QuotedData

Monthly summary | Investment companies

November 2018

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

Markets fell in October with stocks in Asia and emerging economies being particularly weak, on average. The pound lost more ground as the dollar strengthened (possibly in anticipation of further US interest rate increases). The oil price went into sharp reverse, ignoring any potential impact from the imposition of Iranian sanctions.

United Kingdom

Brexit, trade wars, rising US rates and even reduced availability of research are cited as reasons for concern. However, many commentators still believe stock pickers can make money.

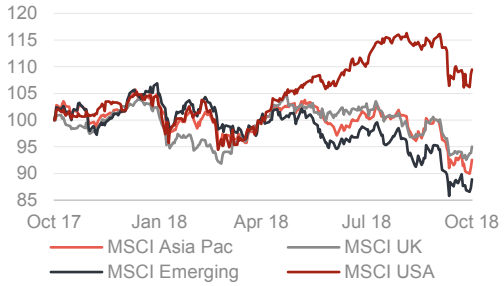
Michael Hughes, chairman of JPMorgan Mid Cap, thinks that valuations of UK mid cap companies do not reflect their growth prospects, regardless of the outcome of Brexit. The managers of that trust say it would be wrong to be too gloomy. However, the managers of Dunedin Income Growth feel that valuations are relatively full. The managers of Mercantile believe that, while earnings growth is coming through, geopolitical concerns may weigh on markets for some time. The managers of Strategic Equity Capital think that the advent of MiFID II has accentuated volatility within the UK small cap market, as investors are less well informed. Jonathan Brown, chairman of Invesco Perpetual UK Smaller Companies, is concerned about the impact of the rejection of the principles of free trade, drawing an analogy to the 1930s. Nicholas Fry, chairman of BlackRock Smaller Companies, highlights the challenges facing central bankers. The managers of that trust are cautious on the UK economy but think selected UK companies can still prosper.

Exchange Rate	31/10/18	Change on month %
GBP / USD	1.2766	(2.0)
USD / EUR	0.8617	2.6
USD / JPY	113.7	(0.7)
USD / CHF	0.9817	2.7
USD / CNY	6.8688	1.6

Source: Bloomberg, Marten & Co

MSCI Indices rebased to 100

Time period 31/10/2017 to 31/10/2018



Source: Bloomberg, Marten & Co

	31/10/18	Change on month %
Oil (Brent)	75.47	(8.8)
Gold	1214.76	2.0
US Tsy 10 yr yield	3.1435	2.7
UK Gilt 10 yr yield	1.437	(8.6)
Bund 10 yr yield	0.384	(18.1)

Source: Bloomberg, Marten & Co

Europe

While there are good reasons to be cautious, there is a sense that investors have become overly pessimistic towards Europe.

Alexander Darwall, manager of Jupiter European Opportunities, thinks that slower economic growth and rising interest rates could, in combination, make refinancing high debt levels more problematic. Nicola Ralston, chairman of Henderson EuroTrust, believes that adverse sentiment towards Europe is out of step with the performance of the region's high-quality companies. Tim Stevenson, outgoing manager of that trust, thinks Brexit will be a disaster for the UK and also damaging to Europe. Audley Twiston-Davies, chairman of TRR European Growth, hopes for clarity from the Brexit negotiations. The managers of that trust see the potential for an uptick in mergers and takeovers as buyers snap up good companies that investors are shunning on the grounds of a short-term dip in earnings. Eric Sanderson, chairman of BlackRock Greater European, believes that the ECB will hold off on raising rates for now. The managers of that trust say that any resolution to global trade disputes could be a catalyst for better performance from the region's stock markets.

Asia

Sentiment is being driven by geopolitical noise rather than fundamentals but there may be real world impacts from trade and currency wars.

Kate Bolsover, chairman of Fidelity Asian Values, says Asia remains the most dynamic region in the global economy. Nitin Bajaj, the fund's manager, says the world economy is an extremely complex system and we need to be careful about interpretations we draw from any single policy action such as the introduction of tariffs. James Williams, chairman of Pacific Assets, does not believe that lurid political headlines generally influence the direction of asset prices. He also thinks Asian economies may be more stable than in previous market setbacks. Susan Platts-Martin, chairman of Witan Pacific, expects that markets will continue to be volatile and driven more by macroeconomic and political uncertainties than fundamentals. The management team behind Scottish Oriental Smaller Companies expects to see more rate rises as Asian countries try to defend their currencies. They expect this to weigh on growth in the region.

Japan

The consensus seems to be that Japan's economy is doing well. There are some clouds on the horizon but it may be that the country is emerging from its long deflationary period.

The manager of Baillie Gifford Shin Nippon says that Japan's domestic economy is in good health. Jonathan Taylor, chairman of Schroder Japan Growth, believes that corporate Japan is embracing the challenges posed by its mature economy. The manager of that fund thinks Japan is heading, slowly, out of deflation. He says the Japanese stock market's reaction to trade threats is exaggerated. Nick Bannerman, chairman of Baillie Gifford Japan, notes the planned hike in sales tax, scheduled for October 2019, and also mentions the tightness in Japan's labour market. The managers of that trust point out that wages are rising, unemployment is very low, land prices in the major urban areas are rising, and bank lending is growing. They say that, overall, corporate confidence is strong.

Global emerging markets

Increased volatility and threats to markets in the short-term

Hélène Ploix, chairman of Genesis Emerging Markets, notes the heightened volatility in emerging markets but points out that the long-term growth drivers are intact. The managers of that trust highlight the threat posed by excessive Chinese debt, pointing

out the importance of the financial sector in China to overall earnings within emerging markets. Austin Forey, manager of JPMorgan Emerging, gives us an extended look at the drivers of volatility in emerging markets. He is becoming more enthused about some Chinese businesses. The management team behind JPMorgan Global Emerging Markets Income see some short-term risks but believe valuations are at a more neutral level.

Property

Brexit overshadows the UK property market. Industrial and logistics property still favoured over retail.

Vikram Lall, chairman of F&C UK Real Estate, highlights the threat posed by Brexit and the weakness in the retail sector. The manager of this fund notes that purchases of property by overseas investors and local authorities have been underpinning the UK market. He thinks that Brexit and the direction of interest rates will influence pricing for years to come. The managers of property-lending trust, ICG Longbow, note the disparity in sentiment toward the industrial/logistics sectors and the retail sector.

The management team behind Target Healthcare REIT say that yields in their part of the market are falling. It is concerned, however, about the pressures on local authority funding.

Steve Smith, chairman of PRS REIT, says that the rental market for family homes, as opposed to flats, is especially undersupplied. The REIT's managers say the fundamental imbalance between the supply of good quality rental housing and demand remains large.

Resources

An in-depth look at the drivers behind various commodity prices including gold.

Richard Prickett, chairman of City Natural Resources High Yield, says that there is increasing evidence that improvements in balance sheet discipline and dividend payments are durable. The managers of that trust give us a comprehensive run down of the factors affecting various commodities. Malcolm Burne, chairman of Golden Prospect Precious Metals, covers the drivers of the gold price in some detail and lays out the arguments for why we may have seen a peak in gold production.

Other

We also have comments on the global economy from Henderson International Income; the US from Jupiter US Smaller Companies and Baillie Gifford US Growth; Latin America, from Aberdeen Latin American Income; Thailand, from Aberdeen New Thai, an in-depth look at Vietnam, from VinaCapital Vietnam Opportunities; private equity, from Harbourvest; International Biotechnology's management team answer some questions on their sector; ICG Longbow, CQS New City High Yield and Hadrian's Wall Secured have some thoughts on the debt sector; and Marc Gabelli, chairman of Gabelli Merger Plus+, talks about the backdrop to his merger arbitrage investments.

Contents

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Global

(compare Global funds **here**)

Simon Jeffreys, chairman, Henderson International Income: It is not an easy environment for investors. Interest rates remain low in most major developed economies, and whilst current economic data suggests continuing, albeit moderate, economic growth, Brexit and political developments both close to home and further afield threaten major changes to trading relationships and economic alliances.

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United Kingdom

(compare UK funds **here**)

Michael Hughes, chairman, JPMorgan Mid Cap: The flexibility of UK mid-cap companies, and in particular their ability to respond rapidly to changing markets and technological developments, has been reflected in earnings growth in excess of the growth of the economy over the last five years. We are therefore hopeful that whatever the outcome of the Brexit negotiations, these companies will continue to thrive by identifying opportunities to grow their businesses in both existing and new markets.

Given this, it could be argued that the markets are underplaying the growth prospects of many mid cap companies in a post-Brexit era. The notable merger and acquisition activity in the mid cap universe would support this view, as well as suggesting that valuations remain attractive on a long-term view.

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Georgina Brittain and Katen Patel, managers, JPMorgan Mid Cap: As we write this in September 2018, a crystal ball would be a very useful accessory. It is (almost) without doubt that the UK will leave the EU within the next financial year, but despite the deadline set by Article 50 being less than seven months away, we still do not know what that exit will look like. The Bank of England assumes that the most likely outcome will be a gradual transition to new trading arrangements with the EU. The Prime Minister's recent Chequers speech on Brexit signalled a very soft exit. However, in our view the increased political uncertainty post that speech and the currently stalled negotiations mean that the tail risk of the UK exiting without any deal at all has materially risen. Indeed Liam Fox, the International Trade Secretary, very recently put the chance of no trade deal at 60%.

All of this leads to a huge lack of clarity for both companies and consumers. Add to this the looming threat of global trade wars and it would be easy to become very pessimistic on the short term outlook. However, despite this, the IMF is forecasting UK GDP growth of 1.4% in 2018 and 1.5% in 2019. In the UK, the all-important PMI data (purchasing managers' indices) are still indicating expansion, and lowered inflation expectations are positive for the consumer. While business confidence metrics have slipped, business investment remains low but positive, currently growing at 2-3%.

Recent history, and many years of experience in managing money, teaches us that, despite this backdrop, it is wrong to be too gloomy. The message we hear from companies within our portfolio remains positive. The forecast earnings growth for the companies we own is a striking 16%. As we have argued many times before, it is

possible to find some high quality long term winners within the FTSE 250 Index. These are the companies, found in diverse sectors, which have embraced the data-driven modern world and adapted accordingly. These are the companies which are increasing productivity and will prove to be adept at positioning themselves for the future.

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David Barron, chairman, Dunedin Income Growth: Equity markets remain relatively buoyant although there are a number of headwinds developing, particularly around global trade and the increase in protectionism which could have an impact on global growth, especially at a time of generally tighter monetary policy. In the UK, as Brexit negotiations enter their final phase there is still a great deal of uncertainty regarding the outcome. This, combined with a relatively fluid domestic political situation and an economy that continues to exhibit only modest growth, makes it important to be particularly selective.

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Ben Ritchie and Louise Kernohan, managers, Dunedin Income Growth: Looking ahead, the global economic environment continues to be relatively benign, however there are indications that underlying growth momentum may be gently slowing and regional divergence increasing. We are conscious that a rise in protectionism could have a significant impact on growth with the potential to also increase inflationary pressures. Closer to home, the outcome of negotiations between the UK and the European Union remains unclear and until we gain more clarity this uncertainty is likely to act as a brake on growth. With equities rebounding following their dip at the start of the 2018, valuations remain relatively full so we are still cautious on this front.

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Angus Gordon-Lennox, chairman, Mercantile Investment Trust: Anyone who follows markets or reads the business or even front pages of the newspapers will recognise that we live in uncertain times. Reflecting this, gearing has been steadily reduced over the summer. Brexit, the threat of trade wars, turmoil on the high street, politician's murmurings, geo-political upsets and perhaps other things as yet unrecognised all have the potential to unseat markets for a short while. Despite these, earnings growth remains robust.

