Monthly summary | Investment Companies

October 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	30/09/16	Chg. on month %
USD / GBP	1.2972	(1.3)
USD / EUR	0.8901	(0.7)
USD / JPY	101.35	(2.0)
USD / CHF	0.9714	(1.3)
USD / CNY	6.6718	(0.1)

MSCI Indices rebased to 100

Time period 30/09/15 to 30/09/16

Source: Bloomberg and Marten & Co

	30/09/16	Chg. on month %
Oil (Brent)	49.06	4.3
Gold	1315.87	0.5
US Tsy 10 yr yield	1.5944	0.9
UK Gilt 10 yr yield	0.746	16.2
Bund 10 yr yield	(0.122)	n/m

Global

Risk is building in markets and fiscal stimulus may be on its way.

Paul Burrows, chairman of UIL, says that investors are being driven to seek out yield and risk is being overlooked. Any divergence from the accommodative policies of central bankers is likely to cause deep dislocation and high volatility. The managers of Ruffer Investment Company caution on open ended corporate bond funds, concerned that investors do not appreciate that these investments are illiquid and achieve their high yields in exchange for higher investment risk. They also believe that government induced fiscal stimulus is looming as monetary policy has little room for manoeuvre – though they think that, once this starts, it sets a hare running that will be difficult to control.

UK

While some commentators think investors are best served by favouring companies with overseas earnings, others see upside for domestically focused companies provided that the government makes an effort to support the UK economy. An uptick in M&A activity might provide some relief but the uncertainty around Brexit and other challenges may weigh on markets.

(continued overleaf)

UK (continued)

Rory Macnamra, chairman of Dunedin Income Growth says that UK monetary policy continues to inflate asset prices at a time when economic growth remains questionable and thinks that it is likely that most of the better opportunities for long term growth lie in companies with activities that stretch well outside the country. Philip Remnant, chairman of City of London, points out that larger, FTSE 100 companies are principally dependent on the global economy which has been relatively unaffected by the Brexit vote. Neil Honebon, chairman of Murray Income, says very easy monetary policy looks increasingly like pushing on a string for the real economy. Charles Luke, manager of that fund, makes the point that, in more difficult times it tends to be those companies with globally diverse revenue streams, strong competitive advantages and robust financial characteristics that perform best.

Martin Boase, chairman of Jupiter Dividend & Growth believes the UK economy is likely to slow in the coming months, perhaps materially. However, his expectation is that there will be a range of policy initiatives to boost the economy which would be particularly helpful for domestic companies, which are being priced for recession. Richard Hills, chairman of Strategic Equity Capital, believes the current investment environment, albeit with short-term uncertainties, is likely to offer some attractive long-term investment opportunities. Stuart Widdowson and Jeff Harris, managers of that fund, argue the case for stock picking amongst UK smaller companies saying uncertain times can bring opportunities as well as challenges and nimble smaller companies and quality management teams can often be well placed to capitalise on these opportunities. They think highly geared companies could de-rate but M&A activity might pick up. The managers of Aberdeen Smaller Companies Income echo these sentiments.

Georgina Brittain and Katen Patel, managers of JPMorgan Mid Cap, are concerned about levels of corporate investment as companies face a period of uncertainty which may last for many years to come. They foresee the likelihood of increased volatility as the Brexit negotiations actually get under way. Talking about the referendum, Rupert Barclay, chairman of Sanditon, hopes that common sense prevails and this vote does not usher in a period of protectionism but says, Brexit or no Brexit, these are very challenging times for all investors.

Harry Nimmo, manager of Standard Life UK Smaller Companies, strikes an upbeat note as he says the last 20 months have seen an unusual succession of high quality companies newly listing on the London Stock Exchange leading him to the view that for smaller companies at least capitalism is alive and kicking and creating wealth and jobs within the United Kingdom.

Asia

Warnings that Asian stocks are expensive, buoyed up by low interest rates and ASEAN may be stuck in a rut

Stewart Investors, managers of Pacific Assets, think that, only in very superficial terms can it be argued that Asian markets look reasonably valued. The managers of Schroder Asian Total Return, question the competitive advantage of the ASEAN region and think that, without better government, ASEAN may be stuck in a low-growth rut. Sarah Bates, chairman of Witan Pacific, says that, at some point, the decline in yields (associated with very low interest rates) will start to reverse and those investments borne aloft by abundant liquidity rather than their own intrinsic merits may prove vulnerable.

Europe

Change and disruption create opportunities

Alexander Darwall, manager of Jupiter European Opportunities, is disappointed by the lack of supply side reform in the EU but takes comfort from the fact that change and disruption also creates opportunities so that some companies can still grow irrespective of the general economic conditions.

North America

Recession coming for US market?

Robert Siddles, manager of Jupiter US Smaller Companies, thinks that, whoever wins the US election, the new President may be keen to get a recession out of the way sooner rather than later.

Emerging markets

The future of emerging markets is dependent on the actions of their governments. Frontier markets have been overlooked.

Hélène Ploix, chairman of Genesis Emerging Markets thinks that the future is brighter for companies in countries prepared to reform their economies. The managers of that fund are monitoring China's progress to a more sustainable growth strategy. They think a soft landing in China could see the beginning of a new, more positive cycle in emerging markets. Looking at frontier markets, the managers of Aberdeen Frontier Markets think these countries deserve more attention from investors as they offer relatively low valuations, high yields and low correlation to developed markets.

India

Progress on reforms and a good monsoon are encouraging.

Fred Carr, chairman of India Capital Growth, hails the progress the government has made with reforms such as the Goods and Services Bill. A good monsoon should also help the India economy. He believes, India is well on the road to delivering high quality sustainable economic growth. The managers of that fund expand on the government's reform programme and welcome the new central bank governor. They say that, barring exports focused businesses, they are seeing a revival in earnings momentum which bodes well for the future.

Latin America

Regime change gives Brazil hope

Peter Burnell, chairman of BlackRock Latin American, makes the point that real interest rates in the region are much higher than elsewhere in the world and there is scope for them to fall. Will Landers, manager of that fund, is enthused about the prospects for growth in Brazil following the regime change. Mexico is overshadowed by the US election. Argentina could be upgraded to emerging market status.

Commodities and natural resources

Signs of recovery and supportive environment for resources sectors

Geoff Burns, chairman of City Natural Resources, thinks Brexit gave politicians an excuse to prevaricate over economic tightening which is good news for the sector. He believes the long bear market injected realism into the market. The managers of that fund cite a recovery in Chinese demand, a clampdown on polluting and uneconomic production of resources in China and an inability to invest thanks to balance sheet stress as reasons to be cheerful. They also expect the oil market to balance in 2017.

Debt

Case for alternative lenders as strong as ever

The managers of Project Finance Investments highlight the withdrawal of mainstream lenders from areas of speciality lending, opening up opportunities for alternative lenders. They think uncertainty around Brexit helps that case. The managers of Blackstone/GSO Loan Financing talk us through the European bank loan and CLO markets. They say demand is outstripping the supply of new paper in the high yield and loan markets. The managers of VPC Speciality Lending echo the points made by Project Finance Investments. They think the problems experienced by the speciality lending market over the first half of 2016 were temporary in nature. They think we'll see more securitisations of loans originated on online lending platforms over the second half of the year.

Property

Commentators views differ on whether prime or regional property will fare best post Brexit

Vikram Lall, chairman of F&C UK Real Estate, says uncertainty and pricing weakness in the wake of the referendum appear to be moderating, helped by accommodative monetary policy. The managers of that fund think forced selling (associated with the pressure on open-ended property funds) may have a short-term impact on valuations. They favour quality, well-let properties in established centres.

Kevin McGrath, chairman of regional REIT offers a contrasting view, saying the valuation gap between the regions and London is still well above long-term averages. The managers of that fund go into the regional property market in the UK in some detail. They highlight the good prospects for export-led manufacturing businesses thanks to post-Brexit sterling weakness. The managers of Real Estate Investors also favour regional markets over London and the South East.

Robert Peto, chairman of Standard Life Investments Property Income, acknowledges the threats posed by Brexit but believes unlike in previous downturns, the sector is in better shape with lower gearing, higher occupancy rates, lower levels of speculative development. Jason Baggaley, the manager of that fund, concurs. He also points out that vacancy rates are at below average levels in most markets and development remains relatively constrained.

Other sectors

We also have commentary on Africa, Emerging Europe, Qatar, South Korea, Infrastructure, an in-depth look at the global private equity market from Pantheon International. Within the property section there is also extensive comment on the health care property sector from Target Healthcare REIT plus thoughts on the Irish, German and Macau property markets.

Contents

Global

(compare Global funds **here**)

Paul Burrows, chairman, UIL: The world's economic outlook continues to be weak. The response from central bankers continues to be accommodative. However, the stress imposed on the world's markets by such accommodative policies is imposing significant strains on parts of the market. In particular exchange rates have been and are likely to continue to be volatile. In this environment the world's investors are driven to seeking out "yield" and risk is being overlooked. Any divergence from this "synchronised" global response is likely to cause deep dislocation and high volatility. Given this background we remain concerned about the outlook, especially for social and political divergence, as happened as a result of the Brexit vote. The current global response from central banks, is driving up asset values and gold price; emerging markets and Fintech investments should also benefit. Should a rift emerge to the "synchronised" approach gold should benefit disproportionately.

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Ruffer AIFM limited, managers of Ruffer Investment Company: The Bank of Japan's experimentation with negative interest rates is coming to be accepted as a policy error by the outside world and our belief is that the authorities will move towards a more fiscally orientated form of stimulus. At a stock level in Japan there is still low hanging fruit available for investors. In the last year, there has been considerable progress on corporate governance, dividends and share buybacks. Share prices have generally responded well to this, but the Japanese market continues to be dominated by the macro picture and that has not been favourable in the last 12 months as the yen has strengthened and the ripple effects of China's slowdown have been felt far and wide. With the Japanese 30 year government bond yield hovering near zero, the equity index earnings yield of 8% should be very attractive to domestic investors. However, this requires a departure from the deep-rooted deflationary mind-set and this is not easily achieved.

Looking farther afield, the Central Bank put and miserly interest rates on cash is that savers have been herded out of cash and bonds into riskier investments. This has unintended consequences and in our view these chickens will come home to roost. The property fund promising daily liquidity has been revealed to be the contradiction in terms it was always bound to be and this phenomenon is likely to spread other similarly illiquid asset classes (eg corporate bonds). Of course there is a reason for their higher yield and that is a higher level of investment risk and a lower level of liquidity, but this has been merrily glossed over by the salesmen pushing such products.

Investors have become accustomed to markets forcing change onto politicians, who have otherwise been complacent that the status quo is satisfactory. This seems to be changing as elections, as opposed to market events, are now the clear and present danger to politicians. Paradoxically, this brings us closer to the inflationary denouement that we anticipate. The reaction function of central banks and governments to keep the show on the road remains intact with one subtle difference; central banks have openly stated that monetary policy is running out of road and requires the support of government induced fiscal stimulus.

This is already in evidence with the Treasury kite flying the potential for a corporation tax cut, various housing-related policies, a lightening of the regulatory capital requirements placed on banks and the public debate on helicopter money overcoming its taboo status and hitting the mainstream. In the short term this may help steady the ship, but it sets a hare running that will be difficult to control.

Markets recovered into the end of June after a nasty shock, but persistently low growth, deflationary pressures, rising inequality and an inability to deleverage is a Molotov cocktail of risks to be guarded against. As always, what will not be clear until after the event is exactly which spinning plate will be the first to fall and when. What seems more important is to identify that even the most skilful juggling act cannot go on forever.

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New Star Investment Trust: The shift in monetary conditions that occurred in early 2016 should be positive for equities and bonds. Emerging market assets, in particular equities, may recover further given their low relative valuations. Improvements in the current account balances of many developing economies may also underpin recoveries in their currencies, particularly against sterling, which could weaken further if Brexit talks prove difficult. There is also further capacity for monetary easing, with India likely to cut interest rates if food inflation eases following the monsoon season.

Over the coming months, unpredictable political events such as the US presidential election and the start of UK "Brexit" negotiations will influence market returns. Central banks in aggregate continue to pursue highly-supportive monetary policies and although the Fed is expected to raise rates further the rate of increase is likely to be slow.

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Tom Walker, manager Martin Currie Global Portfolio: For several years we seem to have been living in 'interesting times' in terms of the heightened geopolitical and economic volatility. Despite this, returns for global equity investors have been strong. While it seems alarming that asset prices can outperform economies and investor sentiment to such a degree, it is hard to sit on cash when it earns no return.

We cannot forecast with complete certainty whether the environment is going to remain the same (low interest rates and low growth) or whether growth, inflation and higher interest rates are just around the corner. We favour the former scenario. However, either way, we believe that equities should do better than other assets, particularly bonds.

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United Kingdom

(compare UK funds **here**)

Rory Macnamara, chairman, Dunedin Income Growth: Much of the economic and market activity during the period was in direct contrast to that which we had experienced during the previous twelve months. As we entered 2016, signs began to emerge that after significant monetary and fiscal stimulus China's economy was finally stabilising. This led to a recovery in commodity prices and a resurgence of investor appetite for emerging market assets. Alongside this, the oil price, having hit $27 a barrel in February, began a gradual recovery as supply disruptions in key producing markets which, combined with reduced output in the United States, began the long process of rebalancing the market.

