive story in India, as the sector stands to benefit from rising disposable incomes. We especially favour the two-wheeler segment, which is less crowded and, hence, less competitive, with better economies of scale compared to the car segment. Since motorcycles are seen as a necessity rather than a luxury, being more affordable, the segment is more resilient in difficult times compared to four-wheelers.

Industrials - the sector remains dogged by challenges, including a slowdown in industrial activity, infrastructure bottlenecks, regulatory uncertainty and high leverage.

Utilities - this sector, made up of power and gas utilities, has been hamstrung by shortages of key inputs and regulatory uncertainty. The government has embarked on reform of power distribution companies, given the declining losses at state electricity boards. But more needs to be done with respect to tariff adjustments, the reduction of losses and timely subsidy payments by the states. Such restructuring will attract investments to the sector.

Telecommunication Services - the local telecommunications market is one of the most competitive in the world and the larger players battle hard for market share. Although the competitive landscape has improved amid industry consolidation following the 2G licence scandal a few years ago, the impending entry of Reliance Jio, which plans to offer cheaper 4G services to capture market share, is expected to unleash a fresh price war. Jio has done a soft launch of its service but repeatedly delayed an official launch, which now seems likely sometime this year.

The Indian market's weak performance seems to indicate that investors are increasingly impatient as they await a turnaround in demand and investment. External headwinds persist, with the economies in China and Europe continuing to struggle. On the domestic front, the recent budget has had little immediate impact on the stockmarket. The economy continues to improve, albeit slower than what we would have liked. Private investment remains soft and credit demand muted. However, there are early indications that the cycle might be turning, with industrial production showing signs of life. That said, consumption is more likely to be the key driver of growth, supported by lower rates, energy cost-savings, government wage increases recommended by the 7th Pay Commission, and a possible hike in the minimum support price for wheat. While India still has its fair share of challenges, we believe there is cause for optimism. The RBI has moved beyond its scope of monetary policy and is starting a massive clean-up of banks, structurally strengthening the financial system over the longer term. Fiscal discipline is being enforced, debt levels are not excessive and inflation has been benign.

Given anaemic external demand, the corporate outlook remains subdued. While the stockmarket has sold off quite a bit, valuations remain relatively high compared to other emerging Asian markets, such as China, Indonesia and the Philippines.

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Japan

(compare Japanese funds **here**)

Aberdeen Investment Management Kabushiki Kaisha, managers of Aberdeen Japan: Investor sentiment has improved in recent weeks, but volatility could return as a dominant theme in 2016. Numerous risks threaten to derail a still-frail world economy, and Japan will not be immune from the headwinds. Divergent monetary policy is a source of uncertainty as more central bankers venture into the unfamiliar territory of negative interest rates. Across the region, a further misstep by Beijing could revive global market turmoil. Renewed stress in emerging markets could spark further currency depreciations and greater capital flight.

At home, policymakers' inability to lift the economy on to a sustained growth path remains a key worry. Little headway has been made in tackling the structures essential to boosting productivity and competitiveness. Meanwhile, there are few signs that the negative interest rate programme is having a meaningful impact in terms of raising levels of consumption and investment. Recent deterioration in GDP growth and external demand increases the likelihood that next year's consumption tax hike will be delayed again. Earnings and dividend outlook appear muted against this backdrop. The upcoming upper house election may turn out to be a vote on effectiveness of the prime minister's economic policies.

That said, this dim backdrop should not cloud corporate achievements. Japan's best companies, having gained much experience from overcoming the tough economic challenges of the 'lost decades', have not been sitting idle waiting for a turnaround. Many have been expanding overseas for some time, which allows them to benefit from growth elsewhere, while others are growing domestic share. Some have also relocated their manufacturing to lower-cost countries. Encouragingly, corporate governance is also improving, albeit at a slower pace than we would like.

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Shoichi Mizusawa, Nicholas Weindling, Naohiro Ozawa, investment managers, JPMorgan Japan Smaller Companies: In Japan, the domestic economy has not responded to the tightening labour market where the ratio of job offers to applications continues to make all-time highs. The economy contracted in the second and fourth quarters of calendar year 2015. Wages are not growing strongly enough to stimulate consumption growth and companies remain reluctant to invest in Japan. Inflation remains low, although this is partly the result of falling commodity prices. It is because of these factors that the Bank of Japan (BOJ) announced a third round of monetary easing on 29th January. The second round announced in October 2014 focused primarily on the expansion of asset purchase programme. This time, the BOJ introduced negative interest rates. The initial reaction was to sell the yen and buy equities. However, the equity market came under renewed selling pressure as the BOJ's action failed to reverse the yen appreciation and investors became concerned about the adverse impact of negative interest rates on the financial system. One area where the additional stimulus has had a positive impact is in the domestic bond market: yields on Japanese government bonds are negative for maturities of up to 10 years.

Despite the headwinds from the macro economy, listed companies in Japan have continued to make positive progress in terms of both earnings and corporate governance. Although the recent strength of the yen negatively impacts export sector earnings, aggregate profit for the fiscal year 2015 is expected to have grown to a record high. Total dividend payments have also increased to pass the previous peak in 2007 and the number of share buybacks is continuing to grow.

We have been positive on the Japanese market since at least 2012, and remain so on a medium-term basis. Our base case remains that the global economy will continue to expand, albeit slowly. Accordingly, we believe that corporate earnings will prove resilient to the stronger yen and we do not expect a material fall from the previous year. Corporate governance reforms, in terms of better capital management and shareholder returns, combined with unwinding of cross shareholdings, are slowly but steadily taking hold. Listed companies in general have healthy balance sheets and can afford much higher payout ratios. The valuations are not at all demanding in our opinion. The TOPIX Index trades on around 13x prospective earnings and 1.1x book value, and is cheap relative to its own history. Such positive fundamentals provide downside support in the short term and create opportunities in the medium term.

Given the recent poor performance of the domestic economy and the equity market, it is not surprising that investors are starting to ask whether "Abenomics" has failed. Indeed, many foreign investors appear to have given up on Abenomics and the statistics show they were sellers of Japanese equities throughout most of the last 12 months. It is true that inflation expectations remain low, or are even falling, and as a result both households and corporations are reluctant to spend. Our view is more balanced. We consider the following as the achievements of Abenomics:

- agricultural reform;
- Trans-Pacific Partnership (this is yet to be ratified by the member states including Japan);
- a rise in female participation in the labour market as well as an increase in overall employment;
- corporate tax cuts;
- promotion of Japanese tourism; and
- Stewardship Code and Corporate Governance Code.

Indeed, we are encouraged by the level of shareholder returns that have been announced so far. Although companies in aggregate are guiding their profit to be lower in FY2016, most companies are forecasting dividends to be at least the same as, or even higher than, last year. Share buyback announcements have also been positive. As of 16th May, over 98% of all listed companies had reported their earnings for FY2015 and issued profit guidance for the new fiscal year. The data showed that operating profits grew by over 10% in FY2015 and are expected to fall by circa 3% in FY2016. We believe that such outcomes are largely reflected in the share price as the TOPIX Index has fallen by more than 10% since the end of 2015.

