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Monthly summary | Investment Companies

February 2017

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.

Roundup

For much of January markets were buoyed by the perceived benefits to growth of Trump's economic policies. However, in some quarters, people began to wonder how they were going to be paid for. The US dollar weakened, the gold price rose and long-term yields rose (though less markedly in the US than in Europe and the UK). Asian and emerging stock markets had a good month while US and UK stock markets were fairly flat.

Global

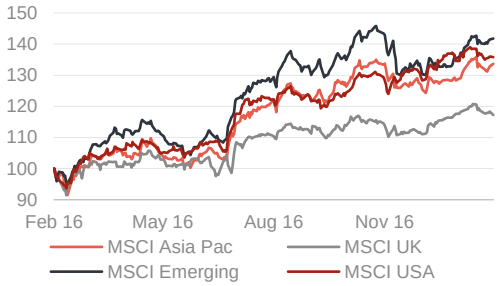
Populist policies, soothing anti-globalisation sentiment, provides a tailwind but could result in rising inflation and interest rates. Caution advised.

Richard Killingbeck, chairman of Bankers Investment Trust, says that there is a positive economic tailwind for markets but draws attention to the possibility of rising UK rates in response to rising inflation. Both James Will, chairman, Alasdair McKinnon, manager of Scottish Investment Trust suggest that recent political events are being driven by large sections of the population feeling disadvantaged by the consequences of globalisation. Richard Martin, chairman of F&C Managed Portfolio Income, favours a cautious approach, overseas holdings and an emphasis on quality.

Exchange Rate	31/01/17	Chg. on month %
GBP / USD	1.2579	+1.9
USD / EUR	0.9261	-2.6
USD / JPY	112.8	-3.6
USD / CHF	0.9892	-2.9
USD / CNY	6.884	-0.9

MSCI Indices rebased to 100

Time period 31/01/16 to 31/01/17



Source: Bloomberg and Marten & Co

	31/01/17	Chg. on month %
Oil (Brent)	55.7	-2.0
Gold	1210.72	+5.5
US Tsy 10 yr yield	2.4531	+0.4
UK Gilt 10 yr yield	1.417	+14.4
Bund 10 yr yield	0.434	+112.7

United Kingdom

M&A may pick up, volatility may create opportunities and value investing may be making a comeback

Neil Hermon, manager of Henderson Smaller Companies, sees the chance of an uptick in mergers and acquisitions (M&A) activity, in part as foreign investors take advantage of the weak pound. Philip Rodrigs, the manager of River & Mercantile Micro Cap points out that volatility is the friend of the active investor. T\he managers of Aberforth Geared Income welcome a resurgence in the value style of investing. They say, given that value has been out of favour for much of the past decade, its rebound might take several years to play out.

Asia

Growth with periods of volatility

The managers of JPMorgan Asian see Asia as a region with numerous opportunities for growth but set against a backdrop of periodic volatility. They cite the unpredictable transition from the old to the new economy in China as a potential source of volatility but seem enthused by reforms in India, Indonesia and Vietnam.

Japan

Optimism over reform programme. Could domestic investors be tempted into the stock market?

Harry Wells, chairman of CC Japan Income & Growth, bemoans the apparent disinterest in Japanese equities by domestic investors and hopes that signs of increasing inflation and a weaker yen might tempt some of the Y1,700 trillion sitting in cash savings into stocks. Richard Aston, the manager of that fund, is optimistic, pointing to the popular support Shinzo Abe has for his reform programme.

Emerging Markets

Sound fundamentals despite anti-emerging market sentiment emanating from the US. Opportunities to buy at attractive levels may emerge

Richard Bonsor, chairman of Aberdeen Emerging Markets, says of emerging markets that currencies are competitive, balance sheets are generally sound, corporate earnings have stabilised and economic growth appears to have bottomed out. The managers of that fund believe volatility associated with things such as Trump's rhetoric towards emerging markets may create attractive buying opportunities.