We witnessed a substantial period of market volatility following the UK referendum and the decision to leave the EU. Sterling dropped sharply, registering the largest one day fall against the US dollar in recent times while government bond yields contracted significantly with yields on 10 year gilts touching 50bps as overseas investors reduced exposure to the UK and domestic institutions sought safety assets. The stock market produced significant declines in the immediate days following the vote, but performance was bifurcated between significant underperformance from companies exposed purely to the UK economy and hefty outperformance from those that would benefit from the diversity of overseas exposure and the translation of foreign currency denominated profits into Sterling. As a result the FTSE 100 Index, with its large weighting to international revenues, performed more robustly than the more domestically exposed small and mid-cap segments of the market.

That all being said, the UK stock market has recovered significantly following the vote and is now trading at levels above those reached prior to the referendum. Intuitively this seems surprising but has been driven by three factors. Firstly, the decline in Sterling has a significant translational benefit for the c.70% of revenues that are achieved from outside the UK by companies within the FTSE-All Share Index; in other words, in Sterling terms, UK companies are on average making greater profits than they did previously. Secondly, the substantial decline in longer dated bond yields has made the appeal of higher yielding equities even greater and has driven those looking for income to invest into those stocks. Thirdly, as economic data has emerged, it does not suggest that the UK economy has suffered the kind of disruption that many feared. The most recent services and construction PMI surveys and house price data all suggest that, after an initial panic, the business environment has stabilised to a degree. Alongside this, the Bank of England has launched a number of supportive measures including the first cut in interest rates since 2008, a further extension of its quantitative easing programme, and significant liquidity and lending support to the banking sector.

UK monetary policy continues to inflate asset prices at a time when economic growth remains questionable. While it is early days, it seems unlikely in the medium term that this period of exit from the EU will enhance the UK's economic prospects relative to the rest of the world. In contrast, we are starting to see some modest signs of stabilisation in parts of the emerging world such as China and Brazil which have struggled in recent years. It is likely that most of the better opportunities for long term growth lie in companies with activities that stretch well outside these shores.

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Martin Boase, chairman, Jupiter Dividend & Growth: The UK stock market has mostly recovered from the shock of Britain's vote to leave the EU. The political vacuum that appeared immediately after the vote together with the temporary suspension of dealing by several large commercial property funds with its echoes of the 2008 financial crisis markedly increased nervousness and the yield on one two-year gilt issue briefly turned negative for the first time. However, the surprisingly quick formation of a new cabinet removed much uncertainty at the margin.

The weak performance of the pound since the referendum result reflects the prospects of an interest rate cut and increased probability of a recession, although UK Q2 GDP was stronger than expected. If the UK has had a minor heart attack then the sterling devaluation should provide a resuscitating shot of adrenaline. The weaker pound has boosted the overseas earnings of many blue chips; British exporters are now more competitive and UK assets should be more attractive to foreigners.

In the immediate aftermath of the referendum, company trading and outlook statements have been scrutinised closely for signs of attrition but so far housebuilders have not reported cancellations nor has ITV reported any major cancellation of advertising budgets or any step change in spending patterns. Clearly, that could change and the balance of risks remain on the downside. Although we have seen some weakness in airline and travel companies this may be as much about terrorism fears as it is about Brexit, if not more.

The economy is likely to slow in the coming months, perhaps materially. However, our expectation is that there will be a range of policy initiatives to boost the economy, which may include interest rate reductions/monetary stimulus, housing market initiatives and infrastructure spending. Such initiatives would be particularly helpful for domestic companies, which are being priced for recession. Whilst this is a possibility, your Company does not regard the current environment as comparable to the 2008/9 global financial crisis when the banking system was bust, there was no availability of bank finance and business/consumer activity was in freefall.

The authorities are mindful of the need for prompt and supportive action. As a statement of intent we note that the chief economist of the Bank of England was quoted as saying "I would rather run the risk of taking a sledgehammer to crack a nut than taking a miniature rock hammer to tunnel my way out of prison."

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Georgina Brittain and Katen Patel, managers, JPMorgan Mid Cap: Subsequent to our year end, the Bank of England has acted swiftly to counteract the potential damage to growth that the Referendum outcome may cause. It has cut interest rates to an astonishing 0.25%, while leaving open the possibility of further cuts to come, and has extended its quantitative easing by expanding its asset purchase scheme, and committing to purchase up to GBP10 billion of corporate bonds. On the back of these actions, it has cut its GDP forecast for 2017 from 2.3% to 0.8%, but it currently forecasts that the UK will not enter recession.

We applaud these pre-emptive measures by the Bank of England. Our concern is that the companies we invest in, and indeed all UK companies both small and large, face a period of uncertainty which may last for many years to come. Companies cannot plan growth and investment opportunities in a knowledge vacuum. This was well put in a recent comment by Andy Haldane, one of the members of the Monetary Policy Committee, which sets the UK's interest rates. He stated that 'the EU Referendum result has thrown up a dust cloud of economic uncertainty, making it harder for companies to plan, with potentially adverse implications for future investment and jobs.' The key word here is 'potentially'. We do not at this stage know how inflationary the fall in sterling will prove, nor how the consumer will react over the coming months and years, and nor do we know the extent, if any, of a reduction in investment by UK companies. We foresee the likelihood of increased volatility as the Brexit negotiations actually get under way.

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Tom H Bartlam, chairman, Jupiter UK Growth: The outlook for the rest of 2016 and into 2017 is particularly uncertain, given the many questions that still need to be answered about the trade and other arrangements that will follow Brexit, an event which is still more than two years away. The UK has seen a large amount of political upheaval in a short period and how the new Prime Minister and her Cabinet go about their 'Brexit' negotiations - and how the European Union nations and global markets will respond - remains to be determined.

The Bank of England has, meanwhile, moved quickly to introduce a range of monetary stimulus measures in response to the referendum vote and the chancellor is expected to announce further fiscal steps to stabilise the economy in his Autumn Statement later this year. For what it is worth, our assessment is that the referendum result creates both opportunities and challenges for UK companies. Companies which have significant revenues and earnings overseas will benefit from sterling's fall.

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Rupert Barclay, chairman, Sanditon: Negative interest rates, elevated asset prices and anaemic global growth remain a significant hurdle for all investors. The United Kingdom's decision to vote to leave the EU at the end of the period has created another layer of uncertainty which is likely to create extra volatility as governments and investors work out the implications. We can but hope that common sense prevails and this vote does not usher in a period of protectionism but, Brexit or no Brexit, these are very challenging times for all investors. We all have to get used to an era of low (or no) returns.

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Richard Hills, chairman, Strategic Equity Capital: The new financial year has started with stock markets, both at home and overseas, assessing the impact of the UK Referendum result. However, the full impact on the medium to long-term prospects for many quoted companies will be unclear for some time.

The current investment environment, albeit with short-term uncertainties, is likely to offer some attractive long-term investment opportunities. The close-ended nature of the company provides the investment manager with a useful tool to capitalise on these opportunities as and when they arise.

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Stuart Widdowson and Jeff Harris, GVQ Investment Management Limited, managers of Strategic Equity Capital: In common with last year's outlook statement, we continue to believe that the next year will see mixed trading from quoted companies. With many companies operating at close to peak margins, combined with a low growth macro environment, companies that cannot benefit from structural growth or significant margin improvement initiatives, are likely to find material, organic, constant currency earnings growth challenging. Alongside this, there are many macro and geopolitical factors for these companies to navigate.

We would be surprised if the UK Referendum was the last geopolitical or economic shock of the current year. Many macro risks remain in the global economy, in an environment where the growth outlook continues to slow.

We believe that the prospects for earnings growth of smaller companies are likely to vary considerably. Companies with low growth prospects, challenged business models and little scope to improve margins are likely to struggle to make headway. In comparison, smaller companies operating in niches which are growing and/or where their financial performance is relatively unaffected by the geopolitical and macro economic gyrations of the global economy, are likely to continue to perform well. Uncertain times can bring opportunities as well as challenges and nimble smaller companies and quality management teams can often be well placed to capitalise on these opportunities.

There are competing influences on ratings in our investment universe. On the positive side, ratings (in absolute terms and relative to the FTSE 350) appear to be below long-term averages and smaller companies offer good growth prospects in a low growth environment. In addition, AIM shares offer significant inheritance tax benefits and there appears to be a relative shortage of high quality non-resource AIM stocks with market capitalisations above GBP50m. We have not seen the impact of a prolonged period of outflows from a broad range of funds for many years and the recent market volatility does not yet appear to have led to material outflows in smaller company OEICs. The positive moves in the smaller company markets over the past few years have been driven by much lower liquidity than during the last cycle leading up to 2007.

Within the market, we believe that investors may take a more cautious approach to company balance sheets, and more highly geared companies could de-rate. Our working assumption on ratings is to expect no material change over the next year.

The prospects for M&A look better than for some time. The fall in Sterling has made UK assets much "cheaper" for overseas investors, particularly where those UK companies have significant overseas earnings. Trophy assets may attract suitors. This is typified by the announcement post the period end of the bid for ARM Holdings by Softbank. In addition, the cost of borrowing remains very low, and in a low growth world, M&A offers an attractive, swift and accessible way for companies to grow. Statistics produced by Liberum imply that M&A among FTSE Small Cap companies as a % of the index market capitalisation is running at the lowest level since 2001.

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Philip Remnant CBE, chairman, City of London: The result of the referendum at the end of June was unexpected and the shape of our future relationship with the European Union is still far from clear. The sharp sell-off in equities which ensued has largely reversed, although medium-sized, domestically focussed stocks continue to be adversely impacted by the expected deterioration in the UK's economic prospects.

Against this uncertain back drop which may well lead to increased volatility in the markets, FTSE 100 companies are principally dependent on the global economy which has been relatively unaffected by the Brexit vote; the fall in sterling will help the competiveness of UK exporters, as well as having a positive effect on overseas profits translated back into British pounds. Prospects for dividend growth have been improved by the depreciation of sterling.

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N A Honebon, chairman, Murray Income: It is difficult to see what will significantly improve the economic growth environment in the immediate future. Hard-to-predict political change is afoot in a coming year with important general elections in the US, Germany, France - and the start of the Brexit process. The massive experiment of very easy monetary policy looks increasingly like pushing on a string for the real economy, and although it has been good for financial asset prices, near zero (or negative) interest rates are a severe problem not only for risk-averse savers but also for the business model of much of the financial sector, banks and insurance companies. Benefits to consumers from lower oil and commodities prices are falling out of the comparisons, and productivity improvements which would support higher real incomes are hard to identify as a general trend. But for the UK the biggest change is lower Sterling - bad for inflation and consumers, but good for exporters and for companies with strong overseas businesses. The search for sustainable and growing income is ever more key and precision of selection essential.

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Charles Luke, manager, Murray Income: Although the UK equity market has recovered swiftly, many uncertainties remain following the decision to leave the EU. For management teams and consumers alike the future is far from clear, a position manifested by the broad range of forecasts for UK GDP growth over the medium term. As monetary policy reaches the limits of its capabilities and effectiveness, we are likely to see the baton passed to fiscal policy to support the domestic economy. However, the lack of transparency regarding the UK's relationship with the EU is unlikely to be easily or simply resolved. This complicates an already challenging global macro-economic picture where vulnerabilities include Europe's banking sector, China's credit-fuelled growth and the outcome of the Presidential election in the United States. In an environment where quantitative easing has benefited asset prices more than the real economy and with an uneven distribution of wealth, it is perhaps unsurprising to see an increase in populist political rhetoric. This rhetoric is being increasingly manifested through, for example, a greater focus on taxation or the introduction of minimum wage legislation, subjecting the profitability of companies to further pressure in a world where structural reform is still required, economic growth remains subpar and pricing power is generally weak. It is difficult to suggest that valuations in absolute terms look attractive although a more powerful argument can be made relative to government or corporate bonds but perhaps this should not be overly relied on given the current highly unorthodox setting. Indeed, in more difficult times it tends to be those companies with globally diverse revenue streams, strong competitive advantages and robust financial characteristics that perform best.

Aberdeen Asset managers, managers of Aberdeen Smaller Companies Income: This time last year we were becoming acutely aware of the strong returns smaller companies had delivered over a number of years and were cautious as to how long this could be sustained. In the twelve months since then we have seen a continuation of more difficult end markets and perhaps an acceptance from investors that growth will simply be more challenging to come by and this has precipitated some profit taking in richly valued companies. Those sectors exposed to the domestic economy have also fallen out of favour owing to challenging trading conditions and downgrades to UK growth.

Our view is that the fall-out from Brexit should be largely concentrated within the UK itself, with some ramifications for the Eurozone, but unlikely to have a material impact on global economic activity. With that in mind, emphasis will continue to be placed on identifying and investing in those companies with the most diversified revenues both geographically and by end market. The importance of strong balance sheets comes to the fore in more challenging times. They give businesses both the ability to invest counter cyclically - and thereby position themselves strongly for when growth returns - and also the optionality to target selective acquisitions and consolidate and strengthen their market share.

Harry Nimmo, manager, Standard Life UK Smaller Companies: A future outside the EU and a tortuous process of disengagement does not, on the face of it, bode well for UK Listed Smaller Companies. Economists are working overtime trying to make sense of it all and many different answers are forthcoming although the overwhelming preponderance is towards the negative. The IMF has reduced its UK GDP growth forecast by 0.2% in 2016 followed by 1.3% growth in 2017. This hardly seems like the end of the world. None of them see it as a good thing except perhaps a small minority in the very long term. That said things will not grind to a halt, there will be winners and losers. Our hunch is that the strong will get stronger and the weak will get weaker.