We acknowledge that downside risks are greater now than six months ago. Firstly, we did not anticipate the strength of the yen. Our view has been that the normalisation of US monetary policy, and the widening interest rate differential as a result, should put downward pressure on the yen. It now appears more likely that the pace of US monetary policy normalisation will be much slower than we originally foresaw, capping the upside for the dollar. Secondly, the domestic economy has failed to gain traction. If the government goes ahead with the planned consumption tax increase from the current 8% to 10% in April 2017, it is likely to put additional downward pressure on the economy and inflation expectations. Although we continue to believe that the BOJ is committed to its 2% inflation target, recent events have shown that there are limits to what monetary policy alone can achieve. As a result, the earnings outlook for 2016 and beyond is less positive than six months ago. Banks and insurance companies will suffer pressure on net interest margins and investment returns but we need more time before assessing the impact of negative interest rates on the domestic economy.

In addition, there are several risks that are structural in nature and we have commented on them in previous reports: the demographic headwind in Japan will only intensify and domestic demand continues to disappoint despite positive employment data; the Chinese economy continues to face downward pressure from the structural shift from investment to consumption; the European Union is yet to address properly the imbalances within the European economy which is therefore susceptible to shocks.

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Harry Wells, chairman, CC Japan Income: The unorthodox policy of a negative interest rate on cash reserves embraced by the Bank of Japan is yet another attempt to stimulate an economy dogged by deflation. However, therein lies the opportunity for investment mandates with Japanese income strategies. In a crime-light Japan, domestic safes are now one of the fastest selling items in department stores, reflecting that 53% of household assets are held in cash and bank deposits. Equally, it is costing money to maintain Y100 trillion on corporate balance sheets and with pressure being brought to bear by corporate governance and stewardship reforms, dividend payout ratios and share buy backs are rising strongly.

It is perhaps a strange reversion to the mean to think of Japan in the context of income, a word almost lost to an entire generation of fund managers and investors. However, when the early pioneers of international investment like Harry Seggerman of Fidelity and Richard Thornton of GT fame arrived in Japan in the 1960s, they found companies with attractive levels of dividend yield. The economic case for Japan may be entirely different today but we have a resurrection in income opportunities which should be factored into the radar of those seeking income on a global basis, where so many sectors in other developed markets have or could potentially disappoint.

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Coupland Cardiff Asset Management LLP, manager, CC Japan Income: With global economic growth moderating and signs of concern emerging in different regions of the world, the last few months have been characterised by weakness in equity markets and volatility in exchange rates. The gyrations have been heavily influenced by the commentary, actions or even inactions of the Central Banks of the major economic regions. This has included the surprise announcement at the end of January by the Bank of Japan to cut the interest rates on excess reserves to -10bps, a negative nominal rate for the first time in history. The initial, albeit brief, success in weakening the currency soon gave way to renewed concerns about global growth and uncertainties over the impact of this additional monetary policy in Japan. The Yen has consequently appreciated from Y123.0/US$ in December to Y106.4/US$ at the end of April, and has been the dominant factor affecting the direction of the equity market and also the sectoral trends within it.

The rapid appreciation of the Yen has heightened concerns about the earnings outlook for the new fiscal year as well as the credibility, in some eyes, of Prime Minister Abe's reflation strategy. While a high percentage of aggregate earnings for the market is generated overseas and consequently has some sensitivity to the exchange rate, the general levels of demand both internationally and domestically remain robust. Criticism of Abenomics ignores areas of notable progress such as the much tighter labour market, evidence of price increases in certain categories and consistently strong inbound tourism. Corporations in Japan are generally in sound financial health and have demonstrated very positive trends with regard to improving their corporate governance in response to another of the Prime Minister's initiatives. Over the last twelve months the aggregate dividend payment for all listed companies rose 14.7% y/y to its third consecutive annual record. The payout ratio increased from 30.7% to 33.6% highlighting not only the scope for offering greater stability in the near term but also the potential for improvement in the long run. Share buybacks also achieved a new record high, rising 50% y/y. This was accompanied by record levels of treasury stock cancellation reflecting the desire to raise productivity and improve return on equity ratios.

In the light of the large currency move and introduction of unconventional monetary policy, the disparity of returns within the equity market has been considerable.

At the margin, there is a possibility that excess deposits in the banking system will be channelled into the real estate sector and therefore into an arguably already overheated Tokyo market. This makes it considerably harder for REITS dependent on external growth (i.e fund raising and property acquisitions) to expand.

Recent economic data have disappointed and prompted the Bank of Japan to adopt a negative interest rate policy in its determination to return the economy to growth. Foreign investors appear to have taken a dim view of these developments and have sold Japanese equities consistently over the last few months. Under the current economic and exchange rate conditions, corporate earnings in Japan are likely to remain under pressure. One interesting consequence of the negative interest rate environment, however, is its perceived penalty for companies holding liquid assets. Company managements are therefore being forced to consider the most appropriate strategy for managing surplus cash balances. Improved shareholder return is a justifiable option for many and it seems likely that it will gain further traction as corporate governance improves.

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North America

(compare North American fund **here**)

Andrew Bell, chairman, Gabelli Value Plus: Although sentiment has been volatile since mid-2015, the U.S. economic recovery has remained resilient. One effect of the much-discussed external concerns (centred on emerging economies, particularly China, and the deflationary effects of falling commodity prices) has been to slow the pace of anticipated U.S. interest rate rises. This has interrupted the earlier sharp rise in the dollar, in turn relieving earnings pressures in the U.S. market. This has also alleviated fears of a damaging squeeze in dollar liquidity for emerging economies that had borrowed in the U.S. currency. Consequently, the mood of investors has lightened in recent months.

A number of risks remain, including the outlook for the European economy (particularly if the UK were to vote to leave the EU) and uncertainties over the forthcoming U.S. Presidential election. With market valuations high compared with history (even if capable of being rationalised, given a prolonged period of low interest rates) markets will remain prey to oscillations in sentiment, given the continuing burden of adjustment to the debt overhang from the 2008 financial crisis. This should work to the benefit of investment strategies that take a selective approach, rather than relying on a general rise in markets.

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Gabelli Funds, LLC, managers of Gabelli Value Plus: Our baseline scenario is one of an uneasy balance between economic fundamentals and financial markets, with already overburdened central banks at the heart of the story. However, with firm consumer spending, subdued oil prices and expansionary monetary policy, it is hard to see a recession materialising over the next year in the United States.

On 31 March 2016, we had solid evidence that the U.S. labour market continues to be firm, as employment gains have been steady if unspectacular. The quarter ended with two months of solid gains, with 215,000 jobs added in March after 245,000 in February. We have now had the best two-year period for hiring since 1998-1999. Labour force participation, which had been falling for the past decade and steeply since 2007, now appears to have bottomed out in September of last year at 62.4%. This participation rate rose in March to 63%, back to where it was two years ago.

The healthcare, hospitality, professional, and business service sectors, and recently even construction, have added healthy job gains this year. However, while the manufacturing sector is recently showing signs of renewed growth in orders and production, manufacturing jobs continue to show no growth. This is due in part to the trend of lost manufacturing to lower cost countries over the past decade and to increased substitution of automation and technology for people. Manufacturing jobs have been important to the ability of those without a college degree to support themselves and their families, and we have seen the frustration and anger over this loss in jobs and wages surface strongly in this year's presidential campaigns.

While U.S. wages have been rising, they are still restrained due to a low labour market participation rate and evidence of slack, including part time workers unable to find full time work. Therefore, we see little chance of domestic inflation accelerating. In Federal Reserve Chair Janet Yellen's speech, on 29 March, she said her expectation for core inflation in the U.S. economy is less than 2% for 2016, with the possibility that it could move higher in 2017. However, she said that the risks are to the downside in achieving the central bank's objective of 2% inflation and, in particular, she said that weakness abroad would probably require the Federal Reserve to adjust downward the trajectory for higher rates that the bank had outlined in December.