Russia

More stable or rising oil price supportive of Russian economy

Gill Nott, chairman of JPMorgan Russian, sees some potential for upside if the oil price continues to strengthen and economic and political stability are maintained. The manager of that fund, Oleg Biryulyov, foresees a more stable oil price over the next 12-18 months. He sees no change in the internal political landscape and expects to see a liberalisation and restructuring of the Russian economy in coming years.

Lack of development in regional markets is helping to boost rents

Property

DREIM, the managers of Drum Income Plus REIT, see welcome signs of rental growth in their markets. ICG Longbow say rising employment and a dearth of new space are bolstering the commercial property market. The supply constraints are most acute outside Central London.

Other

We also have extensive comment on Macau's economy and property market from Macau Property Opportunities, Vietnam from VietNam Holding and on the oil market from New City Energy.

Contents

Global

(compare Global funds here)

Richard Killingbeck, chairman, Bankers: Politics will remain to the fore during the year ahead and the key for financial markets will be whether there are any further surprises, especially from Europe. I suspect there may be. The extent of these potential surprises could keep markets in a state of uncertainty for most of the year.

Putting politics aside, the economic tailwind looks positive. President Trump has inherited a strong economy where growth is accelerating. The strong US economy, despite the protectionist rhetoric, is good for the global economic outlook. In the UK we are bound to see a significant jump in inflation as a result of the weaker level of sterling. One of the key debates this year will be whether the move to higher inflation is a temporary or permanent shift. At the moment the likelihood is that this will be a temporary situation. However, if we see pressure mounting on wage inflation the Bank of England might move more quickly to raise interest rates. Depending upon the resilience of the UK economy in 2017 this could have a negative impact on a number of sectors although it could well be seen as a positive for the financial sector.

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James Will, chairman, Scottish Investment Trust: Since the year-end, there has been a further challenge to the political status quo with the election of Donald Trump as US President. Forthcoming elections have the potential to highlight further rancour towards the European Union.

I do not propose to add to the large volume of material that exists on analysis of these events other than to observe that there is a view, not only confined to the US and the UK, that large sections of the population feel disadvantaged by the consequences of globalisation. In contrast, many large corporations have benefited from these trends but it is still too early to determine what changes, if any, will emerge under new political regimes. Regardless, politicians and bureaucrats are likely to remain sensitive to market movements and will not intend to damage investor confidence.

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Alasdair McKinnon, manager, Scottish Investment Trust: The Brexit vote and, subsequent to the year end, the election of Donald Trump as the forthcoming US President indicate that there may be a shift in the political and investment environment. Large segments of the populations in the developed world clearly feel that a decline in their living standards has been ignored by the establishment.

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Richard Martin, chairman, F&C Managed Portfolio: "Stockmarkets climb walls of worry", has certainly been true this past year, as the FTSE 100 Index has just made an all-time high and yet scarcely has there been a time when financial markets have faced so many uncertainties. The imminent change in administration in the US appears to herald a change in economic policy towards a fiscal-led domestic stimulus through tax cuts and infrastructure spending with an increase in tariffs to protect US industry. This may lead to higher interest rates and a rise in bond yields in the US. Meanwhile in the UK, inflation is set to rise and growth may well slow as the uncertainties around Brexit negotiations come to the fore. Yet at the company level many continue to trade well, due in part to weaker sterling. In summary, the potential downside to equity markets suggests that a cautious approach appears sensible. In

terms of investment strategy, a preference for overseas exposure and a continued emphasis on quality are the key elements in investment selection.

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United Kingdom

(compare UK funds **here**)

Neil Hermon, manager, Henderson Smaller Companies: The outlook remains mixed, with subdued economic performance across the globe. The UK economy has defied the doom-mongers with post-Brexit resilience. However, the triggering of Article 50 and subsequent exit negotiations may lead to a drop in UK consumer and corporate confidence. The recent rise in US interest rates has flagged to investors that loose global monetary conditions will at some stage reverse. However the 'normalisation' of monetary policy should be slow and measured. Inflation, particularly in the UK, is likely to rise, primarily from the rising cost of imported goods. This could squeeze consumers as net disposable income could come under pressure as wage inflation fails to match cost-of-goods inflation.