Our prognosis on the oil price is that it will remain in a trading range of $30 to $60 for a number of years. A similar pattern may become apparent in industrial minerals although gold may remain firm in this rather uncertain period.

The most recent economic data is unsurprisingly weak both in terms of consumer and business confidence. Although on the positive side the political vacuum seems to have been filled there still remains the uncertainty of the disentanglement process.

Within Europe the economic outlook seems uncertain. An EU without the UK is a weaker entity. Many small European nations, particularly in Northern Europe were counting on the UK as a counterweight to the might of Germany. The Italian banking industry is in a mess. The Euro may yet have to face up to further crises if Greece and other peripheral economies can't mend their ways.

The immediate aftermath of the EU Referendum vote displayed indiscriminate selling. Our view is that as companies report it will be "as the shepherd sorts the sheep from the goats". High quality growth companies should continue to report resilient progress as the lower grade businesses struggle. That said, at the time of going to print, there has been a recovery in consumer and business confidence in the UK which suggests that the impact of the EU referendum vote may be muted in the near term.

It sometimes feels that capitalism is failing when one reviews the list of well documented scandals surrounding some of UK's largest companies. However I remain very positive on the outlook for UK Smaller Companies. This view has been strengthened over the last 20 months by an unusual succession of high quality companies newly listing on the London Stock Exchange leading me to the view that for smaller companies at least capitalism is alive and kicking and creating wealth and jobs within the United Kingdom and beyond where innovation and business development are being correctly rewarded.

An emphasis on risk aversion, resilience, growth and momentum still feels right for the future. Caution should be the watch-word however. The surprisingly good out-turn of smaller companies since the referendum on the EU may wilt if there is any sign of real weakness in the UK economy.

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Asia

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

James Williams, chairman, Pacific Assets: Our financial world remains locked in the extraordinary situation where zero or negative yields account for around half of the sovereign bonds in issue. Cash remains plentiful but not always in the places where it is most needed to restore economic vitality. Markets have been rising but without conviction, as investors have been discouraged from placing funds elsewhere.

Your Board remains optimistic that the diverse Asia Pacific Region will continue to provide quality investment opportunities, which will reward patient investors over the long term. As has been demonstrated before, companies where managements take a sustainable approach to their business will be more likely to provide good returns.

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Stewart Investors, managers of Pacific Assets: Only in very superficial terms can it be argued that Asian markets look reasonably valued. Many large capitalisation companies of questionable quality with justifiably lower valuations bring down aggregate multiples. But this doesn't help us very much, because those average valuations mask the fact that we remain in a similar position now to that of the past three years which is that quality remains very expensive.

Now sadly we live in a world where good listed companies are being removed and poor quality companies are coming to market to replace them; little wonder average valuations are lower. The challenge for us in the coming year will be to avoid the pitfalls which emerge as noise levels increase and focus solely on what we know and believe in, that quality and long-termism have to prevail.

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Robin Parbrook and King Fuei Lee, managers of Schroder Asian Total Return: The earnings backdrop for Asian companies continues to look challenging. Falling interest rates in Asia are squeezing net interest margins for banks and insurance companies at a time where non-performing loans are rising across the region after the strong credit cycle since 2010. On the export front, we find it hard to expect a sustained improvement in export demand from Europe, the largest export region for Asian goods and services, given the continued sluggish economic backdrop. We are slightly more sanguine on domestic demand in Asia. Whilst we do not expect a major pick-up, some stabilization and improvement is possible in India, Indonesia and the Philippines where there has been better policy follow-through and where the impact on the agricultural sector of last year's El Nino will wane.

In ASEAN valuations are now high compared to recent history. We see few structural improvements to justify the recent major re-rating and we think the valuation premium is down to an 'anything but China' mentality. We increasingly question the competitive advantage of the region, and without better government, we think ASEAN may well be stuck in a low-growth rut.

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Sarah Bates, chairman, Witan Pacific: Markets across the world have been strong in so far in 2016. This is perhaps surprising in the face of lacklustre economic growth, weak corporate earnings and political uncertainties ranging from the UK's "Brexit" referendum to the forthcoming US Presidential election. For UK investors, the weakness of sterling has flattered results to some extent, but there has been more enthusiasm for the Asian region than for a while.

Asian markets had been under some pressure for several years before 2016 and, whilst uncertainties remain over the Chinese economy's transition to a slower growth rate, regional valuations appear to have reached a point where investors were willing to look for glimmers of hope rather than already discounted faults. Japan, in contrast, has been weak in local terms with the strong yen a double-edged sword - weighing on profit forecasts while boosting returns for foreign investors.

Part of the reason for such startling equity returns relates to the global decline in both short and long-term interest rates, which has made the relative valuations of equities look more attractive by comparison. At some stage, the decline in yields, which has reached extreme levels, will start to reverse and those investments borne aloft by abundant liquidity rather than their own intrinsic merits may prove vulnerable. In the succinct words of Warren Buffett, "Only when the tide goes out do you discover who has been swimming naked." The development of inter-regional economic activity continues and the range of investment opportunities across the region remains of considerable interest.

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Europe

(compare European funds **here**)

Alexander Darwall, manager, Jupiter European Opportunities: Interest rates are at record lows. The ECB's main refinancing rate was 0%; and 3 month Euribor was -0.26% at the end of May 2016. Further growth stimulus should also come from lower oil prices: the US dollar price of oil fell 18.6% over [*H1 2016*] (having fallen by 41.3% in the previous twelve months). Yet growth in Europe remains chronically below the global growth rate. The IMF reported growth of 1.6% for Europe in 2015 and recently forecast 1.5% for 2016 and 1.6% for 2017. These figures compare with 3.1%, 3.2% and 3.5% respectively for world growth rates. The lack of supply side reform continues to hamper the willingness of corporates to invest and thereby dampens economic growth. In 2000, the European Union devised the Lisbon Strategy, a plan to make the EU "the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion", by 2010. It is not too soon to say that it has failed.

Change and disruption abound. Political turmoil, technology developments, changes in regulation and shifting consumer habits and behaviour can certainly present significant challenges. Favourable industry characteristics and a differentiated product or service are important defensive factors. But in virtually every case where there is disruption there is a 'silver lining', a company that can profit from others' discomfort. For example many alternative finance companies are growing just as the mainstream banks suffer; digital or online services present new opportunities even as high street retailers, for example, are in retreat; and consumer tastes are constantly evolving so that some companies can still grow irrespective of the general economic conditions.

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North America

(compare North American funds **here**)

Robert Siddles, manager, Jupiter US Smaller Companies: The stock market rally that began earlier in the year continued after [*30 June 2016*]. The S&P500 Index achieved new all-time highs, although small caps are leading the rally as they have since January. Concerns about Brexit seem to have been shaken off: US exports to the UK make up a tiny part of the total. Brexit has even less direct economic relevance for the more domestically-focused small companies. Brexit may have more significance for the US political scene given that the kind of social divisions that the vote highlighted in the UK also exist in the US, (elites vs the left behind, urban vs non-urban).

Although there were signs of improvement in the economy over summer, these seemed to fade later. This year the White House race has more significance for the wider US economy than usual, potentially meaning either more regulation if Clinton wins or an aggressive "America first" approach if Trump is victorious. The outcome is unclear as "shy Trump supporters" may be distorting the polls. Whoever wins, the new President may be keen to get a recession out of the way sooner rather than later, in order to improve chances of re-election but presenting hidden risks for the market.

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Emerging markets

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

Hélène Ploix, chairman, Genesis Emerging Markets: Companies in emerging markets continue to face challenges: past editions of the Annual Report have articulated concerns such as the drying up of new areas of business opportunity, the increased competition from developed market firms and the corresponding effect on profitability, the negative impact of potentially higher US interest rates, and - crucially - the lack of reforms in many countries that would help companies develop and grow more efficiently. None of these issues have disappeared, and uncertainty over growth and reform in China in particular also weighs heavily on sentiment, but despite all this, valuations for many companies in emerging markets remain elevated.

Against that backdrop, however, the necessary reform process has started in markets like Mexico, India and Indonesia, and others will follow in due course - even in Brazil, a country in the midst of a full-blown political crisis, we can anticipate that in time the eventual outcome is likely to be a better operating environment for companies.

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Genesis Asset Managers LLP, managers, Genesis Emerging Markets: Structurally, investors in emerging market equities have been facing substantial headwinds, such as lower commodity prices, the impact of China's lower growth, greater competition and weaker currencies. Amidst this lower-growth environment the profitability of emerging market companies has declined over the past few years. Despite this, valuations have largely held up, particularly for higher quality companies which offer greater protection when the investment landscape is more challenging.

However, of the difficult headwinds mentioned above, significant adjustments have already taken place in three of the four - commodity prices, competition and currencies - meaning that further downside in these areas is limited. As we have noted, China's orderly transition to a more sustainable growth strategy is, we believe, the key risk facing emerging markets investors. Should a soft landing play out in China, we could see the beginning of a new, more positive cycle in emerging markets.

In the medium to long term we firmly believe that emerging markets are an attractive place to invest: key growth drivers - such as rising consumption, financial penetration and infrastructure development - are still in place.

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Aberdeen Fund Managers, managers of Aberdeen Frontier Markets: The rationale for investing in frontier markets today is little changed from when the Company was launched almost a decade ago. Premium economic growth continues to be driven by long term trends in demographics and consumption. Markets remain uncorrelated to each other and the asset class is therefore likely to continue delivering returns that are less volatile than investors expect. Frontier equity markets remain woefully underrepresented in global indices relative to their economic significance, being home to 31% of the world's population and accounting for 9% of global GDP but with a weighting that is equivalent to just 0.2% of the MSCI World Index (Source: Renaissance Capital, June 2016). Off such a low base, we believe there is scope for the asset class to grow significantly over the long term. For now though, it remains an inefficient and somewhat overlooked asset class, providing opportunities for active stock pickers to identify mispriced companies.

One tenet of the rationale that has changed materially is valuation. Frontier market equities have suffered a material de-rating from a trailing price to earnings ratio of 19.0x in 2009 to just 10.6x at present (Source: Bloomberg). Accompanying the low valuation is an attractive dividend yield that talks to the unlevered and cash generative nature of many frontier corporates. This has been a consistent feature of the asset class over time. Such inexpensive valuations have been reached through a combination of resilient earnings and uninspiring market performance. In a world where both growth (in GDP or corporate earnings) and yield are scarce, we believe investors will, in the years to come, be willing to pay higher valuations for frontier assets than they are today.

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Africa

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

Africa Opportunity Partners Ltd, managers of Africa Opportunity Fund: For the first time since 2004, the International Monetary Fund's latest Sub-Saharan Africa 2016 and 2017 regional GDP forecasts of 1.6% and 3.3% are lower than its corresponding global GDP forecast of 3.1% and 3.4%. Nigeria is experiencing outright recession, with its GDP forecast to contract by 1.8%, while South Africa's Reserve Bank forecasts 0% GDP growth for this year.

The secular headwinds include a declining Chinese GDP growth rate, low commodity prices, and a negative impact from Brexit on the important African export markets in Europe and the United Kingdom. Cyclical headwinds, lasting 12 to 18 months, range from the constricting effects of looming elections in Ghana, Zambia, and Kenya on domestic investment decisions, to large hidden state borrowing by mendicant governments like that of Mozambique, and religious and ethnic banditry in Nigeria. Fortunately, the growing gloom about Africa is expanding the pockets of deeply undervalued securities available from investors to investigate and purchase. The H1 2016 results of several companies across Africa confirm the unfolding slowdown - operating profits are declining in US Dollar terms, year-on-year. Significantly, the strongest companies are responding in a variety of ways: for example, deepening their supply roots in Africa.

The struggle to get African retail consumers to accept that reliable grid-supplied electricity requires cost-effective electricity tariffs paid by them to electricity distributors like Kenya Power and Abuja Electricity Distribution Company is unrelenting and continues unabated. It is certainly proving to be a tough fight. Kenya's energy permanent secretary rejected in early May Kenya Power's request to Kenya's electricity regulatory authority for a tariff increase, although his authority to issue such decisions was questionable.

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Emerging Europe

(compare emerging European funds **here**)

Sam Vecht and Christopher Colunga, managers, BlackRock Emerging Europe: We see emerging markets economies stabilising as the US Federal Reserve keeps interest rates relatively low. Divergence within emerging markets continues to be the dominating theme; however, we believe that emerging markets performance drivers have shifted radically and are now focused on free cash flow optimisation, policy reforms and interest rate changes. As such, stock-specific fundamentals should play an increasingly important role in realising returns going forward,

Importantly, many of the difficulties specific to the region appear to have been priced into markets. In Russia, the conflict in the east of Ukraine remains tense but there has been some improvement in terms of the development of diplomatic channels. While oil prices remain low, the price has stabilised and the flexibility of the floating ruble has helped the economy adjust and become more competitive. As a result, we believe that the economic situation will continue to improve. Valuations are low, dividend yields are high and a re-rating is possible.

In Greece, Greek banks stand to benefit from falling Greek bond rates and further progress in the bailout programme. The banks are trading at exceptionally depressed levels and present an attractive opportunity as the environment normalises.