Oil prices may have bottomed, although we believe that prices will remain low for a sustained period. However, while the price of oil might remain low for another year or two, we do expect that prices will rise over the next five years and we expect some correlation between oil prices and inflation expectations over this time.

During periods of slow growth, investors put a premium on any growth, and so growth stocks outperform. We are now in what appears to be the sixth year of slow (less than 2.5%) growth in the U.S. economy. Some growth oriented companies have delivered impressive growth during this period, and investors bid up their share prices. But profits of most companies in the financial, industrial, retailing, and energy sectors have disappointed.

As a value manager, we are encouraged that prior periods of growth outperformance, including the "Nifty Fifty" market of 1966 - 1972 and the more recent "TMT" - technology, media, and telecom - bubble of 1998 - 2000, were followed by strong periods for value stocks, including seven straight years of outperformance by value from 2000 to 2006. We feel value investing is well positioned to outperform growth investing in the U.S. in the years ahead.

Focusing on fundamentals, the U.S. economic backdrop continues to be relatively good. The consumer sector comprises about 70% of GDP. The U.S. consumer should benefit from lower gasoline and food prices, rising wages and home prices, and improving household balance sheets. Financing is still available at extremely attractive rates, fuelling the merger and acquisition ("M&A") boom.

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Simon Miller, chairman, BlackRock North American Income: The start of the year has proved to be volatile, with investors unsettled by slowing economic activity and concerns about the continued effectiveness of unconventional central bank policies. The outcome of the U.K.'s recent referendum on membership of the European Union has added to market uncertainty globally. Its impact on the economic and political prospects for Europe as a whole remains to be seen. In the U.S., the forthcoming presidential election also adds another element of unpredictability to markets.

For the time being, worries of an impending U.S. recession appear to have abated. Although there has been a reduction in jobs growth recently, U.S. employment overall remains strong. Manufacturing weakness, which is concentrated mostly in sectors exposed to energy and exports, is also showing signs of bottoming out as the key headwinds of falling oil prices and faltering emerging market economies begin to subside.

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Russia

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

Gill Nott, chairman , JPMorgan Russian: The price of oil is a major determining factor for the Russian economy and if recent increases continue it seems likely that it will have a positive economic impact on the Russian economy and the stock market in the second half of the Company's financial year.

However, economic sanctions against Russia remain and the political outlook is uncertain in both the middle-East, USA and Europe. These significant geopolitical and economic issues will continue to impact the Russian market, together with concerns regarding the state of the domestic economy. Thus, the outlook remains uncertain but with some potential for upside if the oil price continues to strengthen.

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Oleg I. Biryulyov, investment manager, JPMorgan Russian: We believe that the long-term fundamental case for the Russian equity market remains intact and continues to provide ample opportunity for active fund managers to add value.

We expect the earnings revision cycle to improve in the second half of the year, and should start to see some positive revisions to economic and corporate profit outlooks in the third quarter. As in any equity market, such revisions are likely to drive the general direction of the market and help investors to differentiate among market participants.

We do not expect any lifting of sanctions in 2016, but think the election cycle in the US and the European Union has the potential to begin driving change in 2017.

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Biotechnology & healthcare

(compare biotech & healthcare funds here)

Samuel D. Isaly, OrbiMed Capital LLC, manager Worldwide Healthcare:

Large capitalisation pharmaceuticals

Global large capitalisation pharmaceutical stocks were not immune to the healthcare sector issues that became the hallmark of the past year. While the re-rating was less severe than their biotechnology counterparts, the effect was significant. Looking ahead, while we do not want to completely ignore the continued rhetoric coming from the U.S. Presidential election cycle on U.S. pricing, we firmly believe that there will not be any notable adverse impact on the fundamentals of these companies, in particular revenues and earnings.

Nevertheless, large capitalisation pharmaceutical companies have been dealing with real price pressure in the U.S. market in recent years. First, Managed Care has become very experienced in selecting therapeutic categories where there is plenty of competition - respiratory, diabetes, hepatitis C - just to name a few. Second, rebating has increased and net prices have come down in these areas. In addition, patent expirations and generic entry in which volumes and prices for the branded incumbent now drop over 90% within a month of generic availability. Therefore, while not directly legislated for, per se, free market pressures have contributed to price containment in the U.S.

These companies now all acknowledge the same thing - only novel drugs that are truly are innovative and satisfy a unmet medical need get premium pricing, and more importantly, reimbursement in the U.S. Market efficiencies in the private sector have provided the appropriate checks and balances for pricing.

Discovering, developing and launching truly innovative products on a large enough scale while navigating patent losses is not easy. We therefore remain selective, targeting only companies with deep pipelines, transformative optionality, and management teams who understand the climate in which they are operating.

Specialty pharmaceuticals

Pricing concerns, triggered by the actions of Turing Pharma, Valeant and other "bad actors", have stifled performance of most stocks in this sector. Although this universe is heterogeneous, consisting of a diverse group of branded companies with varied business models and areas of focus, heightened fears have resulted in investors drawing the incorrect conclusion that these companies are similarly troubled. As a result, better-positioned players may have to demonstrate solid operating performance for several consecutive quarters to re-gain investors' confidence.

We believe patience will be rewarded as stronger operators separate from the pack and outperform their disadvantaged peers in the coming fiscal year and beyond. In Europe, we remain very selective, however, improving economic trends, new launch cycles, and increased M&A activity makes us a little more positive. We expect M&A to remain a dominant theme, especially with recent sector devaluation, as players continue to pursue creative business combinations driven by potential revenue, operating and tax synergies.

Generic pharmaceuticals

Investors' concern about pricing dynamics within the U.S. generic drug market has reached fever pitch, driving notable underperformance and significant devaluations for most stocks in this sector. Continued consolidation within the pharmacy and wholesaler/distributor channels is a major reason for the heightened fears, as it has shifted the balance of power resulting in moderate generic pricing erosion in some generic product areas (oral solid, injectable) and more severe contraction in others (topicals, narcotics/opioids).

In the U.S., generic companies may have to demonstrate solid operating performance for several consecutive quarters to reignite investors' interest in the space. In Europe, generic utilisation is increasing in most major regions, but market conditions, in general, remain concerning due to weak pricing. Throughout Asia, economic expansion, favourable demographics, supportive governmental policies, and other contributing factors continue to drive robust generic utilisation in some regions. In Japan, while some low hanging fruit has already been picked, the secular trend remains strong as the government continues to legislate in favor of increased generic utilisation to help thwart rising healthcare costs there.

We still favour generic players with growing, diversified, branded franchises bolstered by focused, franchise-extending, proprietary pipelines. Further consolidation of the generic industry is likely and we believe some of the small and mid-sized U.S. based companies are attractive targets.

Large capitalisation biotechnology

The large capitalisation biotechnology sector experienced weakness beginning in the summer of 2015 due to investor fears over the sustainability of drug pricing in the U.S. A broad-based sector sell-off was caused by election year rhetoric about the need for stronger government policies to control drug price inflation. We believe these drug pricing proposals are unlikely to become reality given a Republican-controlled Congress, but the news headlines negatively affected sentiment for the sector. Additionally, the blockbuster product launches in the past few years that have driven earnings growth for large-capitalisation biotechnology companies have entered a more mature phase in their growth trajectory, so earnings growth has moderated. However, price earnings (P/E) valuations for large capitalisation biotechnology companies, which are normally higher than the S&P 500 Index, have now dipped below that market index. We continue to believe valuations are compelling and expect strong double-digit growth for the sector.