In terms of valuations, the equity market is roughly in line with long-term averages. To see the market make progress we need to see earnings growth accelerate, a situation which will be aided by the recent devaluation of sterling.

Generally, balance sheets are strong and dividends are growing in the companies owned by the Company. M&A activity in the period has been depressed, probably due to the uncertainty caused by political upheaval. If corporate confidence improves, M&A will increase, especially as little or no return can currently be generated from cash and the cost of debt is historically low. Furthermore, the recent devaluation of sterling has made UK corporates more attractively valued for foreign buyers. These are trends which will help smaller companies in particular, as mergers and acquisition activity tends to be focused in this area.

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Philip Rodrigs, manager, River & Mercantile Micro Cap: Volatility is the friend of the active investor and, as the past year has shown, not necessarily the foe of the Micro Cap section of the market. The resilience seen is in part due to the ongoing discount valuation experienced by many UK Micro Cap Companies. These low starting valuations entering into a volatile period naturally provide an element of protection for share price performance compared to stocks that enter such a period with over-inflated valuations. Meanwhile the underlying economic conditions remain relatively stable, thereby allowing individual companies to continually further their growth or recovery trajectories.

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Aberforth Partners LLP, managers of Aberforth Geared Income: The value investment style started a fightback in early 2016 that was initially concentrated in the highly indebted mining companies. Intriguingly, the six months to 31 December have seen a welcome broadening of the stockmarket's appetite for value stocks. The catalyst would appear to have been Donald Trump's victory in the US election. His rhetoric and, presumably, his policies may mark a turn from austerity towards a reflationary strategy. The promise of tax cuts, fiscal stimulus and protectionism have challenged the positioning of financial markets, which reflected an expectation of low

rates, deflationary pressure and subdued growth. Government bond yields have responded and, as talk builds again of the "great rotation", small value stocks in the UK have been caught up in the repricing of a reflationary outcome, despite the lingering uncertainties of Brexit.

The power of the rotation so far probably says more about how extreme some of the valuation stretches within financial markets had become. For the rotation to continue the new president has to deliver on his promises, while other familiar macro economic issues, not least Brexit, need to be negotiated.

It was notable that the calendar year ended with an upsurge in takeover activity: once again bigger companies are exploiting the valuation anomalies on offer among the lower reaches of the UK stockmarket, with overseas predators given additional encouragement by the weakness of sterling.

Given that value has been out of favour for much of the past decade, its rebound might take several years to play out. The weight of history gives confidence that today's valuations in the sector are anomalous and that, over time, these will be addressed to the benefit of the value style.

Asia

(compare Asian funds **here**)

Richard Titherington and Ayaz Ebrahim, **managers, JPMorgan Asian:** Looking ahead, we expect the outlook for Asian markets to be characterised by numerous opportunities for growth against a backdrop of periodic volatility driven by events inside and outside the region. In China, policy makers are confronted by overall slower growth with oversupply in many manufacturing and commodity sectors, but at the same time an overheating property sector where prices in major cities have rapidly increased over the last year and they are responding with measures to cool this sector. How successful policy makers will be in terms of balancing the economy without unintended consequences remains to be seen but it is clear that the divergence between 'new' industries like the internet and 'old' industries should widen over time. The longer term outlook in India remains broadly positive, driven by our belief that economic growth and earnings are set for a strong cyclical recovery, with falling interest rates a key catalyst. Reform continues to be in focus and, importantly, events such as the passing of the GST are the first in an upcoming series of legislative reforms which required constitutional amendment as opposed to simply procedural reform, which had previously been the prior driver. In addition to the positive reform developments in India and Indonesia, the removal of foreign ownership caps in Vietnam's largest listed company, Vietnam Dairy Products, marks an important turning point for the opening of the country's stock market to further foreign investment.