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Guy Anderson, Martin Hudson and Anthony Lynch, managers, Mercantile Investment Trust: Having accelerated from a low base two years ago, global economic growth has remained reasonable and provided some, but not all, companies with a decent platform from which to drive earnings growth. While it has not been as impressive, the domestic economy has also continued to grow. It has been noticeable and a clear positive that after several years of experiencing gradual declines in market estimates of future earnings growth during the year, so far this year companies are in aggregate meeting expectations. Strong growth in the US has caused the Federal Reserve to increase its funds rates from 1.5% to 2.25%, which has inevitably reduced the risk appetite of equity investors.

Furthermore, the geopolitical landscape remains fraught with uncertainty, the most pressing of which remains the risk of trade wars. The lack of clarity about how businesses may be impacted by Brexit presents a further risk, albeit with the potential for a positive surprise should a satisfactory outcome be achieved.

While continued earnings growth should deliver positive returns for markets, these geopolitical factors may weigh for some time and could present far-reaching challenges in the future.

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GVQ investment Management Limited. manager, Strategic Equity Capital: In our view, volatility has been amplified at the smaller end of the market following the introduction of the MiFID II Directive at the start of 2018. This has perpetuated many historic trends, with reduced 'sell-side' resource and a decrease in the dissemination of research leading to heightened volatility on low volumes, often in response to limited news flow fuelling pricing anomalies, which can take a long time to correct. Whilst challenging, in our view, this will provide greater opportunities over the long-term, where securities are fundamentally mispriced.

The small cap market has demonstrated similar traits to that of recent years. Investors have sought shelter (often from the above) in dependable, highly rated growth stocks, which continue to perform well both operationally and from a share price perspective. Profit valuation multiples of 30-80x are not uncommon and, of slight concern, the definition of 'peers' becomes broader to justify high valuations and there is a growing incidence of public market valuations at premia to precedent transactions.

As an asset class, UK equities remain out of favour with almost £10bn withdrawn from UK equity funds since the EU Referendum in June 2016. This downbeat view is not shared universally with a heightened degree of UK M&A activity over the past twelve months. Having raised record amounts in 2017, Private Equity is believed to have over $1 trillion in 'dry powder' according to Preqin and there have been notable take-outs in UK small cap. Furthermore, European target M&A is as high as it has been since 2007. Where markets don't re-rate good companies, buyers often correct the valuation gap.

At a macro level, we are cautious. Despite an improving global growth picture, one could argue this has been largely reflected in asset prices. Alongside this, the confluence of monetary tightening and elevated debt levels is likely to present a challenge. Although now taken in their stride, it is hard to downplay geopolitical issues ranging from international trade wars, factional politics and potential global conflicts. All of these are set against a backdrop of long-term trends in globalisation, demographics and technology which are creating winners and losers and a sense of inequality and disenfranchisement.

Furthermore, given the 'dual-track' nature of the market where those that deliver become more expensive in the 'fast-lane' and those that have a wobble become quickly de-rated and unloved, a bifurcation of valuations is created. Clearly, there are situations where stocks are 'cheap for good reason', but often nervousness and worry trumps what can be transient issues, or information gaps which create opportunity.

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Michael Quicke OBE, chairman, JPMorgan Smaller Companies: After a period of strong absolute performance, it would not be surprising if the future was a little more difficult. It is certainly the case that there are many significant challenges ahead, some the result of political problems, but others the symptoms of a long period of economic and stock market performance.

Every period has its challenges, and experience shows that whilst short-term performance is difficult to predict, well managed smaller company investment can deliver good long-term returns for patient investors.

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Jonathan Brown, manager, Invesco Perpetual UK Smaller Companies: The biggest potential risk to the global economy emanates from the mistaken belief that economic prosperity can be enhanced by rejecting free trade. This has strong parallels with the policies enacted during the great depression of the 1930's (e.g. the Smoot–Hawley Tariff Act). The policies seem to garner support from electorates, as they are seen as simple solutions to complex problems but history shows that, whilst the impact can be positive initially, ultimately it is destructive to economic activity and prosperity. Whilst we remain hopeful of a reasonable outcome to the Brexit negotiations and that the US will de-escalate its trade war with the rest of the world, the potential for economic and market disruption looms large. With many markets close to all-time highs, there appears to be a degree of complacency amongst investors about the current predicament.

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Nicholas Fry, chairman, BlackRock Smaller Companies Trust: As 2018 progresses, markets across the globe are becoming increasingly volatile, driven by political uncertainty, trade wars and difficult financial conditions. In particular, UK companies face a tougher operating environment as continuing uncertainty over the outcome of Brexit negotiations has impacted consumer confidence and dampened growth.

A divide has opened up between the US economy and other developed economies whose growth is forecast to slow, and the consequent strong dollar creates potential difficulties for emerging markets whose debt is denominated in dollars. Moreover, it will be challenging for the central banks both to adjust interest rates to reflect tighter labour markets and possible inflationary pressures without impacting growth, and also create the scope for significant monetary easing should a recession materialise.

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Mike Prentis and Roland Arnold, managers, BlackRock Smaller Companies Trust: As we move through 2018 we are seeing greater divergence within the global economy, notably with continued strength in the US, whilst in Europe and Asia we have seen some softening. Political uncertainty, trade wars and tightening financial conditions will continue to add to market volatility. Given the increasing risks, there is clearly a need to be selective.

We remain cautious on the UK economy relative to other major developed economies. With escalating tensions around Brexit negotiations, and potential for political instability we see the possibility of below trend economic growth continuing for some time. However, we are positive on the prospects for many UK small and midcap companies.

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Europe

(compare European funds **here**)

Alexander Darwall, manager, Jupiter European Opportunities: The global economic growth rate is, according to the forecasters, increasing. The International Monetary Fund (IMF) has increased its forecasts for 2018 steadily over the last eighteen months, now expecting a figure of 3.9%. The salient reason for this steady increase is stronger US economic growth: over the same eighteen-month period the IMF raised its US Gross Domestic Product forecasts from 2.1% to 2.9%. It is likely that

the final outturn for 2018 will be a yet higher growth rate in the US. By comparison the IMF expects the Euro Area to deliver 2.4% growth in 2018.

Whereas President Trump is boosting business activity by lowering tax rates, the European countries (including the UK) are planning tax rises, thereby choking economic activity. Energy costs rose sharply over the course of the reporting period, reversing the trend of recent years. At the end of the reporting period the price for WTI oil was up 38.1% to $67.0. The European Central Bank's (ECB's) main refinancing rate was 0% as it was throughout the preceding twelve months; and three-month Euribor was -0.3% at the end of May 2018, almost exactly the same figure as a year earlier.

These historically low or negative interest rates are central to the policymakers' aim to stimulate investment. The ECB's May 2018 loan volume data show that year to date aggregate loan growth is 3.2%. Corporate loan growth is increasing at a slightly higher rate than household loan growth. Loan growth is not necessarily the same thing as increasing new investment activity. Loan growth can also be explained by the increase in mergers and acquisition (M&A) activity of which the biggest deal in Europe in recent months has been the acquisition of Monsanto by Bayer. Much of this M&A is aimed at cost optimisation rather than capacity building.

Artificially low interest rates, the manifestation of the Quantitative Easing (QE) policy, have had two other obvious effects. Lower interest costs are one factor behind the increase in corporate earnings growth. Consensus estimates for the constituents of the MSCI Europe Index are for European companies' earnings to grow by 8.8% this year after 14.5% in 2017. And low interest rates have undoubtedly boosted valuations in the stock market. QE has lifted equity valuations markedly.

There are any number of potential threats to the investment backdrop. One comes from business itself. Stakeholder pressures risk subverting the very purpose of business. It is one of the reasons that we will continue to see capital drift from the publicly quoted to private equity. This threat is reflected to an extent in the attitudes towards business of the European (including the UK) political class, where there is some suspicion of free markets. A risk lies too with the threat of slower economic growth and rising interest rates. In such an eventuality refinancing of high debt levels would become more problematic.

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Nicola Ralston, chairman, Henderson EuroTrust: A year ago, I referred to Europe as being "surprisingly fashionable as a destination for investors". Since then, European equities have fallen out of vogue in the eyes of many UK investors. One could speculate as to the causes of such change in attitudes, and the Trump-fuelled tax cuts which have produced an acceleration in growth in the US may be one such factor, but we see this as an even greater opportunity than previously. This is because the overall sentiment has little correlation, in our opinion, with the performance of high quality companies, whilst potentially making individual valuations more attractive.

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Tim Stevenson, manager, Henderson EuroTrust: There are perhaps more challenges ahead for the next year than has been the case for a number of years. Firstly, I think it realistic to expect that growth will be slower than over the past few years. For this reason, the ECB has repeatedly confirmed that it will take a very prudent approach to the reduction in QE, and is unlikely to increase official interest rates until well into 2019 (if at all). Profits growth, which has been supportive for the last few years, should remain positive. Politics looks a major worry and I hope it will be possible to ignore that, as Angela Merkel draws towards the end of her "reign" and Italian machinations continue, while France should be a haven of relative stability. Brexit,

which I continue to believe, is a disaster for the UK and offers not a single solution to any real problem, will also be damaging to Europe, albeit to a much lesser extent. In this climate I continue to believe that good quality companies which reliably invest in the further growth of their business will still do well.

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Audley Twiston-Davies, chairman, TR European Growth: the European smaller companies area of the stock market remains filled with opportunity despite a backdrop of noisy, high-conflict politics within Europe and beyond. No doubt the UK departure from the European Union at the end of March 2019 will attract some headlines in the coming year. We can but hope for clarity in the UK relationship with the EU thereafter. As interest rates in the US begin to increase for the first time in many years.

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Ollie Beckett and Rory Stokes, managers, TR European Growth: Stock markets are currently grappling with understanding the implications of rising rates in the US, the end of Quantitative Easing in Europe, the threat of trade wars, slowing economic growth in China, the disruptive effects of technology and an economic cycle that is now ten years old. Whilst the global economic backdrop is still reasonably positive, the cycle looks somewhat stale and volatility is likely to remain an ongoing feature. Global politics will remain a source of noise, not least in Europe where noisy extremists on the left and the right continue to take ground in national elections across the continent.

However, Europe continues to be a source of outstanding companies producing world leading products in high-tech and high-growth niche markets. We continue to find businesses that have been neglected by the wider market or are misunderstood self-help stories. The stock markets have been through a ten year period of chasing momentum over value that has reached extreme levels in recent months. There are a large number of good businesses that are mispriced for no reason other than they have not delivered earnings upgrades in recent quarters. We note that other pools of capital such as trade buyers and private equity are less focused on the recent earnings performance of a company and more upon the fundamental value and cash generation properties of these businesses. As the cycle matures further we would expect a pick-up in mergers and acquisitions activity which will favour funds invested in attractively priced stocks.

Europe has closed some of the gap with the broader global economy in the last year, but there is still a considerable earnings gap with the broader global economy in terms of recovery from the financial crisis. Whilst valuations are no longer outright cheap, this growth potential leaves European smaller companies looking like an attractive hunting ground.

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Eric Sanderson, chairman, BlackRock Greater European: European markets have recently been characterised by a higher degree of uncertainty about the economic outlook and higher levels of volatility. A further sharp escalation in trade actions globally could derail economic expansion and have consequences for corporate profits. So far, however, the global economy remains strong and corporate earnings are growing at a healthy pace. Additionally, whilst the European Central Bank plans to end its asset purchases by the end of 2018, it is likely that the Bank will keep interest rates on hold into the second half of 2019, thereby creating a favourable interest rate backdrop.