Despite the recent sentiment-driven falls in the sector, industry fundamentals for biotechnology remain strong. Innovation continues to be robust, with a number of key data readouts for potential blockbuster drugs expected in 2016 in areas such as migraine, multiple sclerosis, and cardiovascular disease. The regulatory environment at the FDA remains favorable for the approval of new drugs. We would also expect merger and acquisition (M&A) activity to accelerate with the recent fall in valuations, as larger companies continue to seek smaller companies with innovative assets. New product launches, favourable pipeline developments, and M&A should allow the large-capitalisation biotechnology companies to maintain their steady earnings growth. As the election year rhetoric on drug pricing subsides, we would expect sector valuations to recover.

Emerging biotechnology

After years of outperformance, the emerging biotechnology sector finally took a breather this year. Macro concerns coupled with sector specific risks such as drug pricing concerns drove the underperformance of the sector, regardless of market capitalisation. We believe that pricing overhang will eventually be lifted and remain confident that unmet medical needs are still abundant for an aging population in the major markets. Innovations in the forms of novel drugs and cutting-edge technologies should continue to serve the unmet medical needs and benefit biotechnology companies.

Looking forward to the coming year, clinical catalysts in orphan diseases such as cystic fibrosis, sickle cell disease, haemophilia and rare autoimmune diseases, as well as in oncology and age-related macular degeneration, could drive outperformance in quite a few portfolio names. In addition, positive clinical/regulatory news in emerging biotechnology companies could reinvigorate M&A activity in the sector, especially with many stocks now trading at attractive valuations.

Medical devices

Our collective view on the Medical Devices sector is notably more positive than at any point in the past several years. Fundamentals in the sector, and consequently investor interest, have significantly rebounded in recent months, primarily driven by several sizable new product cycles, overall moderate growth in legacy and market volumes, and pricing stabilisation. This is more uniformly true amongst the large capitalisation firms in the space which has also been the area of our increased investment. The small capitalisation firms are, by definition, a more diversified and niche group of companies whose overall performance has lagged.

Despite the fundamental changes to the industry, our stock selection framework remains consistent. We focus on: (1) innovation in the form of new product cycles that drive emerging therapeutic categories or disrupt legacy therapies; and (2) business right-sizing in the form of strong cost controls and subsequent margin expansion. Within product cycles, areas of significant investor interest include transcatheter heart valves, surgical robotics, left atrial appendage closure devices, drug coated balloons and bioabsorbable polymer coated drug eluting stents, which are all tracking above investor expectations.

Lastly, while valuations have increased for the sector, we think this is more than supported by the improved fundamental picture. 2016 guidance across the sector remains conservative, especially given robust first quarter results, currency tailwinds, and the removal of the Medical Device excise tax in the United States. We see a high likelihood of upward revisions to guidance and consensus estimates through the balance of the year.

Healthcare services

Investors refocused on industry fundamentals after the Supreme Court upheld the Affordable Care Act - a.k.a. Obamacare - for a second time in June 2015. Hospital stocks subsequently underperformed as Obamacare headwinds began to reappear and fears around recession risk and high yield market stress percolated. Looking forward, we are bullish on the sector. Hospital stocks are undervalued based on historical positive correlations between volume growth in a stable economy versus stock valuation, and we prefer companies with relatively lower leverage so that capital deployment can support growth. In addition, there is upside if it becomes increasingly clear that Democrat Hillary Clinton will win the U.S. Presidential election in November 2016, because more states would likely expand Medicaid eligibility under Obamacare. A Republican victory led by political newcomer Donald Trump would create some headline risk, but his actual healthcare policies remain less clear.

Within managed care, industry consolidation has been the theme as companies seek to scale up to operate more efficiently in an increasingly regulated environment. We believe proposed mergers between Aetna/Humana and Anthem/CIGNA are more likely than not to be approved, especially Aetna/Humana based on our case study analysis of past Medicare transactions where anti-trust concerns were successfully resolved by divesting local contracts. Meanwhile, we remain positive on Medicaid HMOs (Health Maintenance Organisation) that are benefiting from structural growth tailwinds as states transition Medicaid populations to managed care (from unmanaged fee for service), in order to save money and improve care quality. We used the proceeds from Health Net, which was acquired by Centene, to maintain exposure to Medicaid.

Life science tools/diagnostics

Looking back at the Company's last financial year, macro themes and product cycles dominated sentiment in the life science tools/diagnostic sector. On the macro front, the unprecedented strengthening of the U.S. dollar relative to currencies of both emerging and other developed markets tampered growth. Coupled with the volatility in the currency markets, trepidation about growth in China also caused volatility in stock prices throughout the course of the year, leading to adjustments in expectations. On the micro front, disappointing product cycles in genomics caused severe multiple contractions in small capitalisation life sciences and diagnostics companies.

Looking forward, macro concerns relating to currency are abating, as currency headwinds look to be less severe than feared. Also, commentaries from the companies with significant exposure in China with "feet-on-the-ground" indicate that the life sciences industry is as healthy and buoyant as before, despite headline concerns.

As leverage in the balance sheets of consolidators nears healthy levels, M&A and additional capital deployment strategies will once again dominate the sector. The industry remains fragmented with scale and geographic footprint being the driving force for further consolidation in the sector. We prefer companies with balance sheet flexibility and operating margin expansion opportunities. We remain cautious on companies with significant exposure to reimbursement.

Emerging markets

Despite the economic, currency, and market volatility associated with emerging markets, we continue to believe that healthcare investment in emerging markets is a good long-term, secular play. Our investment thesis has multiple themes. We believe that aging populations, rising income levels, and increasing healthcare spending as a percentage of GDP are the three key drivers underpinning the growth of healthcare markets in these regions for the next few decades. In addition, we are seeing early signs that suggest drug research and development (R&D) innovation could emerge as a new growth driver in a time horizon that is much sooner than our previous expectations.

As we move into the next fiscal year, we expect to observe a substantial consolidation trend in China among pharmaceutical manufactures, as the government starts to implement dramatically more stringent regulatory and quality requirements on generic drugs. A similar consolidation trend could also be observed for distributors in the country, as a result of the "two invoices" system that is being pushed by the government. As such, we are positively biased towards large established players in each sub sector as we believe it will likely be a "winner takes all" situation. We combine our conviction in macro trends with our fundamental research on specific companies, and favour companies with strong product development capability and commercial channels.

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Debt

(compare debt funds **here**)

Sequoia Investment Management Company Limited, adviser, Sequoia Economic Infrastructure: SIMC expects project finance senior lending margins, especially in the UK and Europe and for “core” infrastructure projects and availability-based PFI/PPP projects, to remain tight, driven by sustained commercial bank appetite for these types of assets and by increasing demand from institutional investors such as continental European insurance companies. However spreads in the mezzanine market, and for senior debt in the US and some asset classes in the UK and Europe, are expected to remain more attractive. US Dollar Libor has begun to increase and SIMC expects this trend to continue over time, increasing the average cash-on-cash yield of the portfolio. Note that this potential growth is not being relied upon to pay dividends, and SIMC’s estimations of investment yields are based on constant Libor. There is some potential for Sterling Libor also to increase, although this is not expected to happen as quickly, or by as much, as for US Dollar Libor.

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Paul Manduca, chairman, Henderson Diversified Income: The global search for yield continues to be fuelled by negative interest rate policies now in Japan as well as Europe which means that returns will come from income with little prospect for any capital growth in the near term. An important risk is a possible Brexit but we see this in terms of price volatility rather than default risk and hence could also present income opportunities.