In Poland, the economy continues to grow. Whilst Brexit has certainly raised the risk of a slight slowdown in growth, the government's fiscal package is providing additional support to a consumer already benefiting from high disposable income growth. However, valuations already reflect this strength, and so the country may not offer the most interesting opportunities relative to its peers.

In Turkey, the market, especially banks, has rallied significantly from the July lows therefore the key to performance going forward will be stock selection. While the government has passed a number of significant and positive reforms during the current state of emergency, for example, automatic private pensions and the establishment of the sovereign wealth fund, we think that investors will be unwilling to pay a higher multiple for the market as a whole until there is greater political clarity.

Going into the remainder of 2016, we continue to be positive about emerging markets as valuations remain cheap in both absolute terms and relative to history, whilst also trading at a discount to developed markets. The currency weakness observed throughout 2015 has resulted in much needed current account improvements and other external adjustments, paving the way for the increased competitiveness of many emerging market economies. Improving emerging markets liquidity and signs of a pick-up in activity, supported by constructive policy reform, continue to provide for an increasingly attractive opportunity set.

We see the potential for further appreciation ahead as both earnings and the multiple the market pays for those earnings rise concurrently for the first time in a good many years.

India

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

Fred Carr, chairman India Capital Growth: your Board has been encouraged by recent news emerging from India, which suggests that the investment argument remains firmly on track. The Government's reform agenda has been boosted by the passing of both the long awaited Goods and Services Bill and the Bankruptcy Law, amongst others. This not only confirms Prime Minister Modi's ability to make change happen, but also ensures significant economic benefits long into the future. It is also encouraging to hear that, politically, Modi's personal popularity remains high and the BJP's recent electoral success at the state level is facilitating the reform agenda. The country's need for a healthy monsoon following two drought years was also very pressing, and as I write the rainfall has been abundant and with good distribution (i.e. raining in the right places). Not only will this replenish reservoir levels, helping to ensure that future water requirements can be met, but will also boost rural incomes in the near term, supporting consumption and economic growth, as well as keeping a lid on inflation. Macroeconomic balances remain under control aided by lower oil and commodity prices and, to date at least, sound fiscal management. Since its election victory in 2014 the Government has worked hard to create the right architecture for macroeconomic stability and investment with much success. Although this journey is by no means complete, India is well on the road to delivering high quality sustainable economic growth.

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Ocean Dial Asset Management, managers of India Capital Growth: India still stands out as one of the few relevant investment destinations that continues to present an improving economic outlook. Key macro data continues to provide stability and confidence to both direct and portfolio investors. Thus GDP growth for fiscal year 2016 came in at 7.6%, a 0.4% improvement on FY15, making India amongst the fastest growing large economies, a nose ahead of China. Sustained lower oil and commodity prices have also ensured that the twin deficits (current account and fiscal) remain within the forecast, and though food price inflation has been creeping up more recently, inflation as a whole remains in check. Following a six month pause, the Reserve Bank of India (RBI) cut the headline base rate by 25bps in its April meeting, subsequent to the Government's commitment to fiscal prudence highlighted in the 2017 Federal budget, but kept rates unchanged at 6.5% in August. Future monetary policy decisions will be directed by an MPC (6 members with casting vote to the Governor) using an inflation target of 4% (tolerance of +/-2%) for the next five years.

More than sound macro data however, is the meaningful and fruitful change emanating from the Government's reformed based initiatives which is nourishing the investment story. Years '14 and '15, the BJP's first in office, witnessed focused efforts to address infrastructure bottlenecks and to revive capital spending. In 2016 the emphasis has changed to creating momentum in the legislative progress. Already several important bills have been passed since the start of the year. Amongst the most important of these are the Aadhaar Bill (targeted delivery of financial subsidies, benefits and services directly to recipients' bank accounts), the Real Estate Bill (a first for a sector which has never been regulated) and the Bankruptcy Bill (faster resolution of cases of business failures and defaults by plugging legal loopholes). These will all serve to increase transparency, eliminate corruption and strengthen the financial system effecting an easier business environment. The benefits can already be felt. Alongside the initiation of new laws, incremental changes to existing laws are also being introduced with effect. For example, the new textile policy has focused on giving tax benefits based on employment generation, rather than providing cheap credit as before. With the aim of improving connectivity, the revised civil aviation policy has incentivised airlines to operate from smaller cities by removing landing fees and lowering duties on aviation fuel. Revisions to the Foreign Direct Investment policy have been made, simplifying processes required to bring foreign capital onshore by instituting an "automatic approval process", instead of the earlier plethora of pre-approval requirements from the Government. This has eased investment conditions overnight in sectors such as defence, civil aviation, healthcare, and the media which in due course will lead to higher levels off foreign direct investment (FDI). After eight long years as the political football, the much awaited Goods & Services Tax (GST) has been approved by both houses of Parliament with expected implementation in the next 12-18 months. This dual tax system, harmonising VAT across all Indian Sates, is estimated to add 1-1.5% to GDP, simply by removing the multiplicity of taxes and enhancing productivity across multiple sectors.

A major setback over the period was the announcement that an extension to Raghuram Rajan's tenure as Governor of the Reserve Bank of India was not forthcoming. Since the "taper tantrum" of 2013, Rajan has provided incalculable stability and credibility to India's economy, as well as initiating reform across many aspects of India's financial system, particularly the public sector banks. His replacement will be Dr Urjit Patel, Rajan's protégé at the Reserve Bank. Although the loss of Rajan is a setback, the choice of successor is the best outcome for markets and a clear sign of Government pursuing stable policies. Like Rajan, Patel also brings an outstanding record, and is expected to provide the policy continuity markets always crave, though we must wait to see exactly how policy will evolve. On the subject of the banks, further anxiety remains over ongoing asset quality issues and how and when they will be resolved, though recent stellar performance suggests the market has looked through the worst. In addition the fragility of rural India, still struggling with the aftershock of successive failed monsoons, and excess capacity in the manufacturing sector as a whole, are both issues contributing to ongoing stagnation in corporate earnings. These concerns impact the market through higher valuations which will need to adjust for equities to push higher.

We do however find some comfort in the corporate results for the quarter ended June'16, recently announced. Here just two prominent areas reflecting continued weakness remain, notably exports and rural consumption growth. The outlook for rural India is no longer such an issue, as good monsoon rain to date (June-September) is eliminating water shortages. Better crop yields will lead to better incomes which in due course will filter through to incremental consumption. This, in tandem with the recent hike in wages for government employees (averaging 24%) should boost consumption in urban centres. Corporate profitability was enhanced on the back of better operating margins, as a consequence of lower input prices, and in some cases, such as cement and specific capital goods items, increased revenues were the driver of improved earnings. This is reflective of a healthier investment climate in the infrastructure sectors such as roads and railways, where the Government has been investing heavily. Amongst the public sector banks, although results remained weak, there were clear signs that the worst of the asset quality are in the past.

Barring exports focused businesses, we are clearly seeing a revival in the earnings momentum all of which bodes well for the future.

Latin America

(compare Latin American funds **here**)

Peter Burnell, chairman, BlackRock Latin American: Although the economic outlook for much of the region remains challenging, there is considerable scope for political reform, albeit that effecting meaningful change will not be straightforward. Unlike much of the developed world, where central banks appear to be running out of policy options in the event that growth falters, real interest rates in many of the regions' economies remain high, and falling real interest rates and associated declines in equity risk premiums may well provide the impetus for further progress in equity markets, even if economic growth remains lacklustre. In addition, although commodity prices are unlikely, in the near term, to reach the levels achieved in 2014, it appears that most have at least now stabilised: this will provide a more stable environment for planning investment and forecasting future revenues.

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Will Landers, manager, BlackRock Latin American: We continue with our more constructive view on Latin America developed over the past few months. We enter the second half of 2016 with a positive view on Brazil and concerns regarding Mexico. In Brazil, the completion of the impeachment process allows the new administration under President Michel Temer to tackle the issues required to get Brazil back on a sustainable growth track. For the first time in several years Brazil has the opportunity to have a clear path to growth; for a return to fiscal discipline and for monetary discipline. The historical government changes in Brazil are opening up the opportunity of improving fiscal numbers over the next two years. This should have a positive impact on investor confidence and eventually lead to a pick up in investment activity in the country. The potential economic recovery in Brazil could trigger powerful earnings revisions.

The Mexican domestic economy has proven to be fairly resilient, however the economy's close ties to the US could become more of a headwind as growth falters in the US and election day approaches.

In the Andean region, we expect the outcome of the recent Peruvian presidential election to usher in another move to the centre-right in the region and spur another round of investment in that country. The underweight positions in Chile and Colombia remain, given sub-par growth in Chile and fiscal headwinds expected in Colombia. For Chile and Colombia the commodity cycle has not yet improved enough to get growth moving in a meaningful way.

Off-benchmark Argentina also continues with its gradual normalisation program. We continue to monitor Argentina's political climate and reform process as we look for potential catalysts for further investments. Inflation is trending downwards from the current high levels; a continuation of this trend is key for this economy to do well going forward. Finally, there is the potential for Argentina to be considered by MSCI for inclusion in Emerging Markets indices within the next year.

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Qatar

(Compare specialist country funds **here**)

Epicure Managers Qatar Limited, managers of Qatar Investment Fund: The long term growth prospects of the Qatari economy remain positive, underpinned by infrastructure spending of c.US$200 billion ahead of the 2022 FIFA World Cup, in line with the Qatar National Vision (QNV) 2030. QNV focuses on the country's diversification policy to transform the Qatari economy from hydrocarbon dependence to a non-hydrocarbon economy. Results are already visible: the share of non-hydrocarbon GDP has grown from 41.9% in 2011 to 63.8% at the end of 2015. This is expected to rise to 68.9% by the end of 2017.

Despite the fact that Qatar is expected to report a fiscal deficit for the first time in 15 years (about 4.8% of GDP), the 2016 budget also shows a commitment to long-term development with allocation to major projects growing by 3.8% to QAR90.8 billion. The majority of capital expenditure is allocated for the infrastructure, health and education sectors, representing over 45.0% of total budgeted expenditure.

Qatar's spending cuts were modest in comparison to other GCC nations and it is better positioned to withstand low oil prices than GCC peers. Qatar's budget deficit for 2016 is one of the lowest in the GCC.

Moreover, FTSE Russell confirmed that Qatar Exchange would be upgraded to Secondary Emerging Market (EM) from Frontier Market (FM) status in two equal tranches, first in September 2016 and second in March 2017.

In the first tranche, Qatar would be removed from the FM Index and a 50.0% tranche would be included to the EM Index, resulting with a weight of c0.6% and estimated inflows of US$602 million. In the second tranche, Qatar's representation in the EM Index would increase to c1.2%. This should mean Qatar experiencing passive inflows of about US$1,204 million in the all-emerging index.

The historic decision by the UK to quit the European Union is expected to have a short term impact on the GCC nations, particularly in the currencies and financial markets.

Sterling weakness could have both positive and negative effects on the GCC economies. Currency weakness, for example, may significantly impact tourist flows to the Gulf.

Moreover, the uncertainly caused by Brexit might delay the US Fed raising interest rates. As a result of these low interest rates, GCC governments could accelerate capital raising from international bond markets.

However, the Investment Adviser believes that the impact of Brexit would be minimal on GCC equities as their earnings prospects are not strongly related. Thus, the Investment Adviser expects equities to recover gradually as their movements are fundamentally linked to domestic factors and oil prices.

Strong economic growth should continue to support Qatari banking sector

In the past few years, the size of the Qatari banking sector has not only expanded but its activities and services have also diversified. Increased involvement by the government through the Qatar Central Bank (QCB) in regulating, directing and controlling sector activities have made it better organised, effective and competitive.

However, the banking industry in Qatar has faced headwinds recently, leading to a tighter liquidity. Loan growth has outstripped deposit growth as lower oil and gas revenues have led to a decline in public sector deposits, causing a tightening of liquidity and driving banks to raise funds abroad. This has also led to a rise in interbank rates and the cost of funding. Additionally, Qatar Interbank Offered Rates (QIBOR) has risen sharply over the past year.

Given the current liquidity situation, QCB has delayed the deadline for the compliance with the 100% loan to deposit (LDR) ratio until 2018. Banks are also in negotiation with the regulators to amend the LDR formula to include long term wholesale funds.

Despite the effect of low oil prices, the Qatari banking system is robust due to its overall credit profile which remains consistent with an "Aa2" rating (by Moody's). This rating was awarded on account of expected persistent growth, high wealth levels, lower vulnerability to the oil price, coupled with prudent fiscal policy when compared to its GCC peers.

According to a study by Global Investment House (based on banks under coverage), during Q1 2016 the profitability of Qatar's banking sector grew 1.7% YoY compared to a 0.7% drop across GCC region banks. On an annual basis, Kuwait and the UAE banks saw profits falling 10.1% and 7.7%, respectively, while Saudi Arabia's bottom-line increased 6.6% YoY in the first quarter of 2016. On a sequential basis, average profitability of GCC banks expanded 6% QoQ, with Saudi Arabia leading the rise (up 13.9% QoQ), followed by Qatar at 13.3%.