Japan

(compare Japan funds **here**)

Harry Wells, chairman, CC Japan Income & Growth: Uncertainty abounds across the global political spectrum, not least the fear of potentially protectionist moves by the new Trump administration. Certainly, it is too early to say what effect President Trump's economic and foreign policies will have on the Asian region, including Japan. The stakes are high, so one hopes that reasoning conducive to continuing free trade will prevail. To some extent, large Japanese manufacturers may escape potential import tariffs or border taxes through their own US production facilities - Nissan is an example. Notwithstanding the global backdrop, our investment managers believe that BOJ policies have created a favourable environment for investing in income generating assets in Japan. It is remarkable that domestic funds are so wary of returning to the Japanese stock market, which is indicative of entrenched risk-averse, and deflationary convictions. Despite the privatisation of public assets at attractive prices, the introduction of Nippon Individual Savings Accounts in 2014, Yen 6 trillion (and rising) company share buy backs, improving dividend metrics and the BOJ's own equity purchase programme set at Yen 6 trillion annually; an astonishing Y1,700 trillion in savings is still sitting in cash suffering negative rates of interest and has not been tempted back into equities. A weaker Yen and something of a cyclical earnings recovery might be a catalyst for Japanese equities particularly if a gathering perception of some inflation gains any momentum.

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Richard Aston, manager, CC Japan Income & Growth: We move forward into 2017 with a great deal of optimism. The domestic economy remains robust and continues to benefit from the broad economic initiatives included under the Abenomics umbrella. In contrast to the political turmoil in other regions of the world, Prime Minister Abe retains strong popular support and is expected to continue with his programme of reforms and incentives. The majority of Japanese companies remain in a robust financial position with the outlook for aggregate earnings growth boosted by the recent weakness of the Yen.

We expect 2017 to be another good year for shareholder returns in Japan. Nikkei have recently announced the launch of the Nikkei 225 High Dividend Yield Stock 50 Index which will further raise awareness of the availability and quality of income from Japanese equities. We continue to believe that initiatives such as these will continue to encourage the move towards best practices in Japan with regard to distributions to shareholders.

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Emerging Markets

(compare emerging market funds **here**)

Richard Bonsor, chairman, Aberdeen Emerging Markets: Although the policies of the new Trump administration may well be more measured than some of the pre-election rhetoric promised, the combination of a more fiscally expansive US at the same time as monetary conditions tighten, creating the potential for further US Dollar strength, presents a challenging backdrop for emerging markets. Nonetheless, despite the recent rally, valuations of emerging market equities remain attractive

relative to developed markets and there are a number of other factors that are supportive of the asset class; currencies are competitive, balance sheets are generally sound, corporate earnings have stabilised and economic growth appears to have bottomed out. With many investors under-exposed to the sector, there is the potential for further gains in the year ahead.

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Aberdeen Fund Managers, managers of Aberdeen Emerging Markets: As we look ahead to 2017, the implications of the UK's decision to leave the European Union and Donald Trump's victory in the US Presidential Election remain unclear. What is likely is that these, and other unforeseen events, will create occasional bouts of risk aversion that, whilst painful to experience, create attractive long-term entry points for emerging market investors.

We take comfort from the fact that despite the rally in emerging market equities over the last year, valuations remain attractive. At the time of writing, the MSCI Emerging Markets Index trades on trailing price to earnings and price to book ratios of 14.3x and 1.5x, 34.6% and 32.5% lower respectively than the same measures for developed markets. Headwinds to earnings growth including currency weakness and low commodity prices have turned to tail winds in many instances. This is being reflected in a recent moderation of downward earnings revisions, a trend which, if it continues, may soon give way to positive earnings surprises. Further evidence of a recovery in earnings in what is an inexpensive asset class to which global investors are quite under-exposed would be welcome, and could be a catalyst for further gains.

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Macau

(compare Asian property funds **here**)

Macau Property Opportunities: Macau's economy returned to a modest growth of 4% year-on-year (YoY) in Q3 2016. Despite the ongoing anti-corruption campaign and global uncertainties, Macau's economic fundamentals remain healthy and gross gaming revenue (GGR) continues to stabilise. Analysts including the International Monetary Fund and the Economist Intelligence Unit (EIU) are adopting an optimistic view of Macau's economic outlook. The EIU expects Macau's GDP to grow by 5.2% in 2017, translating to a 9 percentage point improvement on 2016.

Gross Gaming Revenue Sees Strongest Quarterly Growth Since Q1 2014

GGR registered a modest decline of 3% YoY to US$28 billion in 2016. On a quarterly performance, gaming revenues expanded 10% QoQ to reach US$7.6 billion - the best growth since Q1 2014. Mass-gaming sector has remained stable, and accounted for 48% of total GGR in Q3 and 47% for the first 3 quarters of 2016.

The improved GGR was partially driven by the openings of Wynn Palace and The Parisian Macao in the second half of 2016, attracting a wider range of tourists with non-gaming offerings such as a performance lake, a replica of the Eiffel Tower and a water park for children. Two other new integrated casino resorts - MGM Cotai and Grand Lisboa Palace - are expected to be completed over the next two years. Together, these two resorts will add 3,500 hotel rooms to Macau's existing stock - an

increase of almost 10%. In addition, they will create approximately 14,000 additional employment opportunities and further expand Macau's tourism sector.

Favourable Policies to Support Macau's Economic Diversification

Chinese Premier Li Keqiang has pledged to strengthen Macau's tourism industry and position the city as a service platform between China and Portuguese-speaking countries. A series of policies will be introduced to pave the way for a concerted push towards achieving that objective.

The proposed policies include new initiatives to boost the meetings, incentives, conferencing and exhibitions tourism segment, the establishment of a renminbi clearing centre among Portuguese-speaking countries, the relocation of the China-Portuguese Speaking Countries Cooperation and Development Fund headquarters from Beijing to Macau, and permitting Macau-registered vehicles to enter Hengqin.

Property - Housing Market Remains Healthy

Based on the latest statistics from Macau's Financial Services Bureau, the number of residential property transactions surged 122% YoY to 1,144 in November. The average transaction price was MOP 8,401 (US$1,050) per square foot, up 21% from the same period last year.

According to Sniper Capital Research, the number of residential property transactions in Q4 is projected to reach 3,300, representing an increase of 37% QoQ. The average transaction price is estimated to be MOP 8,400 (US$1,050) per square foot, up 4% QoQ.

The leasing market overall remained healthy, supported by strong market fundamentals such as a low unemployment rate and stable median incomes.

The positive momentum in the housing market is also echoed by the Centa-Macau Climatic Index(1) , which read 57.14 in Q3 2016 - above the neutral line of 50 - indicating that housing prices will tend to rise in the future.

New Supply Focused on Small and Mid-sized Units

Transactions during the past two quarters indicated that local residents, especially newly-formed families, continue to be the primary buyers of residential property in Macau, accounting for more than 90% of total sales transactions.

It is also worth noting that small and mid-sized units of less than 1,000 square feet offered by developers are the most sought-after, as they are of a smaller quantum and higher loan-to-value ceilings may be applied hence, making them more affordable. From an investor perspective, smaller units are easier to lease out and the yields are generally more attractive than larger units. Developers are seizing the opportunity and developing projects comprising more small and mid-sized units. The newly launched Sky Oasis in Taipa, for instance, has a total of 500 units, of which 360 are studio apartments with size ranging from 600 to 700 square feet.

Investor Confidence Showing Signs of Improvement

The Hong Kong government recently raised property stamp duty for second home buyers to 15%. China has also introduced a number of residential property cooling measures in an effort to control surging residential prices, especially in Tier 1 cities.

We believe these factors will lend support to Macau and increase its competitive advantage as a favourable long-term investment destination.

Macau's residential property market is expected to remain stable as home prices are still at an attractive level, currently 31% below their peak in 2014, and the market is experiencing a trough in the current property cycle. With new infrastructure such as the Hong Kong-Zhuhai-Macau bridge and Light Rail Transit in the pipeline, we believe Macau's competitiveness will be enhanced, enabling the city to rival other urban hubs in the Greater Pearl River Delta.