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John Pattullo and Jenna Barnard, managers, Henderson Diversified Income: Markets remain torn between supportive central bank interventions and weak fundamentals namely growth, inflation and earnings. Moreover, the US central bank is hoping to have the opportunity to raise rates whilst the ECB, in contrast, is expanding its QE programme to include corporate bonds. We expect a fiscal expansion from Japan and possibly other countries in the years to come. The strength of the US dollar and the oil price remain key risk pivots. Against this backdrop, we feel the portfolio is well diversified at the asset class level.

Approximately one third is in financials whilst the balancing names are heavily skewed towards larger, non-cyclical consumer facing industrials. We expect returns in the medium term to be from yield (income) with limited opportunity for capital appreciation. In the shorter term, the effects of the UK referendum on its EU membership will likely dominate the price performance of the assets within the fund.

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Real Estate Credit Investments: The first quarter of 2016 saw significant market volatility across most asset classes and geographies. March has seen some improvement in sentiment. However, given the continued significant number of events and uncertainties in the global economy (UK Referendum, US elections, China's credit bubble, emerging market growth, European banks etc.), the Manager's view is that volatility is unlikely to abate anytime soon. Volatility in liquid markets and uncertainty have helped keep global rates low for the last five years. It is difficult to see a sustained catalyst that will cause rates to be pushed up significantly in the immediate future. In this environment, the real estate credit markets (for core, defensive assets with long term income generation capability) continue to benefit from the search for defensive yield generating asset classes and persistently low rates.

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Environmental

(compare environmental funds **here**)

Charlie Thomas, manager, Jupiter Green: We continue to believe there are real causes for optimism about the long-term outlook for environmental investing. The fact that the alternative energy sector appears to be decoupling somewhat from fossil fuels (as shown by the pickup in investment in the former at a time when the latter has fallen in price) is indicative of the profound structural change that is occurring in the global economy, as it gradually decarbonises and improves the efficiency by which natural resources are used. Structural change is at the heart of our investment thesis and we seek to invest in businesses whose products and services are at the forefront of this powerful economic transformation.

Following the success of COP21 in Paris last year, we expect further progress by governments and corporations when it comes to environmental policies (with the exception of some countries, including the UK) and an acceleration of awareness of issues surrounding climate change by individuals. We will also be watching developments in China, a country which has fast become a leader in terms of environmental policy and investment. It has overtaken Europe as the largest contributor to renewable energy investment and recently released its 13th five year plan that included a raft of policies that should support the green economy and lower the nation's carbon footprint. The broader implications of these reforms are vast, with the government committed to encouraging growth in areas such as infrastructure for electric vehicles, environmentally friendly construction and clean energy. We are encouraged by China's aim to transition towards a greener economy and will continue to monitor developments closely for new investment opportunities that these measures may present.

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Renewable infrastructure

(compare renewable infrastructure funds **here**)

John Laing Environmental Assets: The global renewable energy market remains strong and despite other political priorities, climate change remains one of the important areas of focus for governments and policymakers across the globe. Governments continue to promote policies and investment priorities to reduce greenhouse gas emissions in the near future and in December 2015, the UN Climate Change Conference held in Paris (COP 21) provided further support for decarbonisation initiatives on an increasingly co--ordinated basis, including the further build--out of renewable generation capacity and supporting technologies. At the conclusion of the conference the participating 195 countries agreed, by consensus, to the final global pact, the "Paris Agreement", to reduce emissions as part of the method for reducing greenhouse gas. In the document, the members agreed to reduce their carbon output "as soon as possible" and to do their best to keep global warming "to well below 2 degrees celcius". And whilst some have criticised the fact that significant sections are "promises" or aims and not firm commitments by the countries, others believe the plan to be "ambitious and balanced" and an "historic turning point" in the goal of reducing global warming.

The UK renewable energy market continues to attract significant investments and for the EU the European Environmental Agency forecasts that production from renewable sources of electricity is expected to continue to experience significant growth. This increasing contribution from renewables is also mainly driven by a generally supportive policy framework and governments' incentives for renewables, which reinforce investors' appetite for this type of asset. In the UK, whilst the reduced levels of support for new solar PV and onshore wind projects following the election of the new government in May 2015 were largely anticipated given the strength of historic investment, and will impact on developers of new developments in these areas, the government has indicated its continued support for future investment in newer areas of renewable technologies such as offshore wind, tidal and combined heat and power.

This support has been reinforced most recently by the announcement by the Energy Secretary in November 2015 that a second round Contracts for Difference ("CfD") FiT programme will be launched in by the end of 2016. This follows the successful launch in February 2015 of the first competitive auction, which awarded CfD subsidies to 27 renewable energy projects to deliver over 2GW of new renewable energy capacity across England, Scotland and Wales. The first allocation round attracted a high level of interest, with developers' bids significantly below market expectations and administrative strike prices set by the government.

The UK and European renewables markets in 2015 and 2016 have continued to be affected by low electricity prices, mainly driven by consistently falling oil and gas prices since the end of 2014. This commodity environment has primarily impacted conventional power generation but also renewables companies most exposed to electricity prices. In addition, in the UK the revenues of renewable generators were impacted by the early removal of LECs in the July 2015 budget. The ongoing weakness in wholesale electricity prices has resulted in both lower historic revenues and also lower forecasts of short and longer term electricity prices, which in turn has impacted on the NAV of all renewable energy funds. JLEN has been less affected by market conditions than its peers, due to its diversified portfolio (including waste management and wastewater), the inclusion of market forward prices for the next two years in the portfolio valuation and the extent of ROC and FiT revenues in its portfolio, which reduce its exposure to electricity prices. In 2016 and beyond, while the possibility of further falls in wholesale electricity prices cannot be dismissed, there may be upside potential for the portfolio if electricity prices recover over time. The timing and extent of changes to electricity prices will depend on a range of factors, including the impact of continued pressure on the UK capacity margin due to planned closures of coal--fired generation plants and the continued delay in the commissioning of new nuclear plants.

Whilst in the UK the PFI programme for new waste and wastewater projects is now largely completed, there remain a large number of projects which continue to be held on corporate balance sheets which should provide an active secondary market. Despite the issues noted above, the secondary market for environmental infrastructure projects remains both active and significant.

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Resources

(compare commodities and natural resources funds **here**)

Robert Crayfourd, Keith Watson and Ian Francis, managers, New City Energy: The Energy sector has had a difficult six months to the end of March 2016 due to excessive supply as OPEC removed its production quota restriction, led by Saudi Arabia's unwillingness to absorb rising global output from Iraq, Russia and North America, compounded by the untimely shift in US policy allowing crude exports for the first time in 40 years. Souring Middle Eastern relationships, which have traditionally boosted oil's risk premium, was more recently outweighed by increased regional production as warring Sunni and Shia factions pump more to fund campaigns in Syria, Iraq and Yemen. Crude sold off into the turn of the year as global growth expectations declined, before subsequently rising 30% from January lows to reach $41.34 per barrel at the half year end. Prices have been surprisingly resilient in the face of OPEC failing to agree production quotas at the previous three meetings. Our belief remains that Saudi-Iranian tensions are central to the lack of accord within the OPEC cartel as Iran, following the relaxation of US sanctions in January, seeks to restore its national output to former levels. Iranian production has subsequently recovered approximately 1 million barrels, reaching pre-sanction output levels.

Against this backdrop the actions of commercial US producers, often cited as a responsive industry segment likely to contribute significantly to restoring market balance, have received considerable investor focus. The 44.6% fall in the US rig count during the six month period led to a decline of 74,000 barrels per day, although at the time of writing output has fallen by a further 277,000 barrels per day. This reflects action by North Americas' overly indebted operators, including integrated multinationals, to make aggressive capex cuts and sell non-core asset sales to defend their credit ratings and equity dividends.