Qatari banks managed to maintain the highest lending growth at 16% YoY, compared to the GCC average of 8.7%. The strong rise in lending growth was driven by an increase in public sector spending in relation to government-backed initiatives prior to the FIFA World Cup 2022. Total assets of the GCC banks expanded 5.6% YoY in Q1 2016, with Qatar witnessing the strongest growth of 11.8%, followed by the UAE and Saudi Arabia with total assets growth of 6.8% and 2.2%, respectively. However, provision for bad debts rose sharply for Qatari banks during Q1 2016.

Over the longer term, as per the QCB's data, in the 21 months to March 2016, Qatar's lending growth remained robust, up 26.6%, followed by Saudi Arabia and Oman. Qatar also registered the highest credit growth in FY 2015 compared to its GCC peers.

Despite strong credit growth, the asset quality of Qatari banks remained good, driven by prudential regulation and the sizeable proportion of high quality government-related loans. The asset quality of Qatari banks is expected to be supported by healthy operating environment and a robust regulatory regime.

According to the latest QCB data, total credit extended by Qatari banks remained good with total loans increasing by 4.6% between December 2015 and June 2016 and 13.2% YoY in June 2016. Private sector loan growth was relatively slower at 1.7% during first six months of 2016, while public sector growth was robust at 9.9%. However, in FY 2015, public sector loan growth was slower (1.6%) compared to the private sector (23.4%). Strong loan growth in the public sector could be attributed to the awarding and execution of large infrastructure projects. Total deposits grew 5.1% during first six months of 2016. Consequently, the banking sector's loans-to-deposit ratio (LDR) stood at 115% at the end of June 2016, compared to 116% at the end of December 2015.

Public sector credit growth is expected to remain strong due to the fact that the domestic economy has substantial funding needs for FIFA World Cup 2022 related construction and long term infrastructure spending in line with the Qatar National Vision 2030. Additionally, a steady rise in population should bode well for consumer sector loan growth.

Despite on-going concerns about global economic growth, lower oil prices and regional unrest, Qatar's economic growth is expected to remain healthy on the back of sizeable reserves, strong commitment by the government to infrastructure spending and a steady rise in population leading to consumption growth. The Investment Adviser believes that the Qatari banking sector would be a long term beneficiary of this with the considerable opportunities highlighted above.

GCC to introduce VAT in 2018

Low oil prices, shaving off about 20.0% of the combined 2015 GDP in the MENA region, have strengthened the case for implementing alternative avenues for raising revenues for the GCC governments.

GCC government officials recently confirmed that the Gulf countries are to introduce a unified VAT of up to 5.0% from 2018. According to the IMF, a VAT rate of 5.0% could generate revenues in the range of 2.0% of GDP. VAT implementation would be simultaneous across all the GCC nations.

Health, education and social services as well as essential food items and certain financial services would be exempt from the tax.

The Investment Adviser believes that the introduction of VAT would primarily affect the consumer and telecom sectors. Luxury clothing, jewellery and watches would be an obvious target for VAT, along with cigarettes, fuel and cars.

Macroeconomic Update

According to the Ministry of Development Planning and Statistics (MDPS), the Qatari economy continued to grow in Q4 2015, with GDP rising 4.0% compared to Q4 2014. The non-hydrocarbon sector GDP grew 7.4%, mainly driven by expansion in construction, finance, utilities and trade sectors. Lower oil prices meant the hydrocarbon sector was GDP flat with marginal growth of 0.7%.

Going forward, the Investment Adviser believes that Qatar's real GDP growth is set to continue, driven by strong growth in the non-hydrocarbon sector, as investment spending remains strong. According to Institute of International Finance (IIF), Qatar is expected to remain the fastest growing economy in the MENA region in 2016 and 2017, growing by 3.7% and 3.8%, respectively. Underpinned by preparation to host the FIFA 2022 World Cup, the non-hydrocarbon sector expansion is expected to be at around 6.0%, while the hydrocarbon growth is expected to be around 1.4% in both 2016 and 2017.

Qatar's population grew 2.3% between December 2015 and June 2016, to 2.48 million. Population growth is expected to remain strong in coming years, as large project spending related to the 2022 FIFA World Cup continues to attract expatriates. Thus, steady growth in population and high levels of personal consumption is expected to continue to encourage the domestic consumer and services sector companies.

South Korea

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

Weiss Asset Management, managers of Weiss Korea Opportunity: The result of the U.K.'s referendum vote to leave the European Union surprised many market participants. The Brexit vote should remind investors that "unexpected" events occur much more frequently than many investors seems to anticipate a priori. This is one reason why investors can benefit from portfolio diversification. The long-term ramifications for the United Kingdom and Europe are currently unclear.

Japan

In the first half of the year, the Japanese yen appreciated by 12.4% against the Korean won, which has improved Korean exporters' prospects. In previous years, the depreciation of the yen against the won had been a drag on the earnings of Korean companies that compete against Japanese manufacturers. This may serve as a short-term positive for certain Korean companies.

China

Approximately 25% of Korean exports go to China and declining Chinese exports are weighing on the Korean economy. A recession in China remains one of the most significant short-term risks for South Korean equities and for the Company. Separately, China appears to have changed its historical stance toward North Korea (which was one of leniency) when it supported U.N. sanctions after North Korea conducted its fourth nuclear detonation in January 2016. On the other hand China seems very concerned about the deployment of the Terminal High-Altitude Area Defense ("THAAD") system which would enable monitoring of much of China's airspace and could give early warning of missile launches. The THAAD system might also provide protection for U.S. bases in South Korea, (as currently implemented it provides no protection for Seoul). One interpretation of China's concern is that the envisioned deployment of THAAD would give the U.S. enhanced power if there was a confrontation with China in the South China Sea.

Korean Dividends

There is a high correlation between the discounts on Korean preference shares and dividend yield. Korean companies tend to payout a very low proportion of their earnings as dividends compared to companies in other countries. This is due in part to a history of government policy to protect the Chaebols in return for which the Chaebols would invest in the Korean economy. Dividends were antithetical to that policy and consequently are subject to high tax rates for both corporations and individuals while capital gains were not taxed at all. The government has backtracked on previous legislation which reduced the top tax rate on dividends. The Corporate Income Recirculation Tax (CIRT) Act had lowered the maximum tax on dividends, but under legislation passed in July, the tax rate for recipients of large dividends has reverted back to its previous level. In addition, the 10% tax on retained earnings has been revised so that salary increases get at 1.5X weighting while dividends only get a 0.8X rating. These are unfortunate negative developments that incentivise the controlling shareholders of large companies to keep their dividend payout ratio low, and threaten the progress that we have seen in recent quarters. However, in the long run as pension funds increase their ownership share in companies and become more activist there may be more pressure on firms to increase their dividend payout ratios or to increase share buy-backs.

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Commodities & natural resources

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

Geoff Burns, Chairman, City Natural Resources: While the world seems no more certain a place now than it did last year, and recent global growth forecasts are not encouraging, the outlook for commodity markets has improved.

The jury remains out on China's prospects, with strongly divergent views held, but it has for the moment certainly recovered its appetite for raw materials and appears on course to deliver its much heralded 6.5% GDP growth target. The US recovery continues, albeit in subdued fashion, and Europe has proved surprisingly resilient despite a number of ongoing issues, not least the euro. The UK's local issues over Brexit dominate domestic politics, but its main impact so far was the sterling weakness which followed the result of the vote.

The Brexit vote also gave politicians worldwide, already wary of the effects of even threatening monetary tightening, an excuse to prevaricate further; as a result, interest rates once again look likely to remain lower for longer. Central Bank stimulus has been the main intervention to prevent recession turning to depression resulting in an addiction to cheap credit, negative interest rates in some countries, and what increasingly looks like a 'bond bubble'. Real growth derived from productivity gains and raised investment levels, continues to be elusive.

The oil price remains a focus for attention, and while it has recovered, it has not recovered too much.

After a strong run the commodity markets have paused for breath, and may easily be subject to further volatility as a result of the factors mentioned above; but the fundamental injection of realism that the long bear market engendered gives grounds for optimism as to the durability of the recovery.

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Ian Francis, Keith Watson and Rob Crayfourd, New City Investment Managers, managers of City Natural Resources: The last year has been one of the most difficult periods on record for investors, particularly so in the resources sector. Against a background of slowing growth and accentuated by over-leverage, the first half year was characterised by severe commodity price declines and extreme stock price volatility, indicative of market capitulation. Investor relief since the sector tumult at the turn of the calendar year has been palpable over the second six months across equity and debt asset classes whose performances had synchronised. Hindsight has shown that the extreme pessimism at the turn of 2016 was indeed misplaced and the deflationary death spiral has subsequently unwound.

China's economy, still the most important for raw material demand, experienced a strong recovery in imports as its industries restocked, boosted by extensive economic stimulus during the March quarter which, at over 4tr Yuan, was equivalent to half the level of stimulus provided in the 2008-9 crisis. Economic data has subsequently shown a broad based improvement in demand trends, in particular in infrastructure and property where strong price rises have latterly begun to feed through to higher floor space development. China appears on course to achieve its official 6.5% GDP growth target. Away from China demand growth in the US is improving while in Europe, though anaemic, it is showing signs of stability.

The implementation by Chinese authorities of measures to curb exuberant speculation bares testament to the speed of the ensuing recovery in asset prices. Though such actions have cooled short-term excesses we believe they will helpfully smooth out the improvement in underlying demand and sustain momentum, if at a more moderate pace, over the medium-term. Improved stability may encourage greater private sector investment activity which has been understandably cautious given the speed of recent change, providing us with further comfort.

Balance sheet stress is now enforcing producer discipline via capex reductions, impairing the outlook for future supply growth. To date this has been most evident among major commercial mining groups, which are faced with more stringent financing terms constraining future expansion plans, which have stalled. We continue to expect return on equity and cash flow improvement, resulting from spending reductions, to be soaked up by servicing debt, limiting scope for expansion over the medium-term. Despite the recovery in commodity prices the viability of supply expansion remains pressured.

Meanwhile China's central planners, impatient at the less motivated response of domestic state owned enterprises which have benefitted from a degree of debt relief and have suffered fewer-than-expected bankruptcies, are enforcing permanent mine closures and imposing more stringent environmental standards, demonstrating a strong reform commitment as they seek to reduce uneconomic and deflationary overcapacity. As an illustration, China's authorities have ordered the closure of 500 million tonnes of domestic coal production and are drafting new rules to reduce mine pollution and drive land remediation. Such moves together with a general rise in energy prices and an easing of competitive currency devaluation, particularly by commodity exporters, is placing upward pressure on production costs, a complete reversal of trends leading into the Q1 meltdown.

We are becoming increasingly positive to the [*energy*] sector as the oil market looks likely to balance in 2017. Broadly, energy equities continue to discount oil prices above our expectation and above the US$52 per barrel level which has recently incentivised some US shale production but also appears to have elicited a resurgence of Saudi led price discounting.

Debt

(compare Debt funds **here**)

Project Finance Investments: The appeal of the Company continues to be supported by the enduring low interest rate environment, the reduction in yields resulting from central bank intervention and the associated deterioration in risk--adjusted returns across the credit markets generally. Whilst credit markets remain a core investment allocation by investors globally, the enduring market conditions have led to an increasing focus on which segments of the credit markets deliver the highest risk--adjusted returns, generating increased interest in niche and specialist lending opportunities which the Company targets.

The mainstream credit institutions are vacating certain sectors and issuers for reasons other than credit quality due to major economic headwinds experienced since the global financial crisis. Banks have become subject to mis--selling scandals, higher capital requirements and tougher regulations, all of which have made certain sectors unattractive to them. This offers a considerable opportunity for specialist lenders with the resource and expertise to focus on these lending opportunities.

The UK's vote to leave the European Union, and the associated uncertainty this is likely to create, is expected to reinforce the market dynamics described above. Additional reductions in interest rates and the continued withdrawal of mainstream lenders from previously serviced sectors will present increased lending opportunities.

Development in the energy, waste, social infrastructure, property or telecommunications sectors continues to be a strategic focus of governments and corporates alike due to the enduring demand for the services they provide to society, in certain geographies and/or industries, this demand remains undersupplied and the outlook for investors willing to understand such sector-specific areas remains positive.

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Blackstone / GSO Debt Funds Management Europe Limited, managers, Blackstone/GSO Loan Financing:

Bank Loan Market, Overview

European loan issuance has been notably consistent over the past few years. Issuance totalled EUR30.2 billion during the first half of 2016, not far behind 2015's EUR38.1 billion. The majority of the issuance by volume was used for refinancing purposes so much of the calendar created new supply but strong repayment rates held the size of the market to a mere 5% growth The technical backdrop continues to support loan valuations in Europe.

European loans have been on a bit of a roller coaster ride over the past few quarters. Although the market is in good shape from a fundamental and technical perspective, it is not immune to broader market and geopolitical factors. The average price of European loans were flat since the start of the year at EUR95.67 from EUR95.63 as at 31 December, but that belies the swing the market experienced following the result of the UK referendum on EU membership. At the end of May, the price hit an eight-month high of EUR96.68, before declining EUR1 during June.

CLO Market Overview

Demand for European loans was intense, especially during the second quarter. Institutional demand from international buyers has also been robust as Euro hedging costs are cheaper for Japanese investors than Dollar hedging costs, thereby boosting after-currency yields.

CLO issuance was strong in Europe during the first half of the year as demand for AAA tranches improved. Issuance totalled EUR7.2 billion from 18 CLOs versus EUR7.8 billion from 20 CLOs for the same period last year - an 8% decline period over period. US CLO issuance declined far more than that of Europe, totalling 62 deals for $26.2 billion, down 56% from the first half of 2015.