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Russia

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

Gill Nott, chairman, JPMorgan Russian: The price of oil is a major determining factor for the Russian economy and if recent increases continue it seems likely that this will have a positive economic impact on the Russian economy and stock market in 2017. The Investment Manager has maintained his consistent approach of investing in well managed companies with strong balance sheets. He continues to believe that the equity market in Russia provides a good long term investment opportunity if the right stocks are selected. However, economic sanctions against Russia remain and the political outlook is uncertain on many fronts, including the Middle-East, USA and Europe. These significant geopolitical and economic issues will continue to impact the Russian market. There are some signs of improvement in the domestic economy with a stable outlook for fiscal policy and expected growth in Russia's GDP. Thus, the outlook remains uncertain but with some potential for upside if the oil price continues to strengthen and economic and political stability are maintained.

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Oleg Biryulyov: manager, JPMorgan Russian: We believe that economic stabilisation is underway in Russia, with positive implications for Russian equities. At the same time, we anticipate reduced volatility in the oil price over the next 12-18 months as lower investment over the last three years starts to cap global production growth. Greater stability of the oil price will help to improve the outlook for the Ruble and for earnings growth, particularly in US dollar and sterling terms.

Two years on from the introduction of the sanctions, we have started to see early signs of a recovery in domestic demand. The real estate sector was the early indicator, with demand improving for mortgage products. The market for cars has also steadied and we expect growth in 2017. An increase in consumer demand should ultimately feed through into a resumption of corporate long-term investment plans, in consumer sectors and then beyond, supported by falling interest rates.

We continue to see scope for reforms and hope that slowly but surely further liberalization and restructuring of the Russian economy will take place. Privatization can be useful tool for Government to address budget constraints and we would anticipate a number of such transactions in the coming year.

On the dividend front, Russia is beginning to deliver on its promise of becoming a higher-yielding market, and with the payout ratio less than 50% at the market level there is further scope for improvement. It is important to highlight that the state is

becoming more active as a shareholder, so that state-controlled companies are now willing to commit to higher payout ratios.

The domestic political outlook currently looks stable in Russia. Although we would expect to see some rotation of specialists in the government and presidential administration, we think the senior leadership in the country will remain unchanged for the foreseeable future. Parliament elections in September ran smoothly as expected, although surprisingly, United Russia won a landslide victory despite the difficult economic environment. This should allow the implementation of tougher reforms in the next couple of years prior to the Presidential elections in 2018 and supports our view of a stable outlook for fiscal policy. The global political outlook would appear to be improving somewhat for Russia, although there are still many uncertainties whilst western sanctions continue, and the conflict in Syria heightens tensions generally.

Based on the comments above we hope that slowly but surely further liberalisation and restructuring of the Russian economy will take place. For investors willing to accept the current level of country risk, we believe that current equity valuations are attractive.

Vietnam

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

Min-Hwa Hu Kupfer, chairperson, VietNam Holding Limited: Despite the trials and tribulations ahead, there is great cause for optimism in Vietnam. There is an important menu of things it can get right over the coming years, regardless of what's going on elsewhere. Most of Vietnam's exports are likely to see solid progress based on global market share growth amid long-term structural advantages for the country, especially vis-a-vis China. We also believe that several of these positive structural factors, such as a competitive cost base, political stability, and infrastructure improvements are likely to outweigh any tinkering that the new US administration might do to increase protectionist trade policies.

Additionally, when compared to most other major Southeast Asia economies, Vietnam maintains an only partially opened capital account. This bodes well in what could be a stormy year for global capital flows with US interest rates washing capital from emerging and frontier markets. Furthermore, Vietnam benefits from a relatively high proportion of country-dedicated money in its stock market, and a structurally strong overall balance of payments. A surplus of approximately USD 8.5bn in 2016 or 4% of GDP features durable long-term items like foreign direct investment, tourism receipts and remittances.

Finally, Vietnamese policy makers have the power to effect very noticeable improvement in government finances and the overall business environment. There are still some 700+ state-owned enterprises in Vietnam, with a historical total asset value of nearly USD 220bn. While government reform efforts in this area have been generally poor in the past decade, 2016 saw discernible improvement with a spate of new share listings and sales. This is likely to continue in the coming few years, with positive transformational impact on both the stock market and the economy.

Property

(compare UK Property funds **here**)

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

DREIM anticipate occupational demand, combined with a limited supply of new development, will drive further rental growth across regional markets, supporting the delivery of both sustainable income returns and capital value growth to our shareholders over the long-term.

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ICG Longbow Senior Secured UK Property Debt: Since 2009, demand for commercial real estate has been bolstered by the consistent steady growth in the UK economy and strong employment growth, with 31.8 million people in work as at October 2016, up by 342,000 over the year.

Over the same period, the supply of new commercial real estate floor space has been constrained, especially outside London, with construction orders in each year commencing 2009 being lower than every year before 2009 going back to 1985. Additionally, early indications are that Brexit is likely to further constrain near term supply, with a 42% decrease in London office construction starts reported in Q3 2016 compared to six months before. This combination of growing employment and restricted supply has contributed to the low commercial real estate vacancy rates being experienced across the UK.

Looking forward, the potential impact of Brexit on demand remains uncertain but the Investment Adviser's experience is that leasing activity has remained robust in the small to medium size assets market, whilst the largest negative impact is expected on City of London offices, given increased risk to jobs.

Property Investment Market

As at November 2016, UK commercial property market capital values, as measured by the IPD All Property Monthly Index, had increased by circa 22% since the Company's IPO in 2013 and by 37% since the index low point in July 2009 but the index remains 22% below its level ten years ago. This compares with the FTSE 100 index at November 2016, which has grown 82% since its low point in February 2009 and is 14% above its level of ten years ago.

Reflecting the growth in capital values described above, the average UK commercial property initial yield has fallen by over 1% since February 2013. However, property initial yields have remained attractive relative to gilts over the period, maintaining a premium of between 300 bps and 400 bps over the 10 year gilt yield (353bps as at October 2016).

Whilst the future impact of the Brexit vote on capital values will remain unclear until investors can fully assess its effect on the occupational market, we expect the largest impact to be on shorter let City of London offices, given increased risk to jobs from the potential loss of financial services passporting leading to a potential reversal of rental

growth expectations and an outward yield shift. Further, the Investment Adviser believes there is less potential in the regions for adverse capital value correction due to the less stretched rental levels and wider initial yields.

The IPD capital values monthly index fell c. 4% between February and November 2016 and market forecasters expect the index to show a further modest decline in values in 2017 (which is likely to already be factored into transactional activity today). However, the Board and Investment Adviser are confident that there will be no re-run of the 2008/9 market correction due to the strength of occupational markets, lower gearing in both the property and the banking markets and the attractive relative value in the property market demonstrated by the enduring premium over gilts.

Finance Markets

As mentioned above, the UK CRE finance market has evolved significantly over the period since the Company launched, with traditional lenders returning to the market and new entrants joining the market, leading to annual financing flows increasing from c. GBP35bn in 2012/ 13 to circa GBP50bn in 2015, although such flows are expected to have fallen in 2016 due to the Brexit vote.

However, within this increase in activity over the last 5 years, there have been some structural changes in the market place. The traditionally dominant UK, German and other international banks have retrenched from the market - having accounted for 100% of new lending in 2010, their market share had reduced to 61% in 2015, with new entrant institutional and debt fund capital filling the gap. Over the same period, the proportion of lending activity focused on London has increased from 25% to 44% with more lenders favouring the big ticket market.

Consequently, the regions and particularly the small to medium sized investment market are relatively undersupplied with debt capital. Coupled with less stretched underlying property valuations and rental levels in the regions, the Investment Adviser believes that this has resulted in the availability of attractive risk adjusted returns in this part of the market and has consequently focused much of its activity in recent years in these areas.

Even though capital has returned to the market, the imposition of more stringent capital allocation requirements on the banking market under Basel III, coupled with the credit losses experienced by banks in their CRE debt books following the global financial crisis, has resulted in a reduced CRE risk appetite of banks, with the average LTV reducing to 63% at the end of 2015, from 77% at the peak in 2006.