However, at the time of writing crude prices have pushed higher, briefly exceeding US$50 per barrel, due to the impact of the Canadian Wild fires on oil sands production, disruption to Libyan exports and attacks on oil infrastructure in Nigeria. A recovery in production from these regions may now act to depress prices. Further, after crude's price recovery there is now some evidence that US production may follow suit evidenced by news that drilled-but-uncompleted wells are now being brought on stream. With equities still discounting approximately US$65 per barrel, valuations of many operators appear unattractive.

Longer-term, delays to large, costly, long-lead projects will limit future supply with current global demand projections indicating the emergence of deficit conditions in 3-5 years time. We expect the more responsive, shorter lead time U.S. shale producers will be best placed to take advantage. While some U.S. operators have retrenched into the shale market we believe producers may undertake further cycle of M&A aimed at competitive on-shore, shale production. Meanwhile oil demand remains healthy, with EIA and IEA revising up their production expectations to 1.5 million & 1.4 million barrels year-on-year. This is largely driven by US demand and strong growth from China, committing to continued growth of its Strategic Petroleum Reserve.

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George Baird, chairman, Geiger Counter: China continues to pursue its policy of building new nuclear power stations; India has signed a long-term agreement with Cameco for the delivery of uranium; and America is now actively encouraging development of new uranium projects to reduce its dependence on foreign supply. Longer-term it has been estimated that supplies from Kazakhstan, the dominant global producer, will become increasingly difficult to sustain within the next five years.

The other themes that we hoped would come into play delivered more mixed results; Japan continues, albeit very slowly, with its nuclear reactor restart programme. Despite some legal proceedings attempting to stop this process it nevertheless grinds on, and we expect a significant portion of Japan's reactors to be online in the coming years. We also saw mines taken offline in Canada, a reflection of the challenging price environment.

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Robert Crayfourd and Keith Watson, managers, Geiger Counter: Japan's hesitant nuclear power reactivation programme coupled with some seasonal demand weakness continued to weigh on prices towards the end of the period. Despite the softness in physical commodity prices the Fund NAV increased 27.5% during the interim period, outperforming sterling returns for the Solactive Index and Global X Uranium equity ETF of 16.7% and 12.2% respectively.

Promising developments in early January regarding ramp-up of its nuclear generating capacity, as the first of two Takahama reactors authorised to restart commenced operation in February, were unfortunately stalled following a District Court injunction in March preventing their reactivation and requiring reactors to remain idled. Notwithstanding this hesitancy within resistant Fukui prefecture, Japan’s restart programme displayed some resilience with local courts rejecting similar attempts to shut the two Sendai reactors which have already restarted. In addition, Japan's Nuclear Regulatory Authority indicated that the final pair of reactors at Takahama and a reactor at Ikata had successfully completed necessary safety tests prior to approving their restart. The competitive marginal costs of reactivating Japan's installed nuclear power industry compared to more expensive development of incremental fossil fuelled or alternative energy sources remain fundamentally favourable for the regional industry.

China's ambitious nuclear growth plans continued apace driving further strategic M&A, reflecting the nation's longer-term supply requirements. With acquisitions focussed on the attractive Western Athabascan explorers,

India too has taken positive steps which should encourage development of its domestic nuclear power industry, ratifying its nuclear liability laws, in-line with global norms, which will place liability in the event of an accident onto power station operators rather than equipment vendors, a factor which has previously stymied regional development in a region which offers the second largest market growth potential behind China.

We believe consolidation will continue to underpin equity valuations over the next 12 months as the strategic relevance of accessing long-term uranium supply, key to the global reactor build out, increases. The announcement by Shenhua Coal, a $40bn market cap Chinese coal miner, that it is in talks with CNNC and CGN to fund the purchase of stakes in nuclear related projects as it seeks to diversify away from polluting coal fired power generation highlights both the increased emphasis on clean air power generation and prospects for further strategic activity, particularly within the Patterson Lake trend which represents one of the world's most prospective undeveloped sources of uranium.

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UK property

(compare UK property funds **here**)

Andrew Jones, chief executive, LondonMetric Property

Logistics

Online retail is driving demand for a range of different types of warehousing including mega national distribution centres, parcel sortation centres, local parcel depot stations, dot.com warehouses and local delivery centres for same day delivery.

The occupier market remains robust with take up above long term averages. Around 4.5 million sq ft was taken up in Q1 2016 which was 22% up on Q4 2015 and 18% up on Q1 2015.

Supply remains muted. From a peak availability of 94 million sq ft in 2009, it is estimated that current supply is c.15 million sq ft equating to approximately six months' demand. Speculative development has risen as a result of the demand supply imbalance however remains significantly below pre-recession levels of c. 10 million sq ft per annum at 5.6 million sq ft per annum. The average void period for units speculatively built since 2009 is just five months, reducing to five weeks in prime locations such as the Midlands.

Investor demand remains strong for distribution assets. Investment volumes in this sector in the last two years have been the strongest for the last 15 years.

Yields have continued to narrow further with prime distribution yields being c.4.5% having improved by 125 bps in the last two years. Further yield compression is likely to be muted, however rental values are growing reflecting the supply/ demand imbalances in the sector.

Retail

Whilst online is contributing to a successful supply/demand dynamic in logistics, it is causing great disruption to more traditional retail real estate. A shop unit is no longer the only route to market and as a result retailers continue to re-examine and rationalise their store networks. According to Local Data Company, vacancy rates across retail shops stand at 12.4%, however this masks the polarisation within this market. Prime retail real estate is more robust with secondary and tertiary retail increasingly redundant in today's digital age. Rental levels continue to fall in poorer retail locations as shoppers vote with their feet and retailers see no need to be located there.

The success stories within retail real estate revolve around top up, convenience-led retail. Footfall supports the strength of retail parks nationally, with their convenience and the ease at which click and collect orders can be fulfilled. Destination retail remains strong however the consumer expects more which is resulting in increased capital expenditure and operational costs to keep the destination relevant and attract footfall.

Investment volumes in the retail sector are down on historic long term averages, possibly reflecting a perceived nervousness in the sector and the future role the sector has to play in the market. Yields remain robust for prime retail with weakness seen in the secondary markets reflecting the occupational trends.

We believe that the pace of change will continue. The significant evolvement since 2009 demonstrates the impact that technological changes and shopping behaviour is having on real estate requirements.

Non-food online spending is estimated to grow from 17.4% today to 25% of all non food sales by the end of 2019. It is now widely accepted by retailers that the supply chain is consumer facing requiring retailers to have fit for purpose logistics to meet the increasing consumer demands for instant gratification and quicker online delivery.

We believe that the retailers' response and impact to real estate requirements means that sheds are the new shops.

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Picton Property Income: The past twelve months has been an extraordinary year of political and economic uncertainty, which has led to increased risk in global financial markets.

Global economic issues have included the slowdown in growth in China, the fall in oil prices, negative interest rates and deflation in Europe. In the last few days the UK's decision to leave the European Union has added further volatility to financial markets.

At this early stage, the full impact of the changes to the UK's relationship with the rest of Europe is unclear, in particular how the UK economy, financial markets and trade might be affected. In the short term, until the terms of exit are finalised, there will be no immediate change to the UK's trading position with the EU.