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Stefan Gries and Sam Vecht, managers, BlackRock Greater European: The apparent attractiveness of European equities has waned year-to-date. Political headlines have shifted sentiment towards the region and expectations have been reset lower. These expectations, and indeed market positioning, have however come from bullish levels at the onset of 2018. We continue to see earnings progressing positively in the region and note that foreign exchange impacts are probably past their worst. The continued global growth has supported revenues in Europe. Risks are clearly present in the market, but resolutions on trade wars could prove a catalyst for the region and particularly for stocks with depressed valuations. We believe navigating risks and extreme valuations through active stock selection is increasingly important at this stage in the cycle. From a fundamental standpoint, there are ample attractive investment opportunities within Europe which can deliver earnings growth and strong cash flow irrespective of the political environment.

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Asia ex Japan

(compare Asian funds **here**)

Kate Bolsover, chairman, Fidelity Asian Values: Asia remains the most dynamic region in the global economy. So, while a value based approach to investing is currently out of favour, we continue to believe that the long term potential to find good companies to invest in remains intact. The region will present stronger growth opportunities than those available elsewhere in the world due to robust domestic demand and an expanding middle class. It is also possible that potential changes in the monetary policy stance of major central banks and geopolitical tensions could lead to market volatility.

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Nitin Bajaj, manager, Fidelity Asian Values: It is certainly fair to say that political risks have intensified with a new administration in the US, trade wars between the US and China, and Brexit, among many other political changes. It feels as though policy uncertainty is at the highest level it has been in the last 25 years. But it is important to remember the complexity of these developments and there are no certain answers.

The impact of political and economic policy has many forms and occurs at various stages. The first order impacts are transparent and easy to comprehend – for example, a tax on soya exports from the US to China will impact the price of soya beans. This will have a knock-on impact on palm oil, as soya bean oil competes with palm oil. It will also impact animal feed, which uses soya beans as a raw material. Consequently, meat and poultry prices will be high, which will impact inflation and other macro variables. The point I am trying to make is that the world economy is an extremely complex system and we need to be careful about interpretations we draw from any single policy action. That said, we as investors need to remain alert to the implications of political crosswinds.

The world is uncertain and I expect it to be a bumpy ride over the next 5 years. I am conscious that this is what I said last year, but I remain convinced that in times such as these, it is even more important to own good businesses. They must not be overly reliant on a positive macro environment and must be run by competent management teams.

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James Williams, chairman, Pacific Assets: We face a combination of challenging economic and political circumstances in 2018 and beyond. The world has entered what will probably be a long period of adjustment from the quantitative easing which ensured that liquidity was widely available at what historically would have been at an absurdly low cost. This frequently has involved negative interest rates. While unhelpful for values of risk assets, the gentle reversal of this process is something that we need to go through to ensure future stability. Outside the United States, most stock markets have been in decline for much of the year, resulting in a tougher investment environment than has been seen for some time. Beneath the market indices, there have been more serious declines of some sectors and stocks.

We do not believe that lurid political headlines generally influence the direction of asset prices. However, the escalation of global trade tension from rhetoric to actions may risk undermining the global supply chains that have been such a contributor to non-inflationary economic growth over the last 30 years. Asia, as is well known, has had a major part to play in the integration of global economies. It is too early to say that the rules will need to be re-written, but the risk remains that some countries will face a time of adjustment should this bellicose mercantilist attitude prevail over calmer consideration.

The theme of an emerging middle class in countries such as India means that providers of consumer products or financial services will continue to be well placed whatever bizarre geopolitics may unfold.

We have been through an extended period when annualised investment returns have been in the low to mid-teens. This is well ahead of the long-term average rate of return from equities. With a more challenging environment possibly for some time to come, it is important that investors lower their sights of expected returns from Asian investments.

We note that Asian 'emerging markets' have shown less vulnerability to a rising dollar and rising interest rates, than those elsewhere. This suggests that, compared with previous such episodes, there may be more inherent stability to be found in [*Asia*].

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Susan Platts-Martin, chairman, Witan Pacific: Emerging market volatility, escalating trade tensions and geopolitical uncertainty are currently trumping economic growth, earnings growth and corporate governance improvements in influencing market levels in the short term. Exchange rate volatility has also increased and is likely to remain elevated as Brexit negotiations come to a head. Even though the global economy continues to expand at a steady pace, it appears likely that geopolitical uncertainties and shifts in monetary policy are likely to weigh on investor sentiment for a while to come. Meanwhile, earnings continue to improve against a supportive macroeconomic backdrop and governments in Asia are taking the opportunity to engage in reforms that will strengthen their economies and improve corporate business fundamentals in the long term. We expect the volatility in share prices which returned earlier in 2018 after a period of relative calm to continue.

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Vinay Argawal, Wee-Li Hee and Scott McNab, managers, Scottish Oriental Smaller Companies: In the last year, the outlook has become cloudier and most economic commentators are less positive. There are reasons to be negative. Corporate debt levels in Asia are high by historical standards and much of this debt has been taken on in US dollars by companies with no obvious form of US dollar earnings. With interest rates rising and the US dollar strengthening, this is an uncomfortable position to be in. Politics is messy, to say the least, with an increasing cadre of strongmen

presidents competing globally to demonstrate the largest ego. The current result of this is the commencement of a trade war, which, from our perspective, does not appear to be in anybody's best interests. Turkey and Argentina have shown the dangers of poor fiscal management and this has focused recent attention on the vulnerability of Asian countries with current account deficits, namely Bangladesh, India, Indonesia, Pakistan, the Philippines and Sri Lanka. Counterintuitively, these concerns make us more positive as they are well understood and, therefore, we believe are more likely now to be priced into valuations.

There is potential for a trade war to lower growth and impact margins for Asia's exporters. If the worst comes to the worst, there will be few beneficiaries and much dislocation.

A number of Asian countries have belatedly raised interest rates in an attempt to defend their currencies, with a flurry of interest rate rises over the summer in India, Indonesia, Pakistan and the Philippines. It is probable that further rises will be necessary. This is likely to lead to a cooling of these economies. However, any temporary cooling does not change the long-term case for investing in well-run companies in these markets.

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Japan

(compare Japanese funds **here**)

Manager, Baillie Gifford Shin Nippon: Despite rising trade tensions and worries about a cyclical slowdown in a few key sectors, the domestic economy in Japan remains in good health. Severe labour shortage across several sectors is driving strong wage growth and forcing some companies to invest more in labour saving technologies. Continuing the trend seen in recent quarters, growth in corporate capital expenditure remains robust and recently reached levels not seen since 2006. Inbound tourism also continues to be strong. More than 20 million foreigners have visited Japan so far this year and the government is on course to achieving its 2020 target of 40 million visitors.

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Jonathan Taylor, chairman, Schroder Japan Growth: There cannot be many investment trust directors who retire after nearly two decades with the local stock market and economy at much the same levels as when he joined. It is a salutary reminder of the challenges of a mature economy. The good news is that corporate Japan seems to be embracing the challenge. Profits in aggregate are materially higher than in the late 1990s and of better quality, both in terms of returns on equity and a greater awareness of shareholder value. It is possible that even parts of the political framework are more prepared for the future, thanks to Mr Abe. At the least, share valuations are much lower than they were, and therefore, perhaps, more sustainable.

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Manager, Schroder Japan Growth: Short-term economic data may be volatile, not least due to the impact of several natural disasters (earthquakes, flooding and typhoons), but Japan’s underlying backdrop remains broadly positive. The economy has grown in eight of the last nine quarters and continues to head, albeit slowly, out of deflation. The consumption tax increase planned for October 2019 is coming into view but monetary policy remains accommodating, at a time when tightening is already occurring or may be about to occur in other developed economies. The central bank

has made several tweaks to its policy of maintaining 10 year bond yields at around 0% but consensus now is that no substantive change is likely before 2020. The Prime Minister seems to have ridden out the scandal mentioned earlier, and as a result looks set to win his internal party election and potentially become Japan's longest serving post-war prime minister.

At the corporate level profits growth has slowed reflecting the stronger yen and higher input costs, but a positive revisions cycle looks set to resume in the second half of the current fiscal year. Notwithstanding the emergence of examples of poor corporate governance, the broad trend of improvement mentioned in previous reviews remains. For example, 2018 looks set to be another record year for share buybacks.

Reflecting the above and in view of the market recording negative returns so far in 2018, relative valuations continue to look attractive.

Why the negative returns so far this year and why have foreign investors been selling at a record pace (if futures selling is included)? Not for the first time it seems that the Japanese stock market is reacting in exaggerated fashion to uncertainties outside the country, namely trade friction, emerging market unrest and a slowdown in the Chinese economy. The extreme outcome of an imposition of 25% tariffs on Japanese car imports to US would be a significant negative, not least for sentiment, but the direct impact of other iterations surrounding trade friction seem less threatening. Were this to become more widely accepted, the more positive Japanese backdrop could see reversal of outflows from foreign investors.

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Nick Bannerman, chairman, Baillie Gifford Japan: Prime Minister Shinzo Abe recently won the leadership contest in the ruling Liberal Democratic Party by a wide margin. This prospectively leaves him in office until 2021 as Japan's longest serving Prime Minister. Debate about his likely legacy focuses on an expansionist economic strategy (known as Abenomics) and on constitutional reform covering the role of the Self-Defence Forces. The Prime Minister has expressed his firm intention to go ahead with the previously delayed increase in the sales tax from 8 to 10%, in October 2019. A further notable event is set for May with the Imperial succession when Crown Prince Naruhito takes over on the abdication of His Majesty Emperor Akihito.

Against the background of an ageing population and low birthrate, the labour market is extremely tight thus stimulating labour market related innovation among companies.

Corporate governance remains an important pillar of the Government's economic programme. Under the revised Stewardship Code, disclosure, fiduciary responsibility, increased return on equity and reform of cross-shareholding are all highlighted and we have been pleased to see something of a watershed in corporate leaders' prioritisation of shareholder interests.

The economy has grown for six successive years and, despite some distressing and damaging natural disasters this year, the signs are encouraging for 2019. There also remain some political, tensions in the region, especially over US-China trade relations., however we remain positive on the outlook.

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Managers, Baillie Gifford Japan: The over-arching theme domestically is a normalising of the investment environment as many historic issues have been improved. Japanese corporate governance has continued to progress and a concrete output of this is that shareholder returns through dividends and buybacks have continued to rise. While areas for improvement remain, especially regarding cash

hoarding, we should also acknowledge that the absence of scrip dividends, very low options issuance and lack of excessive pay for managers are helpful for minority shareholders. Meanwhile the political situation is quiet as Mr Abe continues his journey to become Japan's longest serving Prime Minister.

We have also observed that conversations with the word "deflation" seem to have become vanishingly rare. While there continues to be lively debate around whether the Bank of Japan will be able to achieve 2% inflation we think that the most important thing is to have moved beyond the destructive effects of deflation. Wages are rising, unemployment is very low, land prices in the major urban areas are rising, and bank lending is growing. Meanwhile corporate confidence is strong, evidenced by strong rises in capital expenditure.

Where might the challenges come from? The most obvious today are changes to established international norms. Up to a point a rise in populism is part of normal functioning democracy; beyond that it can lead to difficulties, trade wars and worse. Another risk is that of recession. Since the Global Financial Crisis of a decade ago we have enjoyed a largely synchronous global economic expansion creating significant opportunities for Japanese businesses. Cycles are difficult to predict but inevitable.

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North America

(compare North American funds **here**)

Gordon Grender, chairman, Jupiter US Smaller Companies: With the Federal Reserve seemingly intent on tightening policy as well as reducing its vast balance sheet holdings of US Treasuries there is always potential for market disruption. Additional risk comes from slower economic growth abroad should this spill over to the US.

It seems that the Federal Reserve is willing to tighten at a moderate pace so the more domestically focused smaller company market which benefits from a growing economy could continue to rise.

The US smaller company sector is an attractive one and interesting for long term investors. Generally it is under-researched and offers areas of undiscovered value.