Given the dynamics in the CRE finance market described above, the Investment Adviser expects to see increased opportunities for funding in support of small to medium sized acquisition or refinancing transactions across the UK, especially where there is a leverage requirement above 70% LTV, which is particularly undersupplied with capital.

Resources

(compare Resources funds **here**)

David Norman, chairman, New City Energy: The investment managers have coped well in a very volatile year but they believe the US commercial shale producers have fundamentally changed the shape of the energy market by replacing OPEC as the swing producer of oil. The US producers have utilised technology to improve yields from their acreage and at the same time reduce production costs. This dynamic means they are very flexible and able to cope with fluctuating prices and to pump oil even at levels that were thought uneconomic two or three years ago. The investment management team believe this will curtail oil price increases and makes a weak investment case for energy.

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Robert Crayfourd, Keith Watson and Ian Francis, managers, New City Energy: It remains our belief that the oil market as we knew it has changed. We believe oil prices will continue to trade within a $45-60/bbl range for the foreseeable future with commercial shale producers resisting OPEC's dominant status as the swing producer. We believe the improved responsiveness of this segment will act to more rapidly balance balancing markets and reduce volatility in oil pricing. The removal of OPEC's quota mechanism in 2014 was in part a pre-emptive move to discourage unconventional oil and gas production. However, US shale production has proved impressively resilient, with production efficiencies from increased sand usage within individual frack's and a greater use of multi well drilling pads, driving significant cost reductions. While not all shale producers have survived, with multiple bankruptcies occurring on lower quality acreage, those that remain are stronger and leaner with many making good returns at $50/ bbl oil.

We believe the Permian Basin to be the most prolific of all the US oil shales, evidenced by the pick-up in land based rig deployment which has increased 46% since the low in May. Testament to the favourable economics of the Permian Basin, it remains the only US basin not to have seen a fall in production. Producers with Permian acreage should continue to benefit as unconventional technologies further improve costs and shortening investment cycles improve productivity. Such low cost, short production lead times provide a significant competitive advantage when compared to capital intensive, long lead time proposition of conventional offshore projects.

At the time of writing OPEC has proposed a production cut of around 500-700k barrels per day. There is a lack of detail on which countries will contribute to these cuts although it appears that Iran, Libya and Nigeria will be granted exemption from the restriction. Iraq is also requesting exclusion in order to fund their military campaign against ISIS. Indeed the number of OPEC members exempted from discussions is placing even greater onus on Saudi Arabia. These exemptions similarly undermine the potential galvanising effect that the fiscal deficits being run by many OPEC's member economies could engender towards an agreement. It is hoped that greater clarity will be provided at OPEC's November meeting. OPEC is also seeking participation from some non-OPEC members. Putin has suggested that Russia, the world's largest oil producing nation, may contribute though this would be reliant on OPEC reaching a collective agreement to cut and even then Russia's track record of honouring such commitments has been poor.

Supply shocks remain an important consideration though for the time being threats of disruption appear to be easing. ISIS appears to be losing position in Libya while the

Nigerian government appears close to agreeing terms with rebel groups which could reduce the risks of sabotage on key infrastructure. Social unrest in Venezuela, whose economy appears on the brink of collapse, could interrupt oil production. However, it is noteworthy that debt funding provided by China is structured for repayment in physical crude.

Oil Demand has been strong following the fall in pricing, with US miles driven up around 3% year on year, though this demand effect may conversely weaken with higher prices. Emerging market GDP growth remains an important driver of demand, with the growing middle classes of China, India and Indonesia key to increased demand. GDP growth in Asia ex-Japan is forecast to remain healthy at approximately 5.7% pa over the next 3 years. We monitor the development of electric vehicles closely and whilst the growth in usage is impressive, the low levels of penetration will limit their materiality is are unlikely to alter oil demand in the next 10 years. They will alter the rate with which demand grows which importantly could lead current OPEC producers to view their oil reserves as finite assets rather than multi-generational appreciating assets.

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