The uncertainty surrounding the EU referendum and a weakening manufacturing sector caused a slow down in the first quarter of 2016 in particular. Based on preliminary estimates UK GDP grew by 2.1% in the year to March 2016 compared to 2.4% in the year to March 2015. The unemployment rate at the end of April 2016 was 5.0%, down from 5.5% a year ago and at its lowest level since 2005. There were 23 million people working full time at the end of April, 304,000 more than a year earlier. Average weekly earnings in the three months to April including bonuses rose by 2.0% compared to a year earlier.

Figures from the Office of National Statistics show that CPI inflation rose by 0.3% in the year to May 2016 which is relatively unchanged from 2015, but well below the Monetary Policy Committee's target of 2.0%.

Against this backdrop, ten year gilt yields at the end of March 2016 stood at 1.5% compared to 1.7% at the end of March 2015. The Bank of England base rate has not changed over the course of the last twelve months and remains at 0.5%.

According to Property Data, investment volumes over the year remained stable but slowed down in the first quarter of 2016, possibly a reflection of the EU referendum. Total investment in the year to March 2016 totalled GBP65.9 billion compared to GBP70.0 billion in the year to March 2015. Uncertainty surrounding the outcome of the referendum resulted in investment in the first quarter of 2016 falling by 26% to GBP13.8 billion, compared to the first quarter in the previous year.

Official figures from the Bank of England showed total outstanding debt to commercial property at the end of March stood at GBP151 billion. At the end of March 2016, net new lending to property was GBP1.5 billion compared to -GBP1.3 billion in March 2015. Lending has improved since the previous year and since February 2016 has seen a significant uplift, however figures can be inconsistent month to month, and therefore should be viewed with caution.

Whilst we expect the impact of the EU referendum to result in lower economic growth, at least in the short term, this may be offset by looser monetary policy. The Bank of England has indicated that it will take additional measures as required to protect the economy.

It is too early to assess the impact of the decision in the EU referendum on future capital values. Looking at the UK commercial property market as a whole, on average capital values still remain some 20% lower than their peak in June 2007, and only markets in London have seen capital appreciation relative to that date. This means that in many markets a lack of development activity and limited supply should be supportive of current pricing.

Industrial total returns were 14.3% in the year to March 2016. Returns comprised 5.4% income return and 8.6% capital growth. Rental growth in the year was 4.5%.

The supply of floor space within the industrial sector has been low for several years, which, together with strong occupier demand and positive rental growth prospects, has led to increased speculative development.

Consensus forecasts suggest that the industrial sector is expected to outperform in the medium term.

Retail total returns were 7.6% in the year to March 2016. Returns comprised 5.2% income return and 2.3% capital growth. Rental growth in the year was 1.4%. Online retailing has caused a structural shift in how people shop, which has exacerbated the oversupply of retail. Whilst London markets and other destination locations have been less affected, the performance of retail over the year has varied by geography and retail segment. Standard Retail in London and the South East and retail warehouses have performed well.

Office total returns were 14.8% in the year to March 2016. Returns comprised 4.2% income return and 10.2% capital growth. Rental growth in the year was 7.8%.

In London, office rental growth has slowed, although it remains at a higher level than in regional markets. Across all key regional centres, take-up has increased over the year and at the end of 2015 was above its five year average. In 2015 regional take-up grew into the double digits for five of the six main key centres. Most notable was Manchester, which was the top performer in terms of take-up.

Looking ahead, regional office rents are at a lower base compared to London, which, together with improving rental growth from growing occupier demand, is likely to result in the sub-sector outperforming..

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Schroder Real Estate Investment Trust: The demand for offices in stronger regional cities also remains healthy. In addition to low levels of new development, changes to the planning system to facilitate residential conversions have resulted in a significant loss of older office space. For example, in Bristol, 10% of secondary stock has recently been converted to residential, reducing the supply of office accommodation.

The growth in on-line retail sales is leading to reduced demand for stores and some high profile business failures. This led to low levels of rental growth outside of south east retail locations. Changing social, demographic and technological behaviours mean that retailers must increasingly provide the consumer with a retail and leisure 'experience' or, alternatively, offer convenience in terms of location. This is leading to polarised returns from the retail market and we expect dominant shopping centres and convenience retail in densely populated urban centres to out-perform.

The industrial sector is benefiting from the growth of on-line retail, with increased take up of large logistics warehouses. Demand for smaller industrial estates around big cities is also increasing as on-line parcel volumes grow and internet retailers offer same day delivery. We favour multi-let industrial estates in higher growth areas benefiting from limited new development and the cyclical recovery in small and medium sized enterprises. Recent acquisitions of industrial estates in Leeds and Milton Keynes have sought to capitalise on these trends and the returns have already proven to be good since acquisition.

Assuming a vote to remain in the EU in the forthcoming referendum, we are positive about the long term prospects for UK commercial real estate. There are however reasons for caution in the short term. Although yields in parts of the market are below 2007 levels, loose monetary policy means that the sector continues to offer a 3.5% premium above the ten year Government bond yield which compares with the long run average of approximately 2%. The investment market is also less dependent on bank finance, with leveraged transactions making up 45% of the total compared with 72% in 2007. Finally, constrained development funding means that there is a relatively low supply of speculative development in most markets compared with comparable points in previous real estate cycles.

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Matthew Oakeshott and Louise Cleary, managers, Value & Income: UK commercial property delivered its third consecutive year of double digit returns in 2015, at 13% nominal and 12% real after Retail Price Inflation. Average capital values have now risen by 40% from the depths of the 2008-9 crash but are still 20% below their 2007 peak. Rental values are also growing across the country, but valuation yields have generally bottomed out and have started to edge up again and put prices under pressure in the riskier and overheated parts of the market.

2016 has started slowly with capital values slightly down on average over the first quarter. Larger properties took a 1% Stamp Duty hit in a market where some institutional investors were already getting concerned that the property cycle had peaked and they might suffer further capital outflows after February's high redemptions. Commercial property auctions, however, have been buoyed up by low interest rates and private investors switching from residential buy to let investments which have been hammered by tax, stamp duty and mortgage regulation changes.

Three years of economic recovery are now feeding through into rising rents. Office and industrial/warehouse rents and tenant demand are growing, especially in Southern England. Retail rental growth is slow and patchy, but rents are growing across the South and in some prosperous smaller towns, suburban high streets and edge of town locations throughout the United Kingdom. Medium term rental growth outside London, especially in high streets but also to some extent in industrial, office and other properties, will benefit from the long delayed rates revaluation, which will take effect in April 2017, based on realistic 2015 rents rather than the peak in 2008.

The internet continues to increase its share of shopping spend, but savvier retailers are benefitting from click and collect, while new openings by convenience and discount stores, cafes and bar/restaurants are soaking up surplus space in many high streets and pushing rental values up again in the most prosperous. Prêt à Manger, for example, is now expanding fast outside London into towns like Cheltenham, Salisbury, Milton Keynes, Stratford-upon-Avon and Taunton. Capital and rental values are also rising for leisure property such as pubs, restaurants, cinemas, bowling centres and health and fitness, if they are let to strong established operators or well backed new entrants competing for new units both in and out of town. Leisure property is one of the few property sectors where capital values are still rising and yields falling because it offers long leases and sustainable index-linked rents, with sluggish investors now struggling to increase their weightings and catch up.

Motor trade investments remain in strong demand, as they also offer long leases, often with indexed rents. A record 2.63 million new cars were sold in the UK in 2015. New car retailing has been transformed by cheap manufacturer-backed financing, so it operates much more like the mobile phone market, with customers returning their cars to the dealer for an upgrade every two or three years. Over three quarters of new cars are now financed by lease or hire purchase, against under half seven years ago.