As the second quarter drew to a close, the UK voted to leave the European Union, thereby creating a weak tone in the European markets and generating some uncertainty for the coming months as the exit takes shape.

Corporate fundamentals in our coverage universe continue to be supportive but the UK referendum will create some uncertainty for issuers. The rallying Euro will impose headwinds for European exporters to the UK but it may also help these issuers recruit talent returning to the continent's mainland. In addition, borrowing costs may fall as central banks implement easier monetary policy to offset any economic problems caused by the vote.

Supply of new paper in the high yield and loan markets, however, is not matching the incremental demand for these products and this is creating a supportive backdrop for speculative-grade products. Senior loans continue to produce steady returns, outperforming equities and high yield during volatile periods and lagging when markets recover. We believe the asset class provides investors with yield and relative performance stability.

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Victory Park Capital Advisors, LLC, managers, VPC Speciality Lending: The Company and the Investment Manager continue to believe that a significant opportunity exists for credit investors in the specialty lending market, primarily through tech-enabled consumer and small business lending Platforms. The global banking industry has been under enormous pressure since the 2007-2009 global financial crisis. The strain has been particularly acute in the U.S. and Europe where banks have been subjected to a flurry of new regulations and heightened scrutiny of their risk profile and capitalizations.

These constraints have given rise to a new opportunity for specialty lending Platforms to fill the void. In 2010, Platforms in the U.S. accounted for approximately US$200 million of loans to consumers and small businesses. By 2015 this grew to nearly US$23 billion Despite this rapid development, research indicated that specialty lending Platforms today represent a tiny portion of the U.S. consumer and small business loan market, estimated at US$3.4 trillion and US$305 billion respectively, leaving ample room for sustained growth.

However, during the Period, the specialty lending market experienced some negative headwinds, highlighted by widening spreads in the ABS markets and issues surrounding Lending Club including the resignation of CEO Renaud Laplanche. The Investment Manager believes these events were temporary in nature and will not affect the long term growth trajectory of the specialty lending market.

The first half of the year showed positive momentum in marketplace lending capital markets activity with $3.4 billion of new issuance. This represented a 94% increase over the first half of 2015 but a 17% decline from the $4.1 billion issued in the second half of 2015. In February 2016, Avant brought to market its initial rated transaction, Avant 2016-1, followed by their second rated transaction, Avant 2016-2 in April. In May 2016, the U.K. closed its first ever SME marketplace lending transaction with SBOLT 2016-1 backed by Funding Circle UK receivables. Many investors seem to be attracted to marketplace ABS investments for short duration spread opportunities, in an increasingly low return investment environment. The Investment Manager expects to see a strong rate of issuance for the second half of 2016

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Infrastructure

(compare infrastructure funds **here**)

P Lester CBE, chairman, John Laing Infrastructure: In the aftermath of the EU Referendum vote, we expect to see a slowdown in market activity while investors take stock of the political and economic situation. However, given that there remains an oversupply of capital seeking investment in UK infrastructure and limited supply of projects, we do not expect this to last long. We also expect to see dual pressure on asset pricing with non-Sterling denominated investors seeking to take advantage of a weakened Sterling, offset by the 'wait and see' attitude likely to be adopted by some investors in the short term.

Brexit implications aside, the UK continues to represent a challenging market in which to find value with an imbalance between supply and demand for assets, a result of the lack of pipeline in recent years. Competition remains stiff with a consequential upward pressure on pricing.

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International Public Partnerships: Overall the Company continues to have a positive market outlook. Despite the uncertainties surrounding Brexit, Government support for private sector investment in infrastructure in the UK and other jurisdictions in which the Company operates continues to feature as a high public priority. Competition continues to be very high for freely marketable operational assets which are trading in the secondary market resulting in continued price inflation for those investors having to purchase in this way. As we have highlighted to you before, the Company's focus continues to be either on investments originated directly from the public sector rather than via the secondary market; or through the secondary market but usually only where the Company has an in-built competitive advantage through holding pre-existing pre-emption rights.

In addition rather than see pricing pressure in the unrestricted secondary market as a negative we are in fact encouraged as these transactions provide us with a great deal of comfort around the value of the Company's existing assets and the market's appetite for infrastructure more generally including being a firmly established class of investment asset in its own right.

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Private equity

(compare private equity funds **here**)

Tom Bartlam, chairman, Pantheon International: Many regions continue to grapple with macroeconomic and political challenges and this has been reflected in the volatility of the global financial markets. Credit availability has fluctuated as markets have become uneasy about the projected slowdown in global growth, a sentiment that has been worsened by low commodity prices and the impact of this on some emerging economies. Nevertheless, equity prices have remained high. Against this backdrop, it is more critical than ever that we only invest in assets with attractive long-term growth potential and with managers that have successful track records of managing assets through economic cycles.

We continue to see interesting opportunities in the secondaries market where pricing has seen a modest decrease. The strong distributions seen in the first half of PIP's financial year moderated in the second half, and we expect this to continue as distributions return to long-term average levels.

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Pantheon International: Global financial stability has been tested again in 2016. Credit quality has declined in some sectors, with rising defaults and increased financial stress particularly affecting borrowers operating in the energy sector. Borrowing spreads have widened for most corporate borrowers and balance sheet repair has slowed owing to disruption in the global capital markets. Unfavourable demographic trends in major advanced economies combined with low productivity growth and continuing debt overhang, especially in Europe, all make for fairly tepid medium-term growth prospects in advanced economies. While a continuation of global economic recovery is still the most likely medium-term scenario, risks to recovery remain. Despite this subdued outlook, we continue to believe that there is still a good volume of investment opportunities for private equity managers that are able to manage assets through volatile conditions.

The global economy is expected to grow by just 2.4% in 2016, roughly the same pace as in 2015. The key factors contributing to the slowdown in the global economy relative to expectations are easy to identify. Firstly, financial market volatility at the start of the year raised concerns among investors about the soundness of the global capital markets. Secondly, low commodity prices, especially for oil, have increased economic stress in a number of large emerging markets such as Russia and Brazil. Thirdly, investors increasingly worry that Chinese policy makers may not be capable of managing a smooth transition away from an investment- and export-driven economy towards a more sustainable consumption-led growth model. These factors, together with the increased uncertainties facing policy makers such as was illustrated in June by the "Brexit" vote, have contributed to heightened investor uncertainty and a slowdown in global investment spending, which was already weak to start with.

Economic and political developments difficult to predict in the US

Low productivity and continuing employment growth are starting to raise inflation expectations in the US. While there were signs of the US Federal Reserve's intention to slow the pace of US interest rate rises early in 2016 in the face of global capital market volatility, it appears that financial market participants might be underestimating the speed with which the Fed intends to tighten monetary policy over the remainder of 2016. If the US unexpectedly tightens monetary policy while the European Central Bank and the Bank of Japan continue to pursue aggressive monetary stimulus, we believe that a further bout of global currency instability is likely. This could nip any recovery in emerging markets in the bud, and in extreme cases could see some major emerging economies suffer an outflow of foreign capital with corresponding negative knock-on effects for domestic demand. A higher dollar might also dampen the recent rally in oil prices. While the cost of a barrel of oil has recovered to within sight of $50 a barrel, oil prices are still not high enough to justify the level of government expenditures planned for many oil-dependent economies, especially in the Middle East, Latin America and Russia.

While economic conditions in the US are more conducive to normalising monetary policy, raising interest rates in the US while other advanced economies are still weak will likely lead to significant upward pressure on the US currency. Dollar strength would dampen US exports, especially manufacturing exports, and slow the pace of overall US growth. The potential ramifications of the upcoming US presidential election results can also not be ignored.

Emerging markets expected to be the driver for future economic growth

Concerns over the transition in the Chinese economic model extend far beyond the borders of China. China is currently a top 10 trading partner for over 100 countries representing about 80% of global GDP and 40% of global metals demand. China's position as a lynchpin for Asian regional and global supply chains makes it a potential flashpoint for the transmission of global trade shocks.

However, despite the headwinds, the IMF expects emerging markets to drive the recovery of the global economy in 2017 and beyond. The IMF's medium-term forecasts assume conditions in several large emerging markets will stabilise by 2017; that Chinese economic rebalancing will occur smoothly; and the outlook for global commodity exporters will improve, most especially for oil exporters.

Uncertainty continues to weigh on Europe

Despite exceptionally loose monetary policy, the continuing risk of deflation remains highest in the Eurozone. This is particularly troubling given the high debt burden of some large Eurozone economies, most notably Italy, that would be further exacerbated by a general decline in prices. In addition, European policy makers continue to struggle with resolving the Greek and Italian debt bailouts, and co-ordinating a response to managing the risks of global terrorism and to handling the Syrian migration crisis.

In June, many European banks saw their share prices tumble as a result of "Brexit" and, although market commentators for the secondary market have reported that activity has been largely unaffected by the uncertainty following the Brexit vote, with only a brief hiatus in activity and an impact that seems to have been confined to UK-focused private equity funds, the long-term consequences of Brexit are still unknown.

On a more positive note, consumer spending is expected to be the main driver of growth in many regions and private equity managers are well-placed to benefit from this as they seek new investment opportunities. Despite the ongoing challenges in Europe, Pantheon continues to see good value in the region and believes that the fragmented nature of the private equity market is conducive to producing interesting deal opportunities.

The private equity market

In terms of exits, corporate buyers, looking to fulfil their growth strategies and make use of cash on their balance sheets, continued to be the main source for exits in 2015. The signs are that this trend is set to continue in 2016 - in Q1 2016, over 65% of exits were reported as trade sales.

There remains a strong fundraising environment - approximately $317bn of private equity capital was raised globally across 843 funds in 2015 - which has resulted in high levels of dry powder available for investment. The knock-on effect of this is the propulsion of asset prices. Staying disciplined in the face of rising valuations is exactly the right approach to mitigate the effect of high asset prices on returns. It is also worth remembering that even though private equity is long term and illiquid both by nature and design, the inherent activist approach adopted by fund managers in this asset class provides additional levers for value creation aside from just floating on the tide of market valuations.

Continued strong demand in the secondary markets

After two years of record-breaking deal flow, transactions in the first half of 2016 reached $10.5bn, lower than the $12bn transacted in the same period last year, and perhaps reflecting seller sentiment after January's market volatility, with many adopting a "wait and see" approach to the macro environment prior to launching transactions.

The secondary market saw a modest decrease in pricing, with average high bid levels at 87% of NAV, down from 92% in the same period last year, and 90% overall for the whole of 2015. Buyout pricing levels remained consistent with 2015 levels at 94% of NAV, reflecting strong demand in the secondary market where there is over $60bn of dry powder. The overall reductions in pricing reflect more venture transactions being completed during the period.

Amongst sellers, public pension plans represented over 42% of the market by volume, and have historically tended to constitute the largest secondary transactions. This category of seller, together with endowments and foundations, made up half of the market in the first half of 2016. Aside from transactions involving limited partnership stakes, GP manager-led transactions involving fund restructurings or secondary directs again played a significant part in the market, representing over 30% of first half deal volume, up from 21% in 2015.

Given the improvement in public market sentiment, and the roster of sellers that have delayed activity from the first half of the year, the second half of the year is expected to see an increase in activity with intermediaries projecting overall 2016 deal flow to be only slightly behind the levels of 2015.

It is clear that private equity, along with other markets, is currently facing many challenges: slowing global growth, macroeconomic and political turbulence, as well as volatile equity and debt markets are all contributing to the uncertainty in the financial markets. These dynamics, along with the high asset prices, are prompting managers to consider even more carefully how and where they can achieve the best returns. However, it should be noted that these challenges can also present opportunities for those private equity managers who are able to manage assets through economic cycles and can effectively target industry sectors and geographies that are capable of outperformance. Market dislocations, mispricing and distressed situations can create deal opportunities for long-term investors.

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Property

(compare UK property funds **here**)

Vikram Lall, Chairman, F&C UK Real Estate: There has been market uncertainty and evidence of a pricing adjustment in the immediate aftermath of the Brexit vote, although this does appear to be moderating as transactional evidence to support pricing improves. Market indicators suggest some weakening of values since the end of June 2016 with the IPD Monthly Index pointing to capital falls of 2.8 per cent and 0.7 per cent over July and August respectively.

Investor sentiment has weakened following the UK's vote to leave the EU. A period of uncertainty is in prospect, both with regard to the negotiation process and the likely tone of economic policy under a new administration. Monetary policy has already eased and market expectations are for a prolonged period of low interest rates.

Consensus expectations are that economic growth will be lower, particularly over the next year or so but that there will be no prolonged recession. This is unlikely to be good news for property values in the short term, however in this environment, income is likely to be the main driver of performance.

While nervousness in the investment markets does present some downside risk to near term values, the Manager reports that initial post Brexit demand is still evident across the majority of sectors and geographical areas with increased focus on defensive assets, longer leases and core locations.

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Managers, F&C UK Real Estate: The impact of the UK's decision to leave the EU may well lead to slower economic growth and, in the short term at least, has the potential to lead to wider uncertainty and increased volatility in the capital markets. Weakening sentiment does pose a threat to near term values with the impact of recent transactions, some of them from motivated sellers such as the UK open-ended funds, likely to become apparent in the third quarter valuations. There is little doubt that the weekly and monthly valuations in the weeks since the vote, while reflecting a range of outcomes, point towards a softening of values. City offices, properties with short leases, secondary and development led stock have been most affected in the immediate aftermath. Quality, well-let properties in established centres, particularly in the industrial and distribution sector have been more resilient. Sentiment towards alternative property assets remains robust with concerns persisting about the health of the secondary retail market.