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Robert Siddles, manager, Jupiter US Smaller Companies: The more domestically focused smaller companies sector appears to have shaken off concerns about rising interest rates: the outlook for profits growth is quite good. The Fed may find that it is unable to raise interest rates too fast because of the knock-on problems this would create for developing economies that have borrowed heavily in US dollars.

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Baillie Gifford US Growth: These are exciting times for growth investors. The world is going through a period of almost unprecedented change, driven by the convergence of a multitude of technologies such as the internet, mobile devices and machine learning. The associated disruption was initially concentrated in a couple of big and important sectors, like retail and advertising, but it seems to be speeding up and broadening out. There will be huge value creation and destruction on either side of this change.

Global emerging markets

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

Hélène Ploix, chairman, Genesis Emerging Markets:

At the time of writing emerging markets continue to experience considerable volatility, driven by trade disputes, as well as a stronger US dollar and concerns around the economic management of Turkey and Argentina in particular. Consequently markets have fallen significantly over the last few weeks.

This somewhat challenging environment serves to remind investors - especially following two years of particularly strong returns - that the developmental process in emerging markets does not run consistently smoothly, and that market volatility is an ever-present characteristic to be faced by investors.

That said, looking over the longer term, sterling-based investors have been rewarded by emerging markets over the past few years. Of key importance is the fact that the secular development trends remain positive.

The populations of low-income countries are seeing income levels rising gradually towards those in high-income markets - a trend likely to continue for many decades to come. The steady progress that countries and companies in the emerging markets universe are making (notwithstanding current issues in Turkey and elsewhere) to improve the quality of their governance is substantial. And the inefficiency of many emerging stock markets - through incomplete or misunderstood information, or of extremes in sentiment driving markets to unwarranted levels, both high and low - provides opportunities for skilful investors to buy and sell at attractively mispriced levels.

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Genesis Asset Managers LLP, managers, Genesis Emerging Markets: Following an acceleration of EM GDP growth and a recovery of EM corporate earnings in 2017 we have been somewhat cautious about the sustainability of EM economic and aggregate earnings growth in 2018. US interest rates are rising, activity levels in China are slowing, export growth is decelerating, the potential for damaging trade wars has increased and certain key commodity prices are trading well above our long-term estimates. In addition, aggregate financial sector earnings are over-dependent on a debt-inflated economy (Chinese institutions contribute the majority of EM financial sector earnings, which are in turn a third of total EM earnings).

However, long-term we remain optimistic on the investment opportunity in EM. We expect incomes in low- and middle-income economies to continue to converge with those in high-income economies. Improving institutional quality should further enhance returns. And we are convinced that emerging market equities are less price efficient compared with those in developed markets.

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Austin Forey, manager, JPMorgan Emerging: Markets rose consistently, making 2017 one of the least volatile years on record for emerging market equities, a state of affairs that proved neither typical nor sustainable. After peaking in late January this year, markets surrendered the majority of their gains by June; and they have continued to weaken since then.

The causes of this recent weakness are not hard to identify. Last summer, the dollar was weakening, and American rhetoric on trade and tariffs seemed just talk. But in

2018, with the Federal Reserve shrinking its balance sheet and hence the supply of dollars at the same time as it started raising interest rates, the dollar began to strengthen again. For countries on the other side of this trend, it presents a dilemma: do you accept that inflationary pressures will increase as everything which is priced in dollars (oil, metals, semiconductor chips, iPhones) becomes more expensive in your own currency? Or do you start raising interest rates to stave off that inflation, even if it slows your economy? A number of emerging markets chose the latter course, with the inevitable result that economic momentum is slowing, corporate profit growth is lower, and currencies have weakened anyway.

That was the first headwind. The second and third ones both stemmed from a change in US economic policy: 'America First' turned out not to be just an election slogan. The imposition of sanctions in a more direct and aggressive way, first on Russia and more recently on Turkey shows an America more willing to throw its political weight around; the example of a Chinese producer of telecom equipment, also sanctioned by the US, provides a reminder that America retains a special ability to render businesses anywhere unviable, if it wants to. If you tell a company like this that it cannot use American software or clear dollars through the global banking system, it's hard for the company to continue operating; in that case, the US relented slightly, but the lesson is clear, and for those countries on the receiving end, the effect on their stock markets has been equally clear, and negative.

If sanctions have been the second headwind for some markets, American trade policy has been the third, and China has been the principal target. It's not worth going into the justifications or otherwise of tariffs and trade wars here; but it's not good news for stocks, and the declines in some parts of the Chinese equity market in particular have certainly come partly as a response to this shift in American trade policy.

None of the above, then, has been good news for emerging markets; but these are mostly cyclical and temporary concerns.

If there's one country which I spend more time on than any other, it's China. I was last in mainland China in May this year, when I travelled with colleagues to Shenzhen, Hangzhou and Shanghai, and I can't remember a trip which had a bigger impact on my views. From one who has long been sceptical about Chinese equities, this may seem surprising.

I used to think that a serious financial crisis might trigger reforms and end the dominance of state-owned firms, turning China into a market where corporate skill could drive outcomes, and that what emerged would be a stock-picker's heaven. There hasn't been a crisis, and the state companies are still there, but the private sector is out of the bag and winning anyway, especially in service industries, and especially in the deployment of technology.

Four things in particular struck me during this last visit:

- The first is the level of entrepreneurial activity, allied to a sense of ambition and confidence
- The second is the impact of technology
- The third is the rapid development of service industries
- The fourth is the evolution of business models and the consequences for equity returns

These are all interlinked. In the first place, the rate of entrepreneurial activity in China outstrips most other emerging markets put together. It seems to me that conditions are now more favourable than before, as several factors combine. A generation of Chinese has now studied, worked and lived abroad, and perhaps therefore has a more

globalised perspective. Meanwhile, rapid economic growth has taken the country to a point at which service industries and consumption become increasingly important for the economy. This is happening at the same time that technological innovation, especially due to the adoption of smart phones and the ability to capture and analyse huge amounts of data, is changing the landscape in many industries and allowing new companies to emerge rapidly, sometimes at a large scale. Maybe it's not surprising, given this combination of circumstances, that entrepreneurial activity is so abundant.

It's easy - and hardly original - to expound on the consequences of technological innovation (not all of which are necessarily positive); but it's striking to see the effects it is having in China. Many companies have grown up during the smartphone era, and built their business models as well as their technology platforms on mobile data. They don't have legacy systems still being run on creaky mainframe computers, or have to worry about how their mobile app can be stitched on to their core business applications: it's all the same thing. In some industries, it's not an exaggeration to say that China leads the world: digital payments is a good example. It's hard to grasp how technology is being used until you see it for yourself; try to pay for a meal in a restaurant with a credit card, and you are likely to be embarrassed; digital payments from mobile wallets are now the norm. The scale of this is staggering: recent research suggest that the value of mobile payments handled by the two leading internet firms in China last year was greater than all payments processed by Visa and Mastercard worldwide. As a result of this growth, cities like Hangzhou, where Alibaba and its associated company Ant Financial are based, and Shenzhen, where Tencent and Ping An are headquartered, have become serious hubs for technology, including artificial intelligence. But even in more ordinary aspects of life - running hotels, cleaning blocks of flats, providing education, visiting the doctor - companies are doing things in new and different ways through the application of technology.

I've never been a fan of very capital-intensive businesses. Return on capital is not a bad way to think about the rate at which companies create intrinsic value, and if you have a huge denominator because your business needs to deploy huge amounts of capital, then the return is unlikely to be high. But when your business depends on knowledge, intellectual property or technology, the actual money spent to create value can be much smaller, and the return on capital higher.

In a market where I used to struggle to find businesses I really liked, now there are appealing possibilities, and really it's just a question of being patient enough to find a good entry point. On our travels, we saw several Chinese companies whose underlying returns are very high, sometimes masked by the accumulation of significant cash balances. This is often being achieved precisely by isolating the intellectual property value developed by a company from the assets employed in the business - in the same way that companies like Nike or Apple outsource production and manufacturing while retaining the value of their expertise in software, design or marketing. In the long run, the ability to create these kinds of business models should be very interesting for investors.

Sometimes it's easy to get negative about the prospects for equities, including those in emerging markets. The world has spent a decade recovering from the financial crisis and in the developed world we are well advanced in the economic cycle. Politics is less predictable than it has been for a long time, and even what passed for geo-political certainties seem less reliable than before. Some emerging markets are facing challenges. But hasn't it always been like this? There are always risks to worry about, but equity investors need, I think, to retain a degree of optimism.

Real life doesn't go in a straight line; but look back on the last couple of decades, and there has still been real progress, and real wealth created: I see no reason to think that the future will be any different.

Omar Negyal, Jeffrey Roskell and Amit Mehta, managers, JPMorgan Global Emerging Markets Income: Looking forward, we believe that valuations in emerging markets are now at a more neutral level, having been more clearly cheap in 2016 and 2017. This partly reflects the improvement in fundamentals after what has been a difficult few years for emerging economies and companies. We continue to think there is room for emerging markets companies to demonstrate improving results going forward. On a multi-year view we think profitability (return on capital) for the asset class should rise further from current levels, which should, in turn, ultimately drive up dividends and share prices.

We acknowledge that, in the short term, uncertainty may prevail. Recently we have seen more evidence of risks that could interrupt the positive trajectory we have outlined above. These risks include the impact from rising bond yields globally and the risk of 'trade wars' affecting corporate sales and profits which have paused the earnings improvement momentum of emerging markets companies in the near term.

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Latin America

(compare Latin American funds **here**)

Richard Prosser, chairman, Aberdeen Latin American Income: I remain cautiously optimistic about the outlook for Latin American markets, as the global appetite for risk assets has abated somewhat on the back of higher interest rates in the US and normalising monetary conditions elsewhere. The deepening trade divide between Washington and Beijing will likely continue to influence commodity prices and stifle investment activity. In Latin America specifically, uncertainty surrounding Brazil's incoming administration will keep investors on edge, while roadblocks to reform in Colombia and Peru could trigger further sell-offs. At the same time, the path to recovery in Argentina will be bumpy, given waning confidence in President Macri's gradualist policies.

However, last year's synchronised global upturn has left several Latin American economies on a firmer footing where their healthy reserves and improved fiscal balances should shield the markets from external shocks. Latin American equities as an asset class retain many of their long-term drivers, including a large population with a high urbanisation rate, underpinning robust domestic consumption and rising demand for infrastructure.

Meanwhile, Chilean and Peruvian miners are set to benefit from the positive market dynamics for copper, as China's emphasis on sustainable growth and recent stimulus measures help it avoid a hard-landing. In addition, the political landscape in Mexico appears clearer: with a major part of the NAFTA re-negotiations completed and allowing the AMLO administration to now focus on domestic issues.

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Aberdeen Asset Managers, managers, Aberdeen Latin American Income: Looking ahead, challenges for the Latin American region remain, but the market has already priced in many of the risks and a relatively gloomy outlook. Fears about a US trade war with its trading partners and its impact on growth and commodities prices might resurface, while in the near term the outcome of the Brazilian election will be a major driver of sentiment. However, it is important to point out that the last few quarters saw a significant adjustment not just in asset prices, but also in economic policies. Argentina

secured a large IMF program, hiked interest rates to above 60% and accelerated the pace of fiscal consolidation. Mexico continued its rate hiking cycle even as inflation moderated whilst Chile and Peru used their central bank reserves to lean against the depreciation pressure on their currencies. We expect policymakers to continue to provide adequate responses to the forthcoming challenges. On the corporate side we also saw an increased focus on controlling costs in the face of what had been a more difficult demand environment. Overall, earnings forecasts for Latin American companies appear reasonable, while valuations seem more attractive as share prices have corrected.

Given the above backdrop, we remain cautiously optimistic about the prospects for the year ahead.

Thailand

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

Nicholas Smith, chairman, Aberdeen New Thai: External risks remain foremost on investors' minds. The escalation of retaliatory measures in response to US protectionist policies is already having repercussions, with businesses in Asia adopting a more cautious stance in terms of capital expenditure. Rising borrowing costs, while beneficial for banks' margins and bottom lines, may hamper earnings as well as dampen end demand for real estate and consumer discretionary goods. With rising US Treasury yields and fears about a US dollar liquidity crunch, further fund outflows from emerging market equities remain a significant risk. On the domestic front, the recent boat accident in Phuket that claimed the lives of dozens of Chinese holidaymakers has hurt visitor numbers and this may have some impact on Gross Domestic Product growth.

On a positive note, public spending is expected to accelerate as the government plans to launch infrastructure funds to raise cash for road and highway construction without having to add to public debt. Additionally, a general election during the first half of 2019 could provide tailwinds to growth in terms of policies that are beneficial to provincial voters. At the time of writing, His Majesty the King passed the last two bills required to hold a general election, removing a long-standing uncertainty that may usher in again the right to vote as early as February 2019.

With Thai exports still holding strong, the outlook for corporate earnings growth in 2018 looks set to improve from mid to high-single digits. All this may trigger greater capital inflows, which could receive further impetus from a possible central bank rate hike over the next six months, although this is unlikely to be the start of a tightening cycle.

Vietnam

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

Steven Bates, chairman, VinaCapital Vietnam Opportunity: Investment in emerging earkets can be a volatile experience. The past year has shown how geopolitical issues in the developed world can cause problems for countries like Vietnam. The combination of a more belligerent trade policy on the part of the US and a trend towards monetary

tightening, however modest, has triggered a dollar rally and led to a deterioration in sentiment towards the emerging world. This disillusion is more perception than reality as economies like Vietnam's continue to grow very satisfactorily. There is concern that growth in China will be hurt by President Trump's tariffs and that these will have a domino effect throughout Asian economies. The Chinese response has been to inject various forms of stimulus into the domestic economy, amongst which has been a willingness to allow the Renminbi to weaken. This has brought downward pressure on the Vietnamese Dong and is the most obvious real economic effect on the country.

Vietnam's economic fundamentals remain robust and growth is set to continue into the medium term, with modest inflationary pressure. Valuations are higher than in the past and certain companies took advantage of the rampant markets in the first quarter of this year to raise capital at high prices. These issues have caused some market indigestion and have further increased the concentration of the stock market.

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Andy Ho, managing director, VinaCapital Vietnam Opportunities: Although market valuations have increased significantly, they are in-line with the regional peer average and are reasonable compared to forecast growth rates. We do see some risks that require monitoring. There have been discussions around whether the sudden rise in valuation seen in 2017 and early 2018 is similar to the rise in the Vietnamese stock market seen in 2006 and its subsequent drastic decline. The concern revolves around potential risks that are perhaps similar and as a result can lead the current market valuation down a similar path seen subsequent to 2006. We believe that today's market conditions are different and so are the associated risks. The top three areas of concern for the Vietnamese market are:

1. External volatility: In early 2018 we witnessed how the US market and global currency volatility can have a negative impact on Vietnam's stock markets, which had been driven up over the previous few months primarily on the back of foreign investor flows. External volatility could force some of these foreign investors to retreat, putting pressure on Vietnamese markets as well as the Vietnamese Dong.
2. Margin lending: This currently stands at approximately USD1.4 billion, or 1.4% of the total market capitalisation of Vietnam's three stock exchanges. It has slightly decreased from its all-time high in the first quarter of 2018. Any volatility could have a downward spiral effect driven by the liquidation of margin lending positions.
3. Inflation and interest rates: Although this risk is on the lower side, it is one that we are nevertheless acutely aware of and monitoring.

We also believe that the Vietnamese stock market today is more reasonably valued than at its height in 2006 where the average PE ratio was at times over 30x. The size and depth of today's market is significantly larger with over 700 listed companies. Furthermore in terms of liquidity, which is driven by both foreign and domestic investors, it is significantly higher and thus lessens various market risks relative to 2006.

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Michael Kokalari, chief economist, VinaCapital Vietnam Opportunities: Vietnam's macro economy was very stable throughout 2017, a trend that has continued into 2018. This was evidenced by modest inflation, a relatively stable Vietnamese Dong (VND) exchange rate to the USD, and steady interest rates. This stability, coupled with robust yet sustainable GDP growth, significantly raised international investors' interest in Vietnam during VOF's 2018 financial year, and supported Vietnamese stock, bond, and real estate prices.

GDP growth driven by consumption and manufacturing

Vietnam's GDP grew by 6.8% in 2017, and we expect the country's economy to grow at a comparable pace in 2018, driven by domestic consumption and by the continued expansion of manufacturing output. The economy grew by 7.1% YOY in the first half of 2018 in comparison to the first half of 2017.

Household consumption accounts for nearly two-thirds of Vietnam's economy, and grew by approximately 9.5% in 2017, and at an 8.6% YOY pace in the first half of 2018. This robust growth contributed over 5 percentage points to Vietnam's overall GDP growth rate and was supported by a record-high level of consumer confidence. Vietnam's consumers were the world's fourth most confident in early 2018, according to market research firm Nielsen.

Manufacturing accounts for 16% of Vietnam's economy, and grew by 14.4% in 2017, and at a 13% YOY pace in the first half of 2018. The strong growth of Vietnam's manufacturing sector contributed over 2 percentage points to Vietnam's overall GDP growth rate and was reflected in a near-record high reading of Vietnam's Purchasing Manager's Index (PMI) of 55.7 in June 2018, which was the highest PMI reading in the Emerging Markets Asean region.

anufacturing growth was supported by an 11% rise in foreign direct investment (FDI) in 2017 to USD11 billion and 8% YOY growth in the first half of 2018, because the majority of Vietnam's FDI inflows are deployed into increasing the country's productive capacity. Many FDI-funded factories produce for export, so robust FDI inflows and manufacturing output growth also helped to drive an expansion of Vietnam's trade surplus from 1.2% of GDP in 2017 to an estimated 2.8% of GDP in the first half of 2018.

Finally, Vietnam's GDP growth continued to be held back by the country's falling oil production. In 2017, oil production volume fell by 10.8%, which reduced Vietnam's GDP growth rate by about 0.5 percentage points, and in the first half of 2018 production again fell at an 10.9% YOY rate. Production volume was previously constrained by low global oil prices (especially in early-2017), but Vietnam's oil production is currently being impeded by physical and other constraints, according to our conversations with industry executives (note that global oil prices rose by approximately 60% YOY during VOF's financial year 2018).

Inflation and interest rates

Vietnam's policy makers continue to prioritise macroeconomic stability but surging global oil prices lifted inflation in most emerging markets, including Vietnam. The country's headline Consumer Price Index (CPI) inflation increased from 2.5% YOY at the end of December 2017 to 4.7% at the end of June 2018, driven by an increase in the Brent crude oil price from about USD50 per barrel to USD80. However, core CPI inflation, which strips out the impact of food and fuel prices, ranged between just 1.2 and 1.5% during VOF's FY2018.

Higher energy prices also indirectly increase the price of food, which accounts for 36% of Vietnam's CPI basket. Food prices were falling at a 3.1% annualised rate at the end of December 2017, but food price inflation reached 5% YOY at by the end of June 2018, which boosted the headline CPI rate by nearly 3 percentage points over that time. In contrast, medical price inflation fell from a 46% YOY rate at the end of December 2017 to 13% YOY at the end of June 2018, which reduced the country's headline inflation rate by about 1.7 percentage points, ceteris paribus.

Despite the increase in inflation during the financial year, deposit and lending interest rates at local banks were more-or-less unchanged at circa 5-6% for short term deposits on average (although some smaller banks paid higher rates to attract deposits), circa 8% lending rates for short term loans, and 10-11% lending rates for loans with a one-year maturity.

Furthermore, interbank interest rates and the yields on Vietnamese Government Bonds (VGBs) were extraordinarily low in the financial year, despite increasing inflation. Interbank rates remained below 2% almost continuously, which helped to drive a 90bp decline in 10Y VGB yields in 2017, and a further 120bp decline to a trough of just 4% in the first quarter of 2018, before rising inflation caused 10 year yields to rebound to 4.8% by the end of June.

The surprisingly low level of interbank interest rates was partly a by-product of the central bank's accumulation of USD13 billion of foreign exchange (FX) reserves in 2017, and an additional USD11 billion of reserves in the first half of 2018, bringing the State Bank of Vietnam's (SBV's) total FX reserves up to nearly USD64 billion, or 30% of GDP at the end of June 2018. Those purchases of USD by the SBV were only partly "sterilised" by the issuance of T-Bills that drained excess liquidity from the money market, so much of the residual liquidity generated by the SBV's FX reserve accumulations flowed into the nation's commercial banks.

The Vietnamese Dong (VND)

In the second quarter of 2018, a 5% surge in the value of the US Dollar Index (DXY) triggered steep depreciations in the values of Emerging Market (EM) exchange rates, and prompted "hot money" capital outflows from most EM stock and bond markets. The VND depreciated by just 1.5% against the USD to the end of June 2018, after having appreciated by 0.3% in 2017. Additionally, Vietnam attracted USD4.1 billion of foreign indirect investment (FII) in the first half of 2018, which was an 81% YOY increase over FII in the first half of 2017, and which was a stark contrast to the significant stock market outflows that most of Vietnam's regional peers endured during the period.

The currencies of India, Indonesia, and the Philippines depreciated by 6-7% against the USD in the first half of 2018, while Thailand and China depreciated by nearly 2% over the same period. EM countries which have current account deficits and/or are oil importers endured the steepest depreciations of their currencies in the second quarter of 2018 (Malaysia is an oil exporter, so its currency was unscathed by exchange rate volatility). Countries with specific political or other issues suffered severe depreciations, including Brazil (-17% in the first half of 2018), Turkey (-21%), and Argentina (-56%).

Vietnam enjoyed current account surpluses averaging 4.8% of GDP for each of the past six calendar years. We estimate that Vietnam's oil and refined petroleum products imports account for only about 1-2% of GDP annually, while India, Thailand, and China import 45-75% of the oil consumed. However, Thailand enjoys an 8% of GDP current account surplus thanks to its huge tourism industry, which explains the relative resilience of its currency in the second quarter of 2018.The other factor which helped to stem the depreciation of the VND in the midst of EM FX rate volatility during the second quarter of 2018 was the central bank's public commitment to intervene in the currency market if the VND depreciates by more than 2%. This was backed up by an increase in Vietnam's FX reserves from 2.7 months' worth of imports at the end of 2016 to about 3.5 months' of at the end of June 2018 (the IMF, World Bank and others recommend EMs maintain a minimum of three-months' worth of FX reserves).

It appears that the Government is targeting FX rate stability versus the USD in order to encourage capital inflows from foreign investors, which helps explain why the VND has been much more stable against the USD in recent years than have the currencies of Vietnam's EM Asean peers.

China followed this strategy in the wake of the 1997 Asian Financial Crisis, when it spent copiously to support the Renminbi at a time when the currencies of other Asian countries plummeted. The confidence that this strategy engendered in foreign investors

was one factor that helped encourage an enormous wave of foreign investment into China in the 2000s.

Structural growth drivers: Emerging middle class and industrialisation

Vietnam's impressive long-term growth prospects are supported by the FDI-funded expansion of the country's manufacturing base, which is driving export growth and supporting the emergence of a vibrant middle class. We estimate that about 20% of Vietnam's citizens are currently in the middle class. The Boston Consulting Group, market-research firm Nielsen and others expect that proportion to rise to one-third within the next few years, making Vietnam's middle class one of the fastest growing in the world.

The two primary drivers of the emergence of Vietnam's middle class are industrialisation and the country's 3% urbanisation rate. Only about 36% of Vietnam's citizens live in the country's major cities, (compared with 59% in China), and Vietnamese urban incomes are nearly double rural ones, according to the General Statistics Office of Vietnam (GSO) .

Industrialisation is a major growth driver because manufacturing still only contributes about 16% of Vietnam's GDP. Manufacturing peaked at approximately 30% of GDP in each of the "Asian Tiger" economies, so industrialisation is likely to be a major growth driver in Vietnam for years to come.

The property sector

Vietnam's residential real estate market remained robust during the financial year, with modest price increases across various segments of the market. However, there are some concerns that a real estate bubble is beginning to form, which prompted banks to clamp down on property lending somewhat in 2018, with the result that transaction activity fell by about 5% YOY in the first half of the year.

The market continues to be primarily driven by mortgage-funded purchases of new affordable and mid-tier apartments by emerging middle-class homebuyers. Demand is being fuelled by demographics (i.e., young homebuyers entering the workforce and forming families), and by industrialisation and urbanisation, which are both raising incomes.

We believe that the real estate market is still healthy, despite frothiness in certain segments, because: 1) demand for owner-occupied housing by middle-class consumers in HCMC and Hanoi continues to outstrip supply, and 2) the prices of affordable and mid-tier housing products are still within reach of many prospective buyers.

In conclusion, the macro conditions in Vietnam remain supportive of a healthy and functioning economy both from a growth and currency stability perspective as well as the growing middle class, who will drive domestic consumption, including real estate.

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Private equity

(compare private equity funds **here**)

Michael Bunbury, chairman, Harbourvest Private Equity: Investment in equities should always be considered a long-term commitment. That is especially so in regard

to private equity investment. There has been much comment in recent months about the elevated valuations of private companies and about deals being struck at record prices. Ten years ago the world was enmeshed in the maelstrom of the global financial crisis. Today many listed markets, which are the predominant influence on the pricing of private equity assets, are close to all-time highs. Yet there are many risks ahead of which the most dangerous look to be political, both in a number of individual countries and on a geo-political scale.

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Property

(compare Property: Direct – UK funds **here**)

Vikram Lall, chairman, F&C UK Real Estate: The outlook continues to be dominated by the political and economic uncertainties surrounding Brexit, and this is likely to become even more pronounced as the March 2019 deadline approaches. Economic growth has been positive, but modest, and consensus forecasts have been revised lower. The Bank of England raised interest rates after the end of this reporting period, and further gradual increases are anticipated. However, the property yield premium remains attractive against the risk-free rate.

The difficulties affecting the Retail sector are an area of concern, as is pricing in some areas of the market. We believe that in an environment of low growth and of market uncertainty, investors will prioritise income protection and the security of a long-term contracted income stream. We expect property to continue to deliver positive total returns, underpinned by the income return.

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Peter Lowe, manager, F&C UK Real Estate: The UK economy has continued to see modest positive GDP growth. Inflation remains above target, in part reflecting the lagged effect of the depreciation of sterling and higher oil prices. Despite an improving labour market, wage growth remains modest. The Bank of England raised its official rate in November 2017 and again after the end of the reporting period. Gilt yields edged up marginally in the reporting year, but with ten-year yields at 1.38 per cent, they remain at very low levels by historic standards. The Brexit negotiations and the consequent economic and political ramifications remain a major concern for investors with progress at the time of writing seemingly having stalled. The growth of protectionism globally and concern about tariff wars has been a further factor affecting sentiment though it has not to this point fed through in to pricing.

Against this backdrop, property investment activity has been resilient, helped by strong investment flows from overseas and by purchases from local authorities taking advantage of low borrowing costs. Institutions were net investors in property taking the year as a whole, while the open-ended Retail funds saw net inflows resume following the outflows experienced in the aftermath of the vote to leave the European Union in June 2016. The year to June 2018 saw more than £64 billion invested in property versus £52 billion in the previous year. The increase was most marked for non-London Offices, Industrials and Alternatives but investment in town centre Retail moved out of favour. Central London was resilient with some very large transactions concluding towards the period end. The banks have remained restrained in their new lending to commercial property, both for standing investments and development.

There has been sustained depth of demand in the market, with investors generally favouring core product benefitting from long-term secure income. Initial yields compressed further, to 4.5 per cent at the end of the reporting period, compared with 4.8 per cent a year earlier. The hardening of yields was seen across most parts of the market but was most marked for provincial Offices and Industrials.

Performance by segment broadly maintained the pattern seen after the referendum. Industrial and distribution property delivered significant returns of 20.4 per cent driven by both yield compression and rental growth, which were prevalent in London, particularly for multi let terraces inside the M25. The logistics and distribution market, as distinct from certain manufacturing and production supply chains is seen as being more resilient to Brexit related risks and for the right stock, a beneficiary of both technological change and a structural change in retailing. Offices recorded a 7.9 per cent total return. Rest of UK Offices and City Offices out-performed South East Offices and West End Offices but all segments under-performed the all-property average. Risks undoubtedly remain, however to date the central London Office market continues to defy dour post referendum predictions with take up close to the 15-year average and vacancy rates stable, despite a recent slow-down in the pace of rental growth. While serviced Office occupiers are a larger proportion of take up than was historically the case, the occupier base remains broad. There has been an uptick in South-East availability, though regional Office markets showed solid leasing activity over the period, buoyed by a number of large corporate and government acquisitions and grade A availability falling.

The Retail segment has had a difficult year, buffeted by significant and much documented structural headwinds, and marked by Company Voluntary Arrangements ("CVAs"), administrations and store portfolio rationalisation, particularly in the second half of the period. Total returns were 4.5 per cent and all the IPD Retail segments under-performed the all-property average while total returns for shopping centres were negative. Sentiment towards the sector, alongside the continued appetite for Industrials, has had the effect of reversing the traditional yield hierarchy, with Industrials (5.4 per cent) now offering lower equivalent yields than both Offices (5.7 per cent) and Retail (5.5 per cent) at the standing investment level. Despite relatively robust consumer spending, rental growth has now remained weak over a prolonged period, save for London and the South East, a disconnection with trend. Similarly, low vacancy rates within the Retail Warehouse sector have not been enough to generate meaningful rental growth. Alternatives, including healthcare, hotels and hospitality and student accommodation, out-performed the all-property average and are now a growing part of the IPD data set, reflecting the weight of capital pursuing the sector and delivering a 9.9 per cent total return.

Open market rental growth was 1.7 per cent at the all-property level, representing a slight deceleration from the pace seen in the previous reporting period. Rental growth eased for Retail and Offices but improved for Industrials and Alternatives.

The property market has stabilised following the EU referendum result but there is polarisation both by sector and within sectors, and considerable uncertainty remains with both investors and occupiers displaying caution. The yield premium over gilts remains attractive and an all-property annual income return of 4.5 per cent on relatively long-term contracted income may continue to look appealing when compared against other asset classes.

Brexit and its economic and political repercussions will inevitably be a major factor influencing investors for several years. The consensus economic outlook is for sustained but fairly modest economic growth and some moderation in inflation. In this environment, we would expect investors to continue to favour core product and prioritise the longevity of a secure income stream. The other major factor is the likely

path of interest rates. The Bank of England has indicated that long term central bank interest rates may be lower than in the past and while some further rate increases are anticipated by the market, this may act to reduce upward pressure on property yields as rates rise, though a weakening of rental growth may justify a softening of capital values for selected sub markets. Despite marginally higher yields in UK core markets than comparable European counterparts, the scope for further yield compression to drive performance looks to be limited. We would therefore continue to expect income to be the major driver of performance over the coming years.

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Target Fund Managers, managers, Target Healthcare REIT: The market for investment properties in the UK elderly care sector continues to be very active, particularly in the segment of the market in which we operate - modern purpose-built homes with flexible layouts and excellent resident facilities, including single occupancy bedrooms complete with en-suite shower or wetroom. What may be surprising to many is that this proportion of the sector comprises only approximately 100,000 of the overall 450,000 beds with an alarming 100,000 without any form of en-suite and 250,000 with WC and washbasin en-suite only.

There has been a general inward movement in investment yields in the sector, largely driven by the search for yield. Sharper yield tightening has followed for the best assets let to the strongest financial covenants, often acquired by more generalist property/ annuity investors who lack sector specialism.

There is an active current M&A landscape with three of the five largest operators currently for sale. HC1, Care UK and Barchester make up just 9 per cent of beds which underlines how fragmented the UK elderly care market is. Much of this activity is driven by normal private equity market exit requirements and we think endorses our favouring of good local operators with longer term operational horizons to whom we bring stable capital.

'What a difference a day makes' - the old idiom held true at the turn of the year when Jeremy Hunt, then Health Secretary, came out of a No10 reshuffle as head of the "Department of Health and Social Care". A change widely unnoticed by the general public, but of significance to the Social Care sector who had felt unloved for decades. 2018 of course heralded the 70th 'birthday' of the NHS and the government duly announced a £20bn 'birthday present' albeit as an IOU, and the sourcing of which is a matter of ongoing debate. Closer cooperation between Health and Social Care is much discussed, as it has been for decades, with wide recognition that if the NHS is to cope with the demands of an ageing society, better resourcing and coordination of services is urgently required. This provides at least one issue for the long promised 'Green Paper' which unfortunately seems to have taken a backseat while Downing Street grapples with Brexit.

The elephant in the room is Local Authority funding of carehome residents with low savings/assets. Much new carehome development is now polarising around geographical areas which can support a helpful degree of private fees, and established homes which are heavily reliant on public funding are feeling stretched. Most councils in April 2018 exercised the Adult Social Care Council Tax legislation allowing up to 3 per cent extra on council tax to be collected, and while this has no doubt been helpful for their social care budgets, little has found its way through to carehome operators. This issue should be a high priority in the aforementioned Green Paper, but there is a general consensus within the sector that other political matters will divert attention.

Care remains a challenging sector to operate in; a constantly changing regulatory landscape; difficulties with staff recruitment and retention (particularly nurses); and

profit margins in services with a high proportion of local-authority funded residents continue to be eroded. Social media quickly highlights any deficiencies, genuine, misguided or scurrilous, and a popular press is often happy to expand thereon. Many questions abound regarding the impact of Brexit, not least from a staffing perspective. Overall however, we feel that operators will find a way through, perhaps even with more open availability of staff from the 'old' geographies of India, the Philippines and Asia more widely.

Despite the apparent gloom, well managed and forward-thinking operators continue to thrive and they value our specialist support.

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Steve Smith, chairman, PRS REIT: The structural drivers supporting the growth in the private rented sector remain strong, and the limited supply of high quality new rental housing, house price inflation, affordability constraints, and an increase in the number of households, will be favourable to our growing stock of high quality rental houses.

The rental market for family homes, as opposed to flats, is especially undersupplied.

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Managers, PRS REIT: Demand for high quality rental housing, particularly for families, across the UK's major urban centres remains very strong. There are a number of factors driving this demand, including population growth, house price inflation and mortgage constraints.

In 2016, the UK population was nearly 66m, with approximately 27.8m households. Over the next eight years, the population is widely forecast to grow by 5.4% or 3.5m people, and the number of households is expected to increase by 8.1% or an extra 2m households.

Since the mortgage market review in 2014, the onus on lenders to ensure that borrowers can afford their loan commitments has increased. Accordingly, mortgage providers may lend no more than 15% of new mortgage contracts, in a given quarter, at a loan-to-income ratio of over 4.5 times. However after a prolonged period of house price inflation, the median household income to median house price stands at 7.6 times. Mortgage deposits have also become a hurdle to ownership, with deposits now approximately 19% of the purchase price. This represents over 60% of annual household income. In the 1990's, buyers typically needed a 5% deposit, representing approximately 12% of household income.

Government and policy makers are now prioritising the supply of new homes and seeking to reform the housing market. The Government's Housing White Paper, published in February 2017, set out such plans and identified PRS as an important mechanism to help accelerate overall housing supply. As we have previously commented, mixed-tenure development typically enables the delivery of housing at a considerably faster rate than market-for-sale developments. The Government's revised National Planning Policy Framework ("NPPF") and Planning Practice Guide, published in July 2018, also recognised Build to Rent as its own tenure type that should be prescribed on certain sites where the need is apparent. This recognition should help to unlock further opportunity.

According to research by Savills, there are only approximately 22,500 completed build-to-rent units currently in the UK, over half of which are in London. The pipeline of units under construction is higher at approximately 37,500, 60% of which are in the regions.

Demand in the rental sector continues to grow. The fundamental imbalance between the supply of good quality rental housing and demand remains large, and the loss of stock, as a result of legislative changes that have made the buy-to-let sector much less attractive to private individuals, exacerbates supply constraints. Lack of affordability in the market-for-sale sector continues to drive up demand for rental homes.

The family housing rented market, which according to the Residential Landlords Association represents just under 50% of tenants, is large.

In the draft analysis of a review into build out rates in the UK by Rt Hon Sir Oliver Letwin, build-to-rent was cited as a key component in a basket of measures to deliver more housing stock more quickly. We view this as further helpful, independent affirmation of the role that build-to-rent has in assisting in speeding up housing delivery in the UK.

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ICG Longbow: The economic environment continues to be generally positive for the occupational markets, with another robust quarter in UK office markets, led by Central London take-up at over 3 million sq. ft. – the best quarter since Q2 2015. In the regions, strong activity was evident in Glasgow, Birmingham and Bristol. According to GVA, take-up in the Big Nine regional cities totalled 2.57m sq. ft. in Q2, an increase of 12% on the first quarter and 15% higher than a year ago.

Industrial take-up totalled 6.3 million sq. ft., down 32% on a strong Q2 last year. However, with a lack of 'ready' supply, prime rents remain under upward pressure, as evidenced by the record £30 per sq. ft. rent secured for an industrial unit in Battersea. JLL are currently forecasting over 5% p.a. rental growth in the sector for 2018 and 2019.

The weakness in retail markets identified in previous quarters has become more broad-based, with a number of high-profile retailers announcing CVA's and/or closures, most recently Homebase. Whilst retail and leisure vacancy rates held stable at around 12%, this figure is expected to increase as store rationalisation programmes continue.

The Investment market was robust in the first six months of 2018 with £13.5bn worth of assets transacted in Q2 2018 according to Lambert Smith Hampton, closely in line with Q1 volume albeit 8% down on the five-year quarterly average. Central London office deals totalled £4.3bn in Q2 after three quarters of subdued investment; this was underpinned by several large transactions notably CK Asset Holdings' £1.0bn acquisition of 5 Broadgate. Post-quarter end, the largest transaction in The City this year was announced as the Korean Pension Fund agreed the sale and leaseback of the Goldman Sachs HQ for £1.16bn. These transactions provide evidence that overseas interest in UK commercial property has not been deterred by Brexit uncertainty, in particular demand for prime assets.

Appetite for industrial and logistics assets continues to remain strong despite strong upward movements in prices over the past two years. In particular, regional industrial deals at £636m were 28% above the quarterly average to June 2018. The retail investment market meanwhile remains subdued amid the challenges in the occupier markets, with the reported £1.87bn of deals identified by Lambert Smith Hampton flattered by a few large transactions, including Motcomb Estates acquisition of Burlington Arcade for close to £300m, and M&G's purchase of Fort Kinnaird Retail Park, Edinburgh for £167m. These deals are not reflective of the wider market however, and overall sentiment remains weak.

Biotech and healthcare

(compare biotech and healthcare **here**)

John Aston OBE, chairman, International Biotechnology: The factors which contributed to flat growth for much of the year, namely President Trump's drug pricing war, have abated, allowing strong growth in the final months of the financial year. While the looming mid-term elections in November may create some short-term uncertainty, the healthcare demographic argument for growth in the biotechnology sector remains strong.

Looking further afield, Brexit continues to cast a shadow over European investment markets and it is difficult to predict the paths the UK and the EU will follow in 2019, which could see volatility in these currencies.

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Q&A with Carl Harald Janson and Ailsa Craig, managers, International Biotechnology Trust:

How will the sector change over the next decade?

The sector is shaped by demographic trends. Populations are ageing: there will be a doubling of those aged over 65 by 2040. This will drive demand, as older people tend to be sicker. And biotechnology firms will be able to meet this requirement as they have become more effective at innovation. Over the last 15 years, there has been a doubling of drugs in the last two phases of clinical trials and we expect that pace to be maintained over the next decade and a half.

While the larger biotechnology firms have done well over the last decade, their growth is starting to stall as their drugs reach their peak sales potential.

Pricing pressure is the main concern for investors in the healthcare sector, particularly with respect to the US market. However, the latest Republican government is yet to implement any tough pricing regulations on innovative drugs, instead encouraging large pharmaceutical companies to self-regulate. This resulted in Pfizer and Merck, among others, stalling price increases of some drugs. Moreover, the regulatory approach so far has been to increase the introduction of generics and encourage more competition in ‘older’, more established drugs.

Where is the most exciting part of the market, in terms of drug development?

There has been an explosion in the number of new oncology compounds. For example, in 1996, there were only four drugs approved for the treatment of lung cancer. By 2016, however, there were 19 drugs approved spanning five different therapeutic categories. The rapid rate of development shows no signs of slowing. Gene therapy is another example. The head of the US drug regulator said recently there would be 40 new gene therapies on the market by 2022.

Will M&A remain an important driver in the sector?

Now that growth has started to slow at the large biotechnology firms, there will be increased pressure for them to acquire innovative new products with significant sales potential. Investors in smaller firms will benefit from this impetus.

How can investors interested in responsible investing benefit from an allocation to biotech?

Over the last five years there has been a revolution in responsible investing, with a growing number of investors embedding this approach into their portfolios. While it's quite straightforward to select companies with a good environmental and governance record, selecting those with a strong social agenda is more difficult. Investing in biotechnology is an effective way to ensure your capital will benefit society. The healthcare sector has a unique contract with policy makers and consumers. Periods of patent exclusivity incentivise the industry to find new drugs which treat unmet needs. Once those patents expire, however, these new therapies are often available for cents in the dollar in perpetuity

Debt

(compare debt funds **here**)

ICG Longbow: The Cass (formerly DeMontfort University) Commercial Real Estate Lending Report for the calendar year 2017 was published during the period, which recorded flat year-on-year lending activity at circa £44.5 billion. Non-bank lenders were reported as continuing to increase market share. The period also saw the modest return of UK CMBS issuance, with BAML and Goldman Sachs both sponsoring new transactions at pricing levels which, if sustained, would allow the investment banks to compete for deals where they have previously been uncompetitive. It should be noted that these issuances have focused on larger loans. In the sub £100m bracket, liquidity continues to remain challenging, particularly in the regions, and the continued lack of activity amongst the UK clearers allows alternative lenders room to grow.

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James G West, chairman, CQS New City High Yield: Twelve months on, geo-political uncertainty remains the defining characteristic as we look ahead, with Brexit locally and protectionist measures globally making for an uncomfortable backdrop. The slow normalisation of the world economy ten years after the collapse of Lehman Brothers, marked by rising interest rates, especially in the United States, is more encouraging, however.

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Ian Francis, manager, CQS New City High Yield: When I began to write the report for the year to 30th June 2018 I naturally looked back to what was said in last year's Annual; in what feels like a bad case of déjà vu it reads "we feel the greatest risks to global markets going forward are from the potential impact of Brexit in our economy and the unpredictable effects of Donald Trump's dictate by Twitter." Fast forward twelve months and you could be forgiven in thinking nothing has changed!

In the UK, Theresa May and the Conservative party have clung on to power despite being battered internally and externally by the forces of Brexit. No matter the loss of most of her senior team Theresa May is still moving inexorably towards the Brexit finishing line and no-one knows what deal or not will eventually emerge. We still believe that there is too much to lose for both sides and some sort of compromise will be fashioned that can be accepted. Over the next few months expect to see endless amounts of Brexit hyperbole no doubt finalising in a dramatic end game where a deal is secured with seconds to go.

The UK economy has been sluggish - since the Brexit vote Sterling has been weak against the Euro and the US$. This has some inflationary effects and we saw inflation peaking in November last year at 3.1% before falling during the course of 2018 to reach

2.4% most recently. Inflation was cited as a major reason for the Bank of England's 25bp rate rise in December to ½%. The retail and consumer sectors have had a tough time over the last year with inflation squeezing household finances with low rates of wage growth. This has led to savings falling and consumers relying on their credit cards to continue spending. The High Street has seen a number of prominent retailers going out of business and new car sales falling sharply. In a generally gloomy picture there have been a few bright spots with employment remaining at historically high levels and the manufacturing sector holding its own.

Across the Channel, Europe has continued to expand with manufacturing, services, retail sales and car sales all rising at a steady pace. The jobs market in Europe is strong and there has been a modest pick-up in inflation. In the early months of 2018 we were concerned about problematic coalition talks in Germany and Italy but these appear to have been resolved satisfactorily. All of this puts Europe in a strong position for the Brexit finale but there are worrying concerns over economic immigration and the future of the bigger European project which may temper how the EU approaches the Brexit end game.

Economically the United States has had a very good twelve months, continuing to add jobs throughout the period with unemployment falling and wages rising. The corporate sector has been given a massive boost in the form of tax changes introduced in December which benefitted companies and wealthier Americans. The Federal Reserve Bank has been increasing rates steadily on the back of continuing strength in the US economy. The downside to all the good news is the potential for inflation in the US to rise to uncomfortable levels. President Trump's frequent forays into the Twitterverse have been a prime target for comedians and sometimes viewed as being remote from the real world where US companies continue to power ahead. In recent months this has stopped being an amusing issue as the President has attacked his allies and initiated a series of tariffs and trade wars that have the capacity to slow and potentially depress global growth.

On the macro side the overall picture of the High Yield Corporate Bond market has been positive with default rates continuing to fall with Moody's projecting the high-yield default rate to fall to 1.5% by April 2019, from 3.7% in April 2018. Since the end of the oil slump in 2016, the number of companies not making their debt payments has steadily fallen even as corporate leverage has increased. The strength of the High Yield Bond market has seen a number of the companies in the portfolio seek to repay their higher yielding bonds and replace them with lower yielding paper. Whilst this is laudable act it does have consequences as we have to work harder to find equivalent yields from companies we like.

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Manager, Hadrian's Wall Secured Investments: The uncertainty around the form of Brexit and the UK's future trading relationships has created further unpredictability for the economy. For example, according to the Office of National Statistics the total UK trade deficit widened from £5.0 billion to £8.3 billion in the three months to May 2018, mainly due to costs of falling goods exports and rising goods imports. Exports of goods and services represent approximately 30% of UK GDP, and 49% of goods exports went to the EU. The full consequences of Brexit to the economy will only be apparent with the passage of time.

The Bank of England raised its base rate 25 bps on 2 August 2018. Although the future course of interest rates is uncertain, inflation over the past year has exceeded 2%. When measured against a historical interest rate environment, interest rates remain extraordinarily low and the Investment Adviser expects UK interest rates to continue to rise at a slow pace.

Many large banks continue to reduce their lending in the asset finance sectors. Challenger banks are more active; however, they are also subject to the bank capital rules that impact the appetite of large banks to make loans.

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Hedge Funds

(compare hedge funds **here**)

Marc Gabelli, chairman, Gabelli Merger Plus+: …a backdrop of global stock market advances, rising interest rates, and an acceleration of corporate events including record breaking levels of announced takeovers. A relatively strong economy continues to position U.S. equities in the global sweet spot versus non-U.S. stocks. The Federal Reserve is signalling higher rates ahead and this is keeping the dollar strong, emerging markets weak and inflation in focus. Migration related political risks in Germany and Italy are stress testing European unity.

Second quarter earnings reports are healthy relative to the first quarter gains. The U.S. tax cuts have helped propel inbound U.S. investment in capital expenditures, financial engineering led by share buy backs, and mergers and acquisitions activity. Deals are back with fervour.

Merger volumes globally are increasing as corporations flush with cash pursue strategic growth via mergers and acquisitions. Global merger and acquisition activity set a record high in the first half of 2018 as the value of announced deals rose to a new high of $2.5 trillion.

The U.S. economy remains upbeat and, as always, we are watching world economic and political developments as they may impact financial markets and opportunities. Although we started in July 2017 with the euphoria of a pro-business U.S. administration, several actions have brought cause to shudder, and merger spreads have widened across the investible universe. In the U.S., the break of the Tribune Sinclair transaction and the scrutiny of AT&T's acquisition of Time Warner signalled a period of newly defined U.S. domestic regulatory influences. Internationally, the recent Chinese regulatory decision to reject approval for the NXP-Qualcomm merger illustrates that arbitrage investing is at the epicentre of geopolitical manoeuvrings.

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Resources

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

Richard Prickett, chairman, City Natural Resources High Yield: In developing countries, the prospect for increased infrastructure spending implicit in growing urbanisation remains undiminished. Renewable power continues to get cheaper and electricity storage more efficient, hastening the pace of an electric vehicle revolution that will benefit some of our core holdings.

The resources sector has seen much solid progress, with increasing evidence that improvements in balance sheet discipline and the reinstatement of dividends are durable features of the new landscape. They are underpinned by better corporate

governance structures, while the prospects for the sector are brightened by a prolonged period of inadequate investment which begins to threaten supply shortages.

Yet, for all the positives, it remains difficult to look beyond President Trump and the policies of the US Administration. The threat of import tariffs becoming a full blown trade war with China and Europe must head the list of concerns, but the strengthening US dollar with its implications for capital intensive emerging markets that are dollar denominated debt should not be overlooked.

The fundamentals of the commodities markets remain firm suggesting there could be a correction to this dislocation at sometime in the future.

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Ian Francis, Keith Watson, Rob Crayfourd, managers, City Natural Resources High Yield: We remain highly encouraged by the continued capital discipline from the mining and energy sectors as a whole, as evidenced by large mining conglomerates such as Rio Tinto and BHP, with the latter approaching zero net debt by mid-2019 following the sale of their US shale assets to BP. The resultant lack of growth investment across the industry over the last 5 years is tightening commodity markets and given a resilient demand backdrop remains supportive for the sector. Resource companies do ultimately need to replace their reserves, but the current dearth of exploration spending will limit new supply and M&A may offer an appealing means of replenishing growth.

China's environmental policy benefits zinc

China's environmental focus continues to limit supply. While China's Blue Sky Policy has widespread appeal and has helped support high quality coal and iron ore price premiums we believe China's environmental focus on pollution will continue to benefit metals such as zinc. We believe the zinc market remains in deficit with declines in global mined zinc production estimated of 2% year-on-year to end-July led by China, which was previously self-sufficient in zinc production. We believe this market has over reacted to the prospect of some new production commencing in 2019 and with warehouse inventories having reduced to less than 10 days usage we believe this market will recover. The zinc market remains tight as warehouse inventories continue to decline despite recent mine additions and trade war fears.

Crude prices are relatively resilient

In our view the outlook for crude oil markets faces challenges from rising output as OPEC/nOPEC unwind 1 Million barrels oil per day quota restrictions and US exports increase as 4 Million barrels oil per day of new pipeline and port capacity starts to be delivered from H2 2019. Despite trade concerns which have weighed heavily on other commodities and prospective supply growth, crude prices have been relatively resilient and investors appear to be ascribing a premium for OPEC's market backing, to buffer against potential downside demand risk. LPG and crude shippers offer the potential to benefit from rising trade of cheap gas produced as a by-product of US output growth..

Precious metals ignored despite uncertainty

In the context of rising risk aversion and the dislocation in emerging market performance, the lack of interest in gold has been surprising. Insurance demand against risks posed by Trump policy (both sanctions and tariff escalation) and possible contagion from Turkey's currency crisis appears to have been conspicuously absent with the gold price and equities ending the year little changed. Indeed a 10% rise in the gold prices to April has since unwound, mirroring trends of other industrial commodities while the performance of precious metals equities, which had shown some stability, has

belatedly worsened slipping 20% since June. Despite the current lack of interest it remains a useful diversifier, particularly against a possible correction of highly rated US equity markets with which gold has shown strong inverse correlation since April, suggesting US investors have reallocated into equities.

Battery metals and copper to benefit from the low carbon economy transition

With regards the electric vehicle theme, both nickel and cobalt lend themselves more readily to technology used in hybrid vehicles that we believe will benefit most from the move away from fossil fuels. Importantly, power generation capacity may well be a bottleneck to achieving EV market penetration rates with electrification also sustaining copper demand.

Uranium market fundamentals improving

Illustrating to the capital discipline, environmental and low carbon themes we note the improving conditions in the uranium market. Against a background of stable Asian-led demand growth, uranium market fundamentals have improved markedly following substantial regional production curbs by dominant producer Kazakhstan, which even after recent production cuts still has a near 35% share of the market, and Canadian producer Cameco. With strong demand growth led by Chinese reactor build out and improving trend of Japanese reactor restarts, the depressed market has moved into deficit. With the uranium price down 85% from its peak we believe the sector offers plenty of scope for improvement. Given extreme regional concentration of uranium production and enrichment capacity the market is also vulnerable to disruption, such as from potential US security policy as the Trump Administration assesses the adequacy of domestic supply, which could materially benefit prices.

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Malcolm Burne, chairman, Golden Prospect Precious Metals: The recent past has proved extremely difficult for the Gold sector with trading momentum broadly on the negative side as investors have preferred the US Dollar. As we know these two constituents of global financial markets move inversely proportionately to each other - i.e. when one is rising the other falls - and vice versa.

In my last Chairman's Statement, I focused more on the geo-political influences on the Gold price and the likely effects of Trump's tax cuts and repatriations and the trend towards de-dollarization. We also looked at interest rates, global debt, quantitative tightening, trade wars and critical emerging market challenges. All of these factors remain very much in play as the latest IMF report talks of dangerous undercurrents in the global system. It spooked the market into a brief but substantial sell off.

But looking beyond today's strong US Dollar that has been piling the pressure on Gold, we see the 'contrarian' investor ultimately winning out against the 'shorts' and other bearish market participants. More on this suite of subjects later.

Peak Gold: The golden rule • He who has the Gold rules

On this occasion I thought I would focus more on the Gold industry's rapidly approaching "PEAK GOLD" stresses that do not bode well for the larger producers in particular for the foreseeable future. However severe supply constraints with 'no let-up' in demand from China, India and Russia can eventually only mean higher Gold prices.

According to market intelligence reports, Gold production is falling by circa 15% by 2022 due mainly to depletion and falling grades. Despite a high number of new mines coming on stream, production is falling away because of shorter mine lives and the end of life of larger mines.

At the same time discovery rates have fallen globally in spite of several years of high exploration expenditure and as a result the pool of potential assets for development over the longer term looks very limited. 201 S's first half has seen Gold output down by 16% at 3 major mines Newmont, Barrack and Goldcorp. Lower grades mean more tons which in turn means more energy, which means more waste. It is a truly substantial shift that works against future Gold supplies.

This scenario is unfolding at a time when the majors are constrained by shareholders demanding their companies reduce debt and refrain from any over commitments to large scale project development. In fact, many of the top ten miners have been prioritising shareholder returns over production growth resulting in little prospect of expanding output over the next few years. Gold is simply getting harder to find and this can only result ultimately in higher Gold prices.

Macro-Economic Climate

Turning back to the macro-economic climate, fears are intensifying over the 'bond bubble' and the impact of a bust caused by some of the emerging market crisis's like Argentina, Turkey and of course the Eurozone and the end of the ECB period of quantative easing.

Italian Bond yields and spreads are back near the European debt sovereign crisis. The worry is that all this and a domino effect threatens the very functioning of the financial markets, governments, corporate and monetary policies all together and as one market pundit put it 'wreak havoc unlike anything we have seen before'. Do we hear the siren call for a new 'Gold Standard'?

Most significant issue of all maybe the sheer size of global debt and the historically high US debt to GDP ratio. Global debt both public and private is now at an all high, fast approaching circa USD200 trillion almost 60% higher than it was 10 years ago when we had the Lehman crash. The financial system is extremely fragile, and we are literally in uncharted territory. Through financial contagion an emerging markets liquidity crisis will have a ripple effect throughout all advanced economy capital markets. The Fed has now raised fund rates to 2.25% and arguably now has little room for manoeuvre. Their hope is that inflation will not increase beyond these same levels during the next 2 years. The Fed has sold off more than 400$ in bonds through their quantitative tightening program.

Geo-political tensions and the uncertain outlook over the dangerous trade wars adds to this cocktail. The Trump administration is currently engaged in a trade war with the EU, Canada, Mexico and China and the outcome of this is hard to predict but it is clearly potentially extremely damaging to global trade and economic growth.

The trend for de-dollarization continues with Putin's government recently admitting to lessening the effect of the dollar on Russia's USD1 .6 trillion economy. It is clear that Gold will play an increasingly important role in any de-dollarization program and investors would be wise to recognise the part it has had in all the major historic currency events.

Meanwhile precious metal prices are heavily influenced by physical ETF's flows which have seen a material reduction of 4.6 million ounces of Gold over the past 5 months.

This selling pressure may soon ease off as Trump continues to say he favours a lower US Dollar going into the mid-term elections. The US Dollar has yet to reflect sufficiently the enormous monetary expansion of recent years with the US Government staring up at a mountainous estimated USD100 trillion in obligations. So while the majority of the investment community in the West, not helped by the financial media, are either shorting or abandoning Gold or selling their ETFs in favour of the US Dollar and cryptos,

China, India and Russia are 'filling their boots' as one professional bullion trader recently described it. Central Banks have upped their Gold reserves at the biggest rate in 3 years. In the first 6 months in 2018 they added a net total of 193.3 tonnes to their reserves - an increase of 8% compared to the previous years. This was driven by 3 main buyers, Russia, Turkey and Kazakhstan but as always China has been very active on the buy side also. And in US Dollar terms they are sitting on significant gains which will enable them to actively manage their liquidity or boost returns through leases, swaps and other transactions.

In mining equities, prices have now fallen to extremely low valuations, not helped by the increased competition of crypto currencies and cannabis stocks in Canada and the USA. However, a healthy M&A activity is rapidly developing led by the majors who have quite rightly begun to seize these historically low levels as witnessed by the recent takeover of Randgold by Barrick. This has focused the industry professionals on looking for the next takeover targets. If this has kicked off a wave of corporate activity then investor attention will be pulled back into this relatively neglected sector and a large contrarian rally could soon be established.

Technically the chartists are on balance predicting a significantly better 2019 for the Gold price with extended rallies over the next 6 months and beyond. This will see many of the 'shorts' running for cover. Speculators have been unusually short of Gold for the past 3 months which is one reason why bullion has been oversold.

Aggressive or fear buying of the US Dollar and the capitulation or liquidation by frustrated Gold bugs means sentiment in Gold has rarely been weaker. And it is "when the darkest hour is just before the dawn" that real opportunities emerge.

When one considers all of the above it's not hard to see why Gold could soon regain its lustre. Not forgetting also that there remains potential for shooting wars that still exist in North Korea, South China Sea, Taiwan, Israel, Iran, Venezuela and goodness knows where else.

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