The out of town retail market is more subdued for both occupiers and investors, with B&Q, Homebase (pre the Bunnings takeover), Argos, Morrisons and Tesco shedding space but discounters such as Aldi, Lidl, B&M, Home Bargains and The Range growing aggressively. The main casualties from the new National Living Wage will be in the care home and health sectors, where operators who are heavily reliant on low paid staff and public funding will find cost increases even harder to recoup, with the 2% extra annual Council Tax increase for care funding clearly inadequate across most of the country.

Long term pension fund and insurance company investors are competing to buy "matched investments" with long index-linked leases to cover their annuity and inflation-linked liabilities with realistic returns from well-let property. These are far better value than index-linked gilts at painfully negative real yields, now down to -1%, or conventional gilts with yields near 300 year lows. But capital and rental values are still falling for large supermarkets, in view of the structural shift in demand away from visits to traditional large food stores.

After a satisfactory year of 2% growth, the UK economy has hit a soft patch, with GDP growth slipping to 0.4% in the first quarter and forecasts progressively downgraded. The public sector and trade deficits are still obstinately high, with the oil and commodity markets fragile. The British economy has grown every quarter for three years, but in a rather unbalanced way, with consumer spending and the service sector providing the main stimulus, productivity flat and manufacturing and the balance of payments now deteriorating again. Disappointing world GDP growth is depressing exports and manufacturing output - bright spots such as aerospace, cars and pharmaceuticals are offset by weakness in metals and energy-related industries, while construction is still running well below the demand for new homes and its historic highs.

The speculative bubble in luxury Central London residential developments has now burst, and the stampede to beat the end-March stamp duty increase by buy-to-let investors has left some indigestion. But ultra-low interest rates and chronic supply shortages should support house building and prices in the more affordable regions and price brackets.

Inflation in most developed economies remains subdued, with low energy and food prices boosting real incomes. But price inflation ticked up a little in Britain in March as oil prices stabilised and sterling came under pressure.

UK property offers outstanding value at a yield premium of 4 points above long-dated conventional gilts and almost 7 points over long-dated index-linked. As an each-way bet offering a high initial yield with some longer term inflation protection, it is likely to stay in demand for the next few years. UK property yields are also attractive against UK equities, because dividends earned from overseas in particular are under pressure but UK domestic rent payers are in reasonable health and real rents are recovering well since they tend to lag rather than lead economic recovery.

Individual properties and small portfolios for sale between GBP2m and GBP10m offer the best investment value now, as they are too large for most private investors but below most institutional and overseas investors' radar. Only 5% of properties in the IPD Monthly Index are now let at above current market rents, an 8 year low, with reversionary potential at an 8 year high, pointing to continued rental growth.

The main downside risk to UK property values would be a vote to withdraw in the European Referendum. Central London offices, valued off very low yields and very high rents, are now priced for paradise but face a perfect storm of Brexit, rates revaluation and transparency as the crackdown on money laundering and tax haven secrecy gathers pace. If the vote were Leave, their rents could easily fall by a tenth and valuation yields rise by a point, cutting capital values by a quarter. But the damage should be much more limited across the provincial property market, which has stickier tenants than the City of London or Canary Wharf, and a much thicker yield cushion against rising interest rates.

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Drum Income Plus REIT: At the end of the first quarter of 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 regional property market due to a lack of new development in regional property over the last 8 or so years. Interest rates remain low and the country enjoys high employment whilst inflation is benign. Improved levels of business and consumer confidence are noticeable on the back of real wage growth which is also having an impact on household finances.

There does, however remain a downside and principal among these concerns is the 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 experienced in the first months of 2016 is a concern. Given the historic relationship of UK gilts to property yield the potential impact of a rise in UK interest rates has been the subject of significant commentary of late. The Investment Adviser is of the view that there is still enough of a yield gap between gilts and regional property, particularly within the stated scope of the Company's Investment Strategy, to provide an adequate buffer to cope with some upward movement in rates, whenever that may occur.

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 a positive economy, increased tenant demand and supply-demand imbalance, along with the sizeable weight of money that has flowed into the sector, 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 and lot sizes where rental growth should be achieved in the coming cycle.

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David Hunter, chairman, Custodian REIT: In 2014 and particularly in 2015, excessive investment demand, both domestic and overseas, was focused on London, the South-East and the dominant regional cities. This imbalance of demand over supply resulted in price inflation, which delivered NAV growth to many funds as a result of the exceptional yield compression felt strongly in prime markets, while smaller lot size regional properties were less affected.

Investment in commercial property was reported to be down 30% in the first quarter of 2016, with circa GBP170m of net redemptions recorded from open-ended funds and many listed property funds moving to trade at a discount to NAV. Market sentiment has not been helped by uncertainty over the EU referendum and, while it is unclear whether property investment activity will pick up post-referendum, there appears to be a less compelling argument for investing for capital growth, with a shift in emphasis to sustainable income and income growth.

While the investment market appears to have become more competitive, in large part this is being matched by a strengthening occupational market. This, combined with a dearth of modern vacant space, is leading to rental growth in most office and industrial markets with reducing vacancy rates on the High Street driving a return to rental growth in many retail centres.

I anticipate occupational demand, combined with a limited supply of new development, will drive further rental growth across regional markets.

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Richard Shepherd-Cross, Custodian Capital Limited, manager of Custodian REIT: Reporting on the UK property market is often focused on London, not least because it makes up a significant proportion of the total commercial property investment market. However, it is important to look through the headlines to understand what is really driving returns from this very varied asset class.

It appears the start of 2016 marked a watershed in recent attitudes to UK commercial property. In January many mainstream listed property companies saw a dramatic fall in their share price, many property investment companies saw their shares fall to a discount to NAV and the open-ended property funds witnessed significant net outflows of capital after three years of positive net inflows.

This shift in attitude might be due in part to the uncertainty of 'Brexit' or the perceived end of a cycle, but questioning whether or not it is appropriate to call time on commercial property investment is too simplistic. Property is a diverse asset class and its investment performance is driven by myriad different dynamics. Furthermore, it might be considered hasty to ignore a high yielding asset class in a largely low return environment, or to conform to a short-term change in sentiment when assessing an asset class that performs well over the long-term.

UK commercial property returns in 2015 were skewed by significant cash inflows chasing a capital growth story that was particularly focused on the prime and central London markets. The capital growth witnessed was largely a result of a self-fulfilling prophecy, in so far as the pressure on fund managers to invest the capital that swung into property in itself caused price inflation, which delivered the lion's share of total return. However, this phenomenon was always going to be short-term and recent out-flows of capital have shown this to be the case.

Meanwhile, the real commercial property story of the last two years has been the return to health of the occupational market. In office and industrial markets a lack of supply following seven years of minimal speculative development is pushing vacancy rates to all-time lows and driving rental growth. Low vacancy rates, which are also a feature of the retail warehouse sector, enhance cash flows from investment portfolios and support dividend cover. We believe the key determinants of return and the sustainability of returns in 2016 are likely to be income and income growth, both of which are driven by the occupational market dynamics described above, rather than flows of capital into the investment market.

The occupational market story is particularly resonant in smaller lot size regional property. As the majority of fund managers set a minimum target lot size for individual assets of GBP10m-15m, market pricing of smaller lots has been more stable, having not experienced the excess demand pressure seen in the broader investment market.

The smaller lot-size, regional market has not yet seen the price inflation which has been a feature of London and large lot-sizes, so it is still possible to acquire properties with strong investment credentials.

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QuotedData

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