Despite historic low valuation yields the case for property still stands up to scrutiny, offering an attractive premium over gilts, with potential for at least some further income growth in selected markets. Against this backdrop, management of the income stream is more important than ever. In more turbulent markets, stock selection is paramount.

The UK offers a large diverse economy and provides a transparent and mature property market, which has delivered solid risk adjusted performance over the long term alongside the opportunity to access a consistent, relatively high income return. These are all attractive characteristics in uncertain times.

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Kevin McGrath, chairman, Regional REIT: In the UK's regions outside of the M25 motorway the fundamentals of supply and, as yet, of occupier demand, have changed little. However, the risk of inactivity by tenants in the face of uncertainty may act to constrain our business and lower rental growth prospects. The Asset Manager's view is that valuation differentials between the regions and London have only recently started to narrow and are still well above the long-term average, giving a continuing opportunity to managers and investors.

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Regional REIT: Following a strong performance in the UK commercial property market in 2015, there were signs of weaker trading in the first two quarters of 2016, with investment in UK commercial property down 35% in Q2 2016 versus Q2 2015. Many occupiers and investors postponed decisions due to the uncertainty generated by the EU referendum. Following the slowdown in both the occupier and investment markets in the first half of the year, sentiment remains robust and we anticipate that trading levels will begin to improve through the second half of 2016.

The shift in investors' focus away from London started with prime regional assets, but is now also firmly focused on good secondary commercial property. Most market sectors are experiencing rental growth, with figures from IPD UK indicating that rental growth for all properties was 3.2% in the 12 months to July 2016. Much of the investment capital seeking regional property assets is for 'stabilised-income' with investors proceeding on a 'macro basis'; that these markets offer good value; that yields will continue to revert to the long-term mean; and rental growth will further bolster performance.

In 2015 investment in UK commercial property reached a record level of GBP61.5bn. This was followed by a progressive slowdown in the level of investment activity over the first half of 2016, with investor caution being attributable to the mounting uncertainty generated by the EU referendum. Figures from CoStar show that investment in the UK commercial property reached only GBP12bn in Q2 2016.

There is evidence of investors increasingly recognising the opportunity for better returns in the UK's regional markets. Continuing yield spreads between prime and secondary properties have fallen in the last 12-18 months. The yield spread remains well above its long-term average levels, which indicates that there remain significant opportunities for high quality secondary properties to outperform in the short- to medium-term.

Rental Growth Continues in the UK Regional Office Market

Research from Cushman & Wakefield indicates positive market sentiment following the EU referendum result across regional markets, with no signs of deals collapsing at the beginning of Q3 2016. Figures from IPD UK indicate that rental growth for all office market stock throughout the UK increased 2.5% in the 12 months to July 2016.

This is as a result of continued demand growth. Take-up of regional office space reached 2.6m sq. ft. in the first half of 2016(2) within the main regional markets, which is 48% of the annual take-up for 2015. The highest levels of take-up in the first half of 2016 were in Glasgow and Birmingham. Growth in service sector employment has continued to benefit regional offices.

JLL research shows that prime rental growth continued across the core 8 regional office markets, however, this was slower in Q2 2016, an average of 5.3% per annum. With very low vacancy rates within prime properties, the Asset Manager anticipates that demand for high quality secondary properties will increase, which will put upward pressure on rents and downward pressure on rent incentives.

Industrial Rental Growth Continues

Industrial rents are now in a sustained period of growth due to the demand-supply imbalance in the market, with data from IPD UK showing rental growth for all industrial stock throughout the UK has grown year-on-year; rental growth of 4.6% was recorded between July 2015 and July 2016. Cushman & Wakefield anticipate that the strongest rental growth will be experienced in markets with limited grade A stock, notably in Nottingham, Newcastle and Cardiff.

Take-up in 2015 totalled 29.7m sq. ft., a 15% decrease from 2014. This trend continued in Q1 2016 with occupier activity diminishing further as total take-up over the quarter fell just below 5m sq. ft.. The reduced take-up was seen across most UK regions as occupiers became more cautious due to global economic concerns, weaker export numbers and the EU referendum. However, subsequent research by JLL indicates that occupier demand in H1 2016 increased 18% with 10.2m sq. ft. of prime space taken up, including 7.9m sq. ft. of new space.

The growth of online spending means that 'e-tailing' is now the most influential sector in the industrial market, accounting for 38% of overall take up in 2015.

With development focussed on Grade A space and pre-let situations for large distribution units close to the main North-South trunk roads, namely the M1, M6 and around the M25, there is very little additional supply to the multi-sized, multi-let industrial estates. The Asset Manager predicts that this will continue to be the case, which will result in a demand-supply imbalance in this market driving rental growth.

Economic overview

UK GDP rose to 0.6% in Q2 2016, compared to 0.4% in Q1. Between the quarters there was growth in services (0.5%) and manufacturing (1.8%), with total production ahead 2.1%. Annual GDP in the end of the second quarter was 2.2% higher than at the same time last year. In the aftermath of the EU referendum forecasters are anticipating that the economy will now not grow for the rest of 2016, resulting in a full year growth rate of 1.6%. Growth is expected to pick up in the start of 2017, but full year forecasts have been reduced to 0.7% for 2017 and 1.5% for 2018.

Employment levels in the UK also grew, with 174,000 more people in work from May to July 2016 than in the prior three months to April 2016 and the rate of unemployment reduced to 4.9% (July 2016) down from 5.5% a year earlier.

It is worth highlighting one example, amongst many, that gives an indication of the potential of the UK's regional economies. The Midlands and northern England - the "Northern Powerhouse" - have a markedly greater exposure to many export focussed engineering sectors favourably disposed to a far more competitive Sterling delivered before and subsequent to the EU referendum. Notable too is the presence of a considerable number of higher education institutions, which have increasingly geared their attentions to foreign students (rising 7.8% since 2010, whole of the UK).

Labour market data recently released, with data to end of June and thereby including the last week after the referendum, showed that the Midlands and North West enjoyed the most impressive declines in unemployment (since June 2011, down 3.25% in the Midlands and down 3.2% in North West), greater employment (since Q2 2011, a rise of 7.4% in the Midlands and up 5.1% in North West) and increases in business formation (2013-15, a 8.6% rise in the Midlands and North West). These trends are likely to continue as a consequence of the environment of monetary and fiscal stimuli in the aftermath of the referendum.

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Real Estate Investors: The uncertainty created by the European Referendum during H1, provided us with the opportunity to grow our portfolio and income. The unexpected result could potentially provide further opportunities to well connected, cash buyers. However, we believe this will be a very short lived opportunity, as the signs are that calm is already returning to the market place, with sentiment and activity recovering, fund redemption pressure reducing and others becoming acquisitive. It is quite possible that the 'Brexit' window of opportunity has passed. Overseas buyers and private equity funds are actively looking to capitalise on the combination of a weak Sterling and expectations of discounts.

At this stage, we remain positive about regional investment values and note that regional occupier activity in the lead up to the referendum was 15% above average and, post-election, occupier demand in particular for retail space has remained buoyant. Our strategic decision to invest in value creation opportunities in the Midlands continues to provide some protection from any downward valuation pressure, whilst generating excellent investment returns and providing potential capital upside.

The Birmingham and wider Midlands economy remains healthy. With the continuation of the HS2 project, the growth of the manufacturing base, which is benefitting from Sterling depreciation, the relocation of HSBC's UK Head Office and the continued growth of the tourism, digital media, creative industries and the service sector, the regional prospects remain positive and we anticipate the continued re-emergence of Birmingham and the West Midlands as an economic powerhouse.

In contrast with London, regional investment remains buoyant, with GBP4.4 billion worth of transactions in H1 2016 (up 17% on H1 2015 and 10% above the 5 year average). Regional volume accounts for 45% of the Q2 totals, its highest share over 5 years. There is a distinct possibility that there will be further increase in demand for regional investment property, as buyers 'look away' from London and the South East, where there remains a long overdue correction for property valuations and a potentially declining occupier market, which may reveal a reducing rental pattern

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Robert Peto, chairman, Standard Life Investments Property Income: At the time of writing there is an unusual level of uncertainty following the decision of the UK electorate to leave the EU. This uncertainty is likely to continue, and although the markets have shown some stabilisation since the election of a new Conservative prime minister, it is not yet possible to forecast what the impact of the decision to leave the EU will mean for UK growth, and in particular the UK commercial real estate market. In the short term at least the sentiments are negative. A number of the open ended property funds have either closed to redemptions or imposed pricing adjustments within days of the vote as retail investors quickly sought liquidity. The share prices of REITS and other closed ended companies were also affected by this negative sentiment.

The UK economy has now entered a period of heightened uncertainty which most forecasters predict will impact on future growth. The International Monetary Fund, for example, recently cut their forecast for UK economic growth in 2017 down to 1.3%, a fall of 0.9% from previous forecasts. One key measure that drives economic performance is confidence and there are early signs that businesses are now less confident than before the referendum which may have an impact on future investment plans. How the real economy reacts to any easing in monetary policy by the Bank of England will be key to the extent of any downturn as will the Government's ability to set out more clearly how the UK will interact with the EU going forward.

The performance of the UK commercial property market has always been closely linked to that of the economy. Hence there can be no doubt that any economic downturn will impact capital values which were already deflated as a result of the 1% increase in stamp duty land tax in the March budget. However, unlike in previous downturns, the sector is in better shape with lower gearing, higher occupancy rates, lower levels of speculative development and a significant yield premium over other asset classes.

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Jason Baggaley, manager, Standard Life Investments Property Income: The slowdown in UK real estate that was materialising prior to the referendum has been exacerbated by the vote outcome. The heightened uncertainties following the result and the subsequent retreat in business and consumer confidence are likely to impact negatively on the outlook for the economy. This is likely to have detrimental consequences for UK real estate given the direct linkage to economic activity. We therefore anticipate increased downward pressure on UK commercial real estate capital values. The magnitude of any declines will depend on the impact on the domestic economy and the level of interest rates and yields from alternative investment classes. The impact will vary by sector and geography. From a sector perspective, we expect Central London offices to be the most negatively impacted in the near term given the linkages to European markets via cross border trading. We expect industrial, given its higher yield, and retail assets to be comparatively resilient, although not immune. Long income assets should provide most resilience in any downturn. Despite the negative outlook, UK real estate continues to provide a higher yield than other assets and, unlike during the Financial Crisis, lending to the sector is at a much lower level than in 2007/2008. Furthermore, existing vacancy rates are at below average levels in most markets and development remains relatively constrained which should all help stabilise the market further out. The current "lower for even longer" interest rate environment coupled with an increasing investor global search for yield and the retention of the UK's safe haven status should all ensure the asset class is reasonably placed longer term.

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UK Healthcare

Malcolm Naish, chairman, Target Healthcare REIT: We are operating in an environment of political and economic uncertainty, both worldwide and more locally as demonstrated by the EU referendum result. Dividends payable by property companies with long lease terms and annual rental uplifts provide an attractive investment case, reflected in robust share price responses by the healthcare investment market. We believe the underlying fundamentals of population demographics and supply/demand imbalance of quality UK care home stock remain compelling.

As in previous years, the care sector in the UK is facing various headwinds, including: introduction of the living wage; nursing shortages; mediocre fee increases from government; and, the ongoing challenges of a more engaged regulatory regime.

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Target Advisers LLP, managers of Target Healthcare REIT: The investment case for high quality recently built care homes in the UK remains compelling. Good levels of investment activity in the elderly care sector have continued during the year although the volume of transactions has dipped slightly recently and there has been somewhat of a post-Brexit, summer lull in new opportunities coming to market. However, we expect to see an uptick in transaction activity in the Autumn.

We had seen a reduction in investment appetite from US REITs who had been very active investors in the UK market for the past couple of years, however, the recent favourable exchange rate on the back of the pound falling in value against the dollar has made the UK market more attractive again for US buyers.

Traditional real estate investors have been active recently making direct investment in UK care homes for pension and annuity funds attracted by income producing assets in a low interest rate economy.

We continue to see some very keen yields paid for the most highly desirable assets particularly in the South East of England. We continue to follow our strategy of seeking out value in the mid-market, single asset/smaller portfolio categories with regional operators. We retain our conviction that they can best apply their local knowledge and market presence to deliver high quality care within their communities which in turn we believe allows them to achieve excellent financial performance.

Brexit

So far, we have not seen any significant movement in yields following voters' decision of 23 June to leave the European Union, one of the most significant political decisions in decades. Whilst the initial reaction has been well documented, and the UK real estate market now faces a period of significant uncertainty, the fundamentals of the Health & Social Care market have not changed. The demographics will continue to shift towards a greater proportion of elderly people creating the supply-demand imbalance that will require greater investment into care home development.

In the four weeks following the vote, Healthcare REITs outperformed core real estate by a significant margin due to their long lease terms and annual rent uplifts providing good visibility of future revenues and cash flows. Care home leases with terms of approximately 30 years compare very favourably with shorter term office leases. Also, the movement in gilt pricing making long income real estate more attractive.

The effects of the Brexit vote cannot be predicted with any certainty or accuracy. The UK will experience a period of uncertainty, however, due to the demographic imperative, businesses in the UK healthcare sector are more likely to be insulated from the worst effects of any such market uncertainty.

Continued headwinds: National living wage; funding; staffing; regulatory pressures; home closures

As reported in 2015 the new living wage came into effect in April 2016. Care homes, while welcoming the sentiment of staff being better rewarded, were initially concerned about individual local authorities having the resources and/or inclination to match the uplift in fees paid to reflect this additional cost of caring for state-funded residents. The government went some way in easing the situation by introducing the 'Adult Social Care Precept' allowing Local Authorities to raise council tax bills by a further 2%, with these funds allocated toward social care, albeit not exclusively for care homes. Laing & Buisson subsequently announced in July 2016 that the average rise in state funded fees across the UK equated to 4%, (3.4% in England) and this has essentially balanced the 3.5% rise in costs experienced by homes. Operators however continue to have longer term concerns as the Living Wage is pushed toward its 2020 target of GBP9.00 per hour from the initial GBP7.20. Operators have noted that wages at all levels have often had to be adjusted, as staff at higher levels expected a realignment of their own pay grade.

From a wider funding perspective research by Prestige Nursing released in Aug 2016, showed that despite the base need for a 3.5% rise in fees to cover costs, the average annual rise had been 5.2% over the last year, showing that care homes had been using the time honoured route of using private fee payers to subsidise local authority residents. This reinforces the sophisticated operator's viewpoint that there is a requirement for a good percentage of a home's residents to be self-funders, both as a safety net against austerity in the public sector and as a route to create a more attractive environment via suitable buildings and services offered to meet the expectations of a more discerning public. This private fee payer requirement also sees operators continuing to favour the more southerly and wealthy regions when it comes to new development, potentially creating a bed crisis in future years for areas with poorer demographics.

As far as individuals requiring care are concerned, those reliant on state funded care will continue to see less choice available to them, with 'top-ups' more likely to become the norm, rather than the exception. Private fee payers also continue to be exposed to losing significant elements of their net worth as the 'Dilnot' protection against 'catastrophic care costs', while still said to be on the government's agenda, is now regarded by most as unlikely to be implemented, not least as a close aide to the May government has recently indicated that people should use their housing wealth to pay for care.

Despite the introduction of the living wage, operators continue to experience staffing difficulties, with many believing that Brexit will further compound the problem. Some operators are noted to be choosing to move away from nursing care, and a number of high profile closures have cited staffing pressure as the 'final nail in the coffin' for their decision.

As reported in 2015, Care Commissions, particularly the English CQC remain challenging. Most homes have now experienced their first check under the new CQC standards, and many have found it a frustrating and challenging experience. The CQC themselves have noted some improvements in those found wanting in the first round of inspections, with the majority making the required improvements deemed necessary by the inspectorate. It is noted anecdotally by Target that there is a significant 'casualty' rate amongst managers in connection with these inspections, and also a growing reluctance by deputies to step up to the manager role with the extra scrutiny and responsibility that the role entails.

Home closures continue to be a theme in the sector, with closures noted on virtually a daily basis. Many of these closures are of homes in the 'mom and pop' operator category, which dominates this sector. These homes are typically sub 30 residents, housed in older, dated conversions. Some operators have little scope to market their homes due to poor or impractical building environments, and trade past their preferred retirement date due to the dilemma of disposing of the business. For some, the final straw is a poor CQC inspection which seals the decision to close. The raft of closures is seen as useful to most continuing operators, with subsequent pressure put upon the authorities for beds and ultimately less opportunity for local authorities to dictate low fee scenarios.

Ireland

Gary Kennedy, chairman, Green REIT: The Irish economy continues to experience strong growth. Ireland was the fastest growing economy in the EU in 2014 and 2015, and growth is expected to continue through 2016 and 2017 at levels well above the EU average. While export growth was the main driver of recent economic growth, growth in the domestic economy is now a greater contributor. The country's unemployment rate of 8.3 per cent is now below the EU average, having peaked at 15.2 per cent in early 2012, while the country's debt to GDP ratio continues to fall and is now below the EU average, with a minor government deficit expected for 2016 and a small surplus forecast for 2017. Long term interest rates remain low, while the Irish government 10 year bond rate stood at 0.50% at 30 June 2016, both of which are supportive of commercial property yields.

Germany

Harry Hyman, Chairman, and Zohar Levy, managing director, Summit Germany: We remain very comfortable with the outlook for German commercial property. We have seen significant variance in reported growth in commercial rental values between regions during the first half of the year. Two of Germany's top seven office locations reported higher average market rents in H1 2016 while the others were broadly flat. We nonetheless expect many of our specific asset locations to benefit from improving regional markets and although reported growth in asset values has been more moderate recently, performance at the property level has been robust. Therefore, we still anticipate further rent increases and yield compression driven by active asset management.

Germany is regarded as one of the world's most stable real estate investment markets. Although domestic commercial property investment volumes during the first half were some 14% below the same period last year, the performance within the underlying markets which represent our core focus has been very stable.

It has also been largely unaffected by recent EU crises and whilst we clearly intend to track Brexit negotiations very closely, we do not currently expect Brexit to materially impact occupancy or investment decisions. There is undeniable potential for the UK's decision to unsettle investment markets, but we have not seen any impact on our portfolio so far. Indeed, we see an argument for Germany's core office markets to increase demand for space over the next few years if international firms decide to relocate all or a proportion of their operations from London to German financial centres.

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Robert Hingley, chairman, Phoenix Spree Deutschland: Demand for residential property from all of tenants, owner-occupiers and investors remains healthy. Despite recent increases, property values, on average, remain below the cost of construction. Recent declines in long term bond yields have increased the relative attraction of residential property as an investment, while reducing financing costs for property owners. For example, as at 31 August 2016, the net yield on the Company's portfolio stood at a premium of around 400bps to 10 yr bunds, which in June 2016 moved into negative territory for the first time. Population growth in most German cities, coupled with limited supply of residential property, is also supportive of further growth in rents and property values. The Company therefore believes there remains significant scope for further growth in property values.

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Macau

Chris Russell, chairman, Macau Property Opportunities Fund Limited: A recovery in property market values, albeit a gradual, cautious one, may now be in sight. Lower-value property transaction volumes have recovered, with some improvement in prices. The pace of Macau's economic slowdown is easing and the gaming industry, the driver of the city's economy, has been showing signs of stabilising.

The completion of infrastructure projects in the next few years, including the Hong Kong-Zhuhai-Macau bridge, will integrate Macau with neighbouring cities in the Greater Pearl River Delta region.

The progressive opening of new mega-resorts in the next two years will help to support full employment and wage growth. The Macau Tourism Industry Development Master Plan aims to boost visitor arrivals to 40 million yearly by 2025 and generate non-gaming revenues to double from US$6.4 billion last year to US$14 billion yearly by 2025.

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Sniper Capital, managers of Macau Property Opportunities: Macau's economy continues to adjust amid a weak performance in the gaming sector, exacerbated by an ongoing anti-graft campaign spearheaded by China's central government. The gaming industry is, however, showing signs of stabilising, with the mass-gaming segment continuing to deliver steady growth.

Following the opening of the much anticipated new casino resorts, Wynn Palace and The Parisian, which will be followed by two more casino resort openings in 2017/early 2018, we believe the increased number of hotel rooms and the large scale of non-gaming offerings will further enhance Macau's position as a world-class tourism and leisure hub. The development of new, integrated resorts has been well-timed to tap the rapid emergence of the middle class in China, whose numbers are forecast to exceed 400 million by 2020.

Gaming - An Improved Business Model

The Chinese government's anti-graft campaign has been in place for almost two years. Determined to make a success of it, the central government and Macau's authorities have pledged to step up efforts to supervise the gaming industry more closely. Newly introduced regulations include a revision to the rules on anti-money laundering procedures and a ban on proxy betting in casinos. A regulation to raise the entry threshold for junket operators has also been proposed.

These measures may hinder a recovery in the VIP gaming segment but mass-market gaming continues to grow steadily in importance. According to Macau's statistics department, mass-market gaming now accounts for 49% of total gaming revenues, up from 26% 5 years ago. This is an encouraging sign that the gaming industry is transforming and is less reliant on high-rolling, VIP gamblers.

Five-year Master Plan - Moving Towards Sustainability

Macau has, for the first time, unveiled a five-year plan in conjunction with China's five-year economic and social development blueprint to reduce its reliance on the gaming industry. The proposed plan includes measures to reposition the city as a world-class tourism centre, accelerate the completion of infrastructure developments and increase non-gaming income to at least 9% of the total revenues generated by casino operators.

According to the proposed Macau Tourism Industry Development Master Plan, the territory aims to increase visitor arrivals to 40 million yearly and double tourism revenues to US$14 billion annually by 2025. To support such vast numbers of visitors, the authorities plan to develop and diversify tourism products focusing mainly on heritage sites, which are currently underutilised.

Infrastructure - Catalyst for Economic Growth

Major infrastructure projects have come under increased scrutiny amid further delays in their development progress. The authorities are working hard to complete the construction of the Hong Kong-Zhuhai-Macau bridge by 2018. Once completed, it is expected that the resulting "golden tourism triangle" will open the floodgates for a range of leisure and business opportunities among the three cities.

The Taipa section of Macau's light rail transit system is likely to begin operating only in 2019. When completed, connectivity and footfall are expected to increase along the Cotai Strip, which is home to a proliferation of new, integrated resorts located near train stations.

Risk and Uncertainties

Credit rating agency Moody's Investors Service recently downgraded Macau's rating from Aa2 to Aa3 due to lower economic growth and a limited policy response to falling gaming revenues.

Although a slew of government measures are being implemented to diversify Macau's economy, they are centred primarily around gaming and tourism, resulting in volatile economic growth that is vulnerable to changes in external demand.

With Macau experiencing almost full employment, a labour shortage could pose a challenge to the new, integrated resorts that are continuing to open.

As Macau's currency is indirectly pegged to the US dollar, a weaker Chinese yuan is likely to have repercussions for the city's gaming and tourism industries because mainland Chinese account for approximately 64% of all visitors to the territory.

Property market overview

Macau's real estate market has remained quiet for most of this year amid an uncertain economic environment. However, more recently, there has been a marked rebound in transaction volumes, which rose by 58% in the second quarter of 2016 compared to the same period last year.

Although average home prices had dipped 15% year-on-year to MOP7,285 (US$910) per square foot as at end of June, we expect prices to hold steady in the near term, in line with an anticipated stabilisation in gaming revenues.

Rising Population Drives Housing Demand

The government's efforts to curb property purchases by foreign buyers through cooling measures such as the Buyer Stamp Duty, Special Stamp Duty and mortgage caps have continued to impact the market. These measures, designed to temper excessive investment and speculative activity, have significantly reduced the number of transactions involving foreigners. Foreign buyers now account for less than 2% of residential transactions, down from 10% in 2012.

This has resulted in more attractive values for local homebuyers, as capital values have dropped 40% since the last peak in 2014. Amid a growing population earning sound incomes, housing demand in Macau will be supported predominantly by local buyers.

Given that a number of new casino and hotel projects will be completed over the next two years, we anticipate that more foreign workers will enter Macau, which is likely to drive stronger demand in the leasing market and lend support to rental rates.

Limited Housing Supply Over Next Five Years

According to real estate consultancy, JLL, 4,838 high-end residential units are expected to be completed between 2016 and 2020, equivalent to only 2% of total existing residential stock. It is expected that new housing supply to remain limited in the near term.

The city's land concession policy, under which undeveloped land parcels will be reclaimed by the government and land contracts deemed invalid once they reach 25 years, could contribute to tight residential supply. To date, the government has listed 113 land contracts as being invalid due to zero development activity on site. Housing supply is thus expected to reduce further as a result of the lengthy process by which the government reclaims and re-releases these land parcels to developers. As a result, actual new supply may be even lower than expected, possibly prompting homebuyers to turn to the secondary market as an alternative.

Investors' Preference for Macau Properties

China has introduced stimulus measures and lowered interest rates to boost the property market, which has led to an increase in property values in Zhuhai and Hengqin over the past year. According to Sniper Capital Research, the average home price in Zhuhai currently stands at CNY2,300 (US$350) per square foot, and the price in Hengqin is CNY3,300 (US$500) per square foot. Given that the average home price in Macau has declined to MOP7,285 (US$910) per square foot, the price gap between Macau and its neighbouring cities has since narrowed by approximately 23% per square foot, making housing investment in Macau more attractive.

Macau's low tax regime gives it a competitive edge over other Chinese cities, alongside the ease of investing in the territory on the back of an established regulatory system and a strong currency pegged to the US dollar.

Commercial Properties Remain Attractive

Despite the fact that retail rents are in decline, Macau's commercial property sector is still generating strong investment appetite among domestic investors and their mainland counterparts, as the number of quality commercial properties is extremely limited and, unlike residential real estate, they are not subject to additional stamp duties. This interest is expected to keep capitalisation rates at a low level and support capital values going forward.

Conclusion

The property market in Macau is expected to continue to stabilise in the coming months, with a gradual improvement in prices to follow. Although a full-fledged recovery can be expected only when the economy returns to growth and gaming revenues show a sustainable pick-up, we remain confident that the long-term demographic drivers of the city's growth and its limited housing supply will provide support for the property market.

QuotedData

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