

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

March was a better month for markets, with each of the indices in the adjacent chart rising by at least 2%. This was even true of the UK, where Brexit uncertainty is as bad as ever. Investors still appear to be seeking safe havens; government bond yields tightened (as their prices rose). One of the stand-out performers was India, despite the oil price rise, where it seems more likely that Modi will be re-elected.

Global

Uncertainty prevails, with opinion divided as to whether markets represent good value.

Peter Moon, chairman of Scottish American highlights a number of wildcards (including Brexit, China's economic growth and international trade) that make predicting the future challenging. Andrew Bell, Witan's CEO, says time appears to be more clearly on the side of contrarian, patient equity investment than a year ago, with valuations lower and risk aversion in the ascendant. The managers of Alliance Trust think market expectations for US earnings growth for 2019 are optimistic - leaving scope for earnings disappointment.

United Kingdom

Uncertainty providing buying opportunities in small-cap space

Simon Fraser, chairman of Merchants Trust, believes that UK shares are relatively cheap, in spite of the mixed economic and political signals all around us. Robert Lister, chairman of Aberdeen Smaller, believes that levels of uncertainty have (continued on next page...)

Exchange Rate	31/03/19	Change on month %
GBP / USD	1.3035	(1.7)
USD / EUR	0.8914	+1.4
USD / JPY	110.86	(0.5)
USD / CHF	0.9952	(0.3)
USD / CNY	6.7121	+0.3

Source: Bloomberg, Marten & Co

MSCI Indices rebased to 100

Time period 31/03/2018 to 31/03/2019



Source: Bloomberg, Marten & Co

	31/03/19	Change on month %
Oil (Brent)	68.39	+3.6
Gold	1292.38	(1.6)
US Tsy 10 yr yield	2.405	(11.4)
UK Gilt 10 yr yield	1.000	(23.2)
Bund 10 yr yield	(0.072)	(139.6)

Source: Bloomberg, Marten & Co

UK (continued)

...elevated globally, and particularly so in the UK with the Brexit issues. The manager adds that quality is becoming increasingly important and that the small-cap space remains an attractive hunting ground. Andrew Sutch, JPMorgan Claverhouse's chairman, believes most of the worst news has been priced into the market, which is presenting opportunities. The fund's managers add that they do not believe a global recession to be imminent, which in their view has been priced into equity markets. Frank Ashton, executive chairman at Athelney Trust, focuses on the uncertainty created by Brexit and the protectionist rhetoric coming out the US, with signs that global companies are moving capacity away from the UK. Elsewhere, the managers at Dunedin Income predict a high chance of further market volatility.

Asian markets to feel the effects of a global slowdown but fundamentals still there

Asia ex Japan

The managers at Schroder Asian Total Return remain fairly pessimistic in their outlook for Asian markets, on the basis that global liquidity will continue to tighten with monetary policy no longer as accommodative and the view that trade tensions between the US and China are unlikely to let-up. They also see Asian exports having a tough year and China not being to stimulate its economy as it has done previously. The managers at Symphony International Holding paint a more sanguine picture, expecting the Asian economies to continue growing and pointing to longer-term forces such as the growing spending power of middle-class consumers.

Most uncertain environment for ten years sees funds double-down on fundamentals

Europe

Jack Perry, chairman of European Assets, believes it is important to remain focused on the fundamentals in uncertain climates, pointing to how sanguine investors were a only a year ago. He does, however, share concerns about how the gradual unwinding of central bank support will play out. European Assets Trust's manager makes a similar point. He believes the outlook for the global economy to be at its most uncertain since the financial crisis and stresses the need to focus on fundamentally solid companies that can deliver irrespective of the market cycle.

An ageing population in China creates enormous demand. Equity finance for biotech companies may be harder to come by

Biotech and healthcare

The managers of BB Healthcare draw attention to China's ageing population and the growing healthcare needs associated with that. The managers of care home company, Impact Healthcare REIT, still see a shortage of supply in their market. The managers of biotech finance company, BioPharma Credit, think that biotech companies are going to find it harder to access stock markets for funding and will be turning to debt instead, where they can.

Debt

Where you position yourself in the debt market depends on your view of the severity of any downturn. Many commentators seem relatively optimistic

Norman Crighton, chairman of RM Secured Lending, thinks investors should favour higher quality secured debt investments as we approach the end of the economic cycle. Rupert Dorey, chairman of NB Global Floating Rate Income, suggests that short duration asset classes are the place to be. The managers of that fund are not expecting a recession in the near term and valuations are pricing in modest levels of defaults. Alex Ohlsson, chairman of GCP Asset Backed Income, notes that mainstream lenders are still constrained in their ability to lend, allowing opportunities for other lenders. John Hallam, chairman of NB Distressed Debt, notes that their part of the market was resilient in 2018.

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Infrastructure

Political threats to the infrastructure market are dismissed

Colin Maltby, chairman of BBGI, discusses the prospect of political changes on the PFI/PPP and PF2 markets (the various wheezes whereby the UK government finances infrastructure). The managers emphasise the attractions of geographic diversification, given that backdrop. Mike Gerrard, chairman of International Public Partnerships, says that governments and regulators are committed to the private finance model. The managers of Premier Global Infrastructure say that many of the companies they follow are producing very strong earnings growth.

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Private equity

Expect to see more takeovers of listed companies. Smaller deals maybe offer better value

Tim Breedon, chairman of Apax Global Alpha, foresees an increase in public-to-private deals in the current environment, a sentiment echoed by the managers of that fund. They think the future looks brighter for debt rather than equity. Hamish Mair, manager of BMO Private Equity notes that prices are rising for private equity deals but sees value in the lower mid-market area of private equity. The managers of LMS capital concur; their niche is in the sub £50m enterprise value and they say there is much less competition here.

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Property - UK

Uncertainty helps perpetuate the demand for yield in the UK

Martin Moore, chairman of Secure Income REIT, says uncertainty is likely to persist in the UK well beyond 29 March and quite possibly for a number of years. He thinks that this is likely to perpetuate the "lower for longer" interest rate environment in the UK and the search for yield. Stephen Inglis, manager of Regional REIT, talks us through the landscape for UK regional property in some detail. They think a lack of new supply underpins the attractions of regional offices. The managers of TOC Property Backed Lending highlight the divide between the housing markets in London and the North East (the focus of their fund). Tim Atlee, CEO of Empiric Student Property, provides an in-depth look at the dynamics of the student accommodation market in the UK.

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The picture is rosy in some European property markets

Property – Europe

The investment managers behind Starwood Europe Real Estate Finance highlight the attractions of property markets in Ireland and Spain. Glyn Hirsh, CEO of Raven Property, reports a picture of rising rents and a stronger economy in Russia.

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UK and Europe energy markets will remain entwined

Renewable Energy

The managers of Foresight Solar expect that the UK's energy market will remain entwined with Europe's post-Brexit. Rónán Murphy, chairman of Greencoat Renewables sees considerable growth prospects within the Irish wind power market.

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Other

We have also included comments on North America from JPMorgan US Smaller Companies; global emerging markets from Fundsmith and ScotGems; India from India Capital Growth and Apax Global Alpha; and the Technology sector, courtesy of Walter Price, manager of Allianz Technology.

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Global

(compare Global funds [here](#))

Peter Moon, chairman of Scottish American: Last year I suggested that the likelihood of continued economic growth around the world seemed strong, but that concerns relating to valuations and rising interest rates made share price progress less than certain. This year the opposite may be the case, both because economic growth is likely to slow as the cycle progresses and trade wars loom large and because recent falls make equity valuations appear more reasonable. Appearances may be deceptive however, particularly if corporate earnings growth slows dramatically from the strong levels of 2018.

Wild cards such as brexit, the extent of any slowdown in China, international trade relations and the broader geopolitical risk around China and the US make predictions challenging as quite different outcomes are entirely possible.

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Andrew Bell, CEO, Witan: Towards the end of 2018, investors became unnerved by concerns that US interest rate rises and tightening liquidity might be overdone, jeopardising global economic growth. The trade disputes initiated by the US with its trading partners, particularly China, were a further negative factor. Oil price rises earlier in the year had also increased inflation rates, while the uninspiring progress of the Brexit negotiations continued to dampen the domestic mood in the UK. Corporate earnings and dividends grew while share prices as a whole fell, particularly in the final months of the year, so equity valuations finished the year lower. A mood took hold that 2018 might prove to be the peak in the economic cycle, leading investors to discount today's sunshine for fear of rain tomorrow.

Although it is normal for financial markets to be forward-looking, they are not clairvoyant, being prone to over-optimism and excessive gloom. Even as the investment mood darkened in December, the prevailing policy worries appeared to be improving. The oil price fell sharply, as new supplies came to the market. This acts as a tax cut for consumers of oil and, by lowering inflation rates, reduces the risk that central banks will have to raise rates to combat inflation. The US-China trade dispute is unresolved but talks are under way to mitigate it. The US Federal Reserve still plans to raise rates but has made clear that its actions are dependent on news from the economy, not on an automated path.

The risk of a 'cliff-edge' Brexit with no transitional arrangements appears to have reduced, although the shape of any ultimate deal remains profoundly uncertain. The risks have been widely analysed over the past two years and may well be largely discounted given the weak performance of the UK stock market (most of whose economic exposure is overseas). The risks for the UK domestic economy are more significant and the political uncertainty related to the lack of unity in the government and the radical policies of the opposition continue to cloud investor attitudes towards the UK.

2018 started with apparently improving economic growth and (in the wake of the US tax cuts) a tangible mood of optimism. This set the stage for a tricky year as liquidity tightened, economic growth disappointed and US trade and foreign policy surprises proved unsettling. By contrast, 2019 started with sentiment overwhelmingly pessimistic. Whilst concerns over trade, recession and European disunity might be proved correct, recent developments suggest this is not a one-way bet. The risks are more fully recognised and positive surprises seem just as possible as unexpected shocks. Given

current equity valuations, against a background where interest rates are likely to remain well below historic norms, we believe that 2019 has the potential to deliver attractive investment returns, despite (or partly because of) the pervading gloom at the end of 2018. At worst, time appears to be more clearly on the side of contrarian, patient equity investment than a year ago, with valuations lower and risk aversion in the ascendant.

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Craig Baker, David Shapiro, managers, Alliance Trust: Our outlook for 2019 is set against a backdrop of increasingly difficult global economic conditions and political uncertainty. This uncertainty has brought about significant, and broad-based volatility and price weakness in the equity market. We expect active management can take advantage of this volatility by identifying companies that have been sold without regard for their true intrinsic value.

Because economic policy and political uncertainty are elevated globally, it is increasingly difficult to predict economic outcomes, with an increasing range of potentially negative ones. We expect growth in the major economies to steadily slow. While there are many drivers for this, rising interest rates and the unwinding of quantitative easing by central banks will make developed equity markets overall more challenging. We expect liquidity to fall and volatility to rise.

Market expectations for US earnings growth for 2019 are optimistic - leaving scope for earnings disappointment. As such, under current valuations, we view more risks to the downside in US equities. On the other hand, emerging market equities have been declining over 2018 and are cheap on a relative basis, with greater potential for growth.

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United Kingdom

(compare UK funds [here](#))

Simon Fraser, chairman, Merchants Trust: When I wrote to shareholders in late September with the half year results, I noted both the increasing risk profile for the UK economy and the increasing volatility being experienced across global stock markets. This was before we experienced substantial market swings in the fourth quarter of 2018 which saw the FTSE All-Share Index tumble by approximately 10% (total return), before recovering somewhat in January. This was a period of quite extreme moves at both sector and stock level.

We remain in a period of heightened geopolitical and economic risk. In spite of the mixed economic and political signals all around us, there are good stock opportunities to be found. UK shares are relatively cheap at the time of writing and this is potentially a good environment for active investors.

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Robert Lister, chairman, Aberdeen Smaller: 2018 has been a tougher year, following several years of a bull market. The levels of uncertainty have elevated globally, and particularly so in the UK with the Brexit issues.

The economic picture globally and in the UK also looks more challenged. Economic growth is under pressure, industrial production and manufacturing numbers are abating, there is a prospect of further interest rate rises, commodity prices have fallen sharply, and political interference is at heightened levels particularly in the UK and US.

Abby Glennie, manager, Aberdeen Smaller: Levels of uncertainty in markets are high relative to history, partly driven by Brexit but also wider concerns globally about where we are in the economic cycle. This has been a long bull market, and it does feel like that has now come to an end.

Markets in 2019 are likely to remain challenging, coming from years of bull market territory. Brexit remains the main overhang in the UK, and we continue to lack clarity of a resolution for that. We expect that quality will become increasingly important in tougher markets. The sustainability of earnings growth will also be an important factor driving share prices, where we saw an extreme level of profit warnings in 2018 and shares sharply falling on those warnings.

The UK Small Cap space remains an attractive hunting ground for quality growth businesses, which provide attractive income levels; with a diverse range of exposures and stock specific drivers.

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Andrew Sutch, chairman, JPMorgan Claverhouse: While Brexit has continued to dominate the headlines in the UK and has adversely affected business and investor confidence, the fall in global markets in 2018 was caused by a number of factors. These included a slowing of growth in China, Europe and elsewhere, and political upheavals in a number of countries.

At the time of writing, the Brexit political endgame is still uncertain and the risks of falls, or at least volatility, in sterling and the UK equity market will remain for some time. However, these risks have to an extent already been priced in and there are a number of opportunities for investment at acceptable valuations. Since the year end there has been some recovery in stockmarkets.

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William Meadon, Callum Abbot, managers, JPMorgan Claverhouse: The world economy is slowing and profit forecasts for many companies are being trimmed accordingly. However, we do not believe that the world is about to enter the recession which equities have recently priced in. Consequently, we believe that the risk/reward in UK equities for medium term investors is now looking much more attractive. Indeed, for those prepared to weather the new levels of stock and market volatility, a prospective yield on the FTSE 100 of 5% looks very appealing in a world where inflation remains low.

However, some patience will be required, since the subdued market sentiment may linger for some time. A clear path to resolve many of the macro and geo-political issues will be needed before many investors are prepared to commit new money to volatile equities. A failure by politicians and policy-makers to deal successfully with them may lead to further market falls but this will simply throw up even more opportunities.

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Frank Ashton, executive chairman, Athelney Trust: Externally, uncertainties continue for a UK small-cap fund. Brexit rumbles on, struggling between the need for a political outcome that reflects the balanced voting 52:48 in the referendum, and the realities of negotiation between two sides with a lot to lose, economically and politically - the UK government and remaining 27 member states of the EU. How or even when this will end is still uncertain. The manner of Brexit, whatever it is, and also developments on the global stage will impact the economy and sterling in the short term.

The US economy is unlikely to repeat its 2018 outperformance and Washington's more hostile approach to trade is a driver of convergence of larger developed economies' growth and a thorn for the UK's trade negotiators post Brexit. More protectionism and continued uncertainty has already translated to companies deferring investment or freezing recruitment, and there are signs global companies will move capacity away from the UK over time.

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Ben Ritchie and Louise Kernohan, managers, Dunedin Income Growth: Equity markets have partially recovered over the past two months following the marked drawdown in the latter part of 2018, however as we write this, many of the economic and political headwinds have not gone away and we see the likelihood of further market volatility as high.

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Asia ex Japan

(compare Asia ex Japan funds [here](#))

Robin Parbrook, Lee King Fuei, managers, Schroder Asian Total Return: Our views as we start 2019 remain pretty much unchanged from those at the beginning of 2018.

We expect global liquidity to continue to tighten as it has for the last 18 months. Even if we see a quick reversal from the Federal Reserve (unlikely, though clearly a pause is possible), the lag from past tightening is likely to mean further economic weakness and result in a headwind for stock markets. The growth in base money (currency in circulation plus short-term deposits) has slowed to almost zero. With the Federal Reserve still aiming to shrink its balance sheet and the European Central Bank keen to end quantitative easing we don't see any immediate let-up. This is likely to remain a significant headwind for Asian markets as the lagged effects (slower economic activity and weaker corporate profitability) feed through.

We remain sceptical of any real let-up in US and China tensions despite President Trump's desperate tweets that he has brokered a deal. It is clear that US-China tensions are not just about trade but something much bigger. It involves US perceptions around China's intellectual property theft, cyber-crime, the way China projects its political and financial power via One Belt One Road, and China's desire to dominate key industries via massive state subsidies (Made in China 2025). These issues are much harder to resolve to say the least!

We suspect there has been material front-loading of exports prior to the threatened 25% tariffs and if we are correct this is likely to mean a weak start to the year for Asian exports (in addition to a general slowing picture). Asian exports actually held up pretty well in 2018. However, the outlook appears distinctly cloudy. This backdrop suggests a weak picture for Asian earnings given the high historic correlation between Asian earnings and exports. Samsung's recent earnings announcement - we suspect - is just an indication of what is to come.

The scope for China to undertake major stimulus measures is now much more limited, unless they wish to suspend the effective currency peg. We expect the Chinese economy to continue to slow given the authorities' (correct) desire to rein in excessive leverage and bring shadow banking (unregulated entities) back on balance sheets.

Given the pegged currency, a current account no longer in surplus and a leaky capital account, we view monetary options as limited assuming devaluation is not considered an option (which would cause market chaos and global deflation). The monetary situation is much more finely balanced than in the past. We do expect some fiscal measures to boost consumption but given the size of the economy and high housing and auto ownership rates, such measures are likely to have limited efficacy compared to the past. Our base case is for the Chinese economy to slow but with debt effectively internalised, the immediate triggers for a financial crisis are unlikely to come to pass. But one of the major tail risks we see for the region is a messy unwinding of the Chinese currency peg.

Structurally we think the world remains deflation prone. As we have discussed many times over the last 10 years, the combination of the 4Ds (debt, demographics, disruption, disparity in income) means the world is likely to remain deflationary. We expect this to continue to mean that economic numbers surprise on the downside (and as they have in Japan for 25 years!). The key question your portfolio managers are mulling over is: given this backdrop, does this mean talk of a renewal of quantitative easing starts again by the end of the year and what does this mean for markets? Does it provide the usual sugar rush, or do we move into a Japan twilight world where the stock market becomes increasingly irrelevant, or do we instead in the West at least move towards financial repression as quantitative easing does not work so policymakers look at more extreme measures to create inflation/write off debt? We suspect the latter is the ultimate endgame.

Some good news for investors, however, is that excluding China, debt increases in Asia have been negligible and government and corporate balance sheets look in pretty good shape. Corporate gearing has been coming down in Asia, and many Asian companies are sitting on ample cash. Asian companies are in the main well positioned for a more difficult economic backdrop.

Headline valuations also look reasonable after the falls in 2018. There are pockets of value in Asia but it is not broad based and certainly not in the favoured defensive sectors (those where business should hold up well during weak times, like consumer staples). It is also the case that after the euphoria which heralded the start of 2018, we suspect earnings forecasts for 2019 remain too high. We would accept this is hopefully at least partially discounted by markets, but investors should be wary of any market commentators claiming Asia is "cheap" using what are optimistic consensus forecasts.

We remain cautious but not outright defensive. Assuming the tail risks outlined above are avoided (RMB devaluation/financial stress in China, US credit blow ups), then we expect markets in Asia to offer moderate gains (low headline valuations offset by a relatively weak earnings outlook).

With growth slowing and interest rates likely to peak this year, we expect yield plays to come back into focus. Historically 67% of total returns in Asia came from reinvesting dividends and with better corporate governance and dividend policies, this favours the bigger more "sensible" Asian stock markets.

Yield stocks have also underperformed for quite a prolonged period as investor focus has been on growth and new economy names. Whilst we are not forecasting a crisis, we do believe selective yield names can offer good defensive returns even if stock market conditions are difficult.

To end on a positive note - how sustainable are dividend yields in Asia? Profit margins in Asia have remained healthy and cashflow strong. With balance sheets relatively lowly geared, there is ample scope in Asia for more generous payouts despite the weak outlook.

Symphony International Holding, Pierangelo Bottinelli and Anil Thadani:

Following a strong start to 2018, we are now beginning to see slower growth in many economies as less accommodative fiscal policies begin to take effect. Although the weaker investor sentiment in late 2018 and early 2019 have reduced market valuations, we do not view this negatively. Aside from more interesting opportunities coming to market, the gradual removal of excess liquidity is reducing imbalances across the global economy and therefore also the risk of a more dramatic downward cycle.

There are a number of economic and geopolitical risks that could further impact the global business environment in 2019, such as the ongoing trade tensions between the US and China and the possibility of a disorderly exit by the United Kingdom from the European Union. There is also political uncertainty surrounding the elections in Thailand, which may have an impact on the perception of businesses operating there. From experience, governments tend to lean towards pro-market policies, so we feel that the effect of these risks will be short-term in nature. Nevertheless, economies, particularly in Asia, will continue to grow. Increasing consumption from a growing middle class, market liberalisation and growing intra-regional trade is shifting the economic power increasingly towards the east.

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Europe

(compare European funds [here](#))

Sam Cosh, lead manager, European Assets Trust: 2019 in contrast has started strongly. This probably reflects the usual new year optimism combined with the excessive level of bearishness heading into this year. In retrospect it is not surprising that sentiment only needed a little bit of positive news to change the outlook from such pessimistic levels. While there has been little in the way of positive economic data, an apparent thawing in the US and Chinese trade discussions and an agreement between the EU and the Italian government have all been taken well. More dovish comments coming out of the central banks of the US, Europe and China has also helped, while oil price falls are now providing a tail wind.

Nonetheless, the outlook is as uncertain now as at any time since the financial crisis. After all, the upturn in equity markets has lasted more than a decade. While valuations in European equities as a whole look very reasonable, the big concerns centre on deteriorating economic activity and monetary conditions across the world. Central banks, and the US Federal Reserve in particular, are trying to withdraw their unprecedented monetary support at the same time as global growth appears anaemic. China specifically looks vulnerable at the same time as tariffs imposed by the US are biting. This has caused Europe's trade dependent sectors to be hit particularly badly, though we believe that their valuations reflect a poor outlook already.

As discussed at the outset, the aggressive market falls in the fourth quarter, and evidence of a more uncertain outlook has caused the Federal Reserve to, at least temporarily, decelerate the level of liquidity withdrawal. Nonetheless, we are at the start of a long path of monetary normalisation following a decade of unprecedented support. It is not clear how this will manifest itself, but the most worrying aspect of the last decade is that global debt levels have increased significantly since the financial crisis. Of note is US corporate debt. Zero rate interest policies and quantitative easing encouraged US corporates to increase their borrowing by more than 200% over that period. Little of this debt was used productively, but more to fund an unprecedented level of financial

engineering, that is, buying back shares to boost growth of earnings per share. Of course, we do not know whether there will be a day of reckoning but such statistics are of concern.

The outlook is of course uncertain and more often than not reflects current market sentiment. It would therefore be wrong to let the myriad of highlighted challenges dictate what we are trying to do. After all, investors entered 2018 with high hopes of continuing market gains, yet global returns proved the worst since 2008. It is therefore best to focus on companies which have the best chance of delivering attractive returns through, and irrespective, of the market cycle.

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Jack Perry, chairman, European Assets: It is of course challenging to have a definitive view of market direction. To see the folly of this, we only have to look to the beginning of last year, when investor optimism was universally upbeat, yet global returns proved the worst since 2008. Our belief in investing in good companies, and not paying too much for investments, is not therefore dictated by attempts at such predictions. We believe that this is the best way to look after our shareholders' capital, and while this has been more challenging in recent years, over the long term, this approach has been vindicated.

It would however be remiss not to note the challenges we see ahead of us. We are particularly concerned about the unknown consequences of the slow withdrawal of central bank support. The flood of liquidity over the last decade has provoked areas of unnatural activity. It seems peculiar, for example, that debt levels have only increased since the financial crisis, with corporate debt in the US doubling over that period. It is some comfort that in aggregate European companies have not engaged in this financial re-leveraging, and our investment process treats leverage with suspicion. When we look at the characteristics of the portfolio, it has less leverage than the market, has better levels of profitability, and only trades at a marginal valuation premium. This, we believe gives it the best chance of delivering good returns over the long term.

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North America

(compare North American funds [here](#))

Dan Percella, Jon Brachle, managers, JPMorgan US Smaller Companies: We continue to focus on the fundamentals of the economy and of company earnings. Our analysts estimate continued earnings expansion for 2019. While subject to revision, this forecast reflects our expectations for moderate economic expansion in the underlying economy and includes our best analysis of earnings expectations for this year. The implications of tariffs and Fed policy will be integral to investor sentiment and will likely continue to contribute to the uncertainty.

While continued earnings growth and strength in economic indicators should provide support to the equity market, we are monitoring possible risks that could represent headwinds for US stocks. In particular, we continue to watch closely the trade narrative, global economic growth, and the implications of rising rates, all of which have the potential to add to volatility. We are cognizant of heightened risks in the market as we are much more likely to be at the end of the economic/market cycle than at the beginning. With the Russell 2000 Index trading at a below-average P/E multiple, we think these risks are somewhat priced in, though sentiment is fragile. Longer term, we

continue to see opportunity for US smaller capitalization stocks to outperform larger cap stocks due to relatively attractive earnings growth rates, greater leverage to rising interest rates and relatively attractive current valuation levels as compared to larger capitalization stocks.

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Global emerging markets

(compare global emerging markets funds [here](#))

Terry Smith, manager, Fundsmith Emerging Equities: In India we are now experiencing strong company results as the disruptive effects of the GST implementation have waned and its benefits have become apparent. This is in spite of some deterioration in the macro economic situation caused by rising input costs and political uncertainty ahead of the general election due this year.

India has seen some dramatic reforms in recent years under Prime Minister Modi. We have remarked upon two of these at length in previous reports, namely "demonetisation" in November 2016 in which the highest denomination bank notes, the Rs500 and Rs1,000 notes (roughly £6 and £12) were declared no longer to be legal tender. This was followed on 1 July 2017 by the implementation of a countrywide Goods and Services Tax ("GST") which replaced state taxation (India is comprised of 29 states). This was, in our view, a massive step towards turning India into a single economy for the first time and has undoubtedly begun to reap benefits in terms of efficiency for manufacturers and distributors.

At a recent conference Sanjiv Mehta, who runs Hindustan Unilever, opined that the 20 countries he was responsible for when he ran Unilever's operations in the Middle East and Africa division were more homogeneous than the 29 states of India. It is clear that a Herculean effort is required to alter this from an economic perspective and it is being applied.

Having some 85% of banknotes by value withdrawn without warning is obviously disruptive to economic activity. So was the implementation of the GST. Aside from the fact that the new GST regime was almost certainly initially too complex with too many bands, it led to stocking up in advance of implementation in some sectors and destocking in others, depending upon the view of how the GST would affect them. Even the revenue and cost numbers produced by many companies are not truly comparable with their pre-GST numbers because of changes in the way some of their goods are treated for input and output tax. The informal sector of the economy has been hardest hit by this and whilst we might applaud that as the modern retail sector is of growing importance and GST could be expected to stimulate it, some of their sales do rely upon wholesalers and informal retailers who might have cash flow issues and problems with having previously (shall we say) under-reported their sales and profits.

The good news is that we passed the anniversary of GST implementation in mid-2018, some simplification of its application has begun and both Indian businessmen and consumers have begun to understand how it works. We hope and expect that the combination of these reforms will help to transform India's economy.

The bear run in emerging markets which began in July seemed to have passed by the time the major markets started to experience major jitters both in October and December, and in the last two months of the year a reasonably sharp recovery set in.

As we have pointed out several times before, markets do not deliver their performance evenly. Who knows what 2019 holds? We certainly have a general election in the country to which we have the largest exposure - India - which seems certain to bring some nervousness. However, ultimately, we hope for an outcome which will allow the country to continue to progress.

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Ashish Swarup and Tom Allen, managers, ScotGems: It was a tough year for Emerging Market Equities. Share prices of businesses operating in countries with shaky institutions and large external imbalances were hit the most. Our opportunity set in markets such as Turkey and Argentina is limited in any case. Lack of robust political and judicial institutions often mean that crony capitalism thrives in these countries at the expense of honest self-made private entrepreneurs. Unfortunately, share prices in countries like India and Taiwan, where we have traditionally found many well stewarded private companies, still remain expensive.

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India

Elisabeth Scott, chairman, India Capital Growth: After the decline in the Indian equity market in 2018, valuations have fallen to attractive levels. Recent data suggests that the economy is gaining momentum once again. However, it is likely that the market will continue to be relatively volatile until the results of the Indian general election are known. Since the end of 2018 there has been much concern about the fractious relationship between India and Pakistan over Kashmir. A degree of calm has been restored, but border conflict continues to be a concern.

There are many reasons to be optimistic about India's equity market in the longer term. A more stable oil price has removed some of the pressure on the currency and on inflation, allowing the Reserve Bank of India to be more accommodating with interest rates. Corporate earnings growth continues at a strong pace which, combined with the lower valuations, creates a positive environment for investors.

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Jason Wright, partner, Apax Global:

Q: What is the outlook for Indian financial stocks in the coming year?

A: Within the Indian financial services universe, we expect private sector lenders such as banks and retail loan focused non-banks to do well. There are three main reasons for this.

First, the outlook for credit growth in India continues to be positive. According to the Reserve Bank of India, banking sector corporate credit recently grew about 14% compared to a 5% annual growth rate in the previous years. Also, retail credit continues to grow at c.17%, something we haven't seen over the past four years.

Second, I expect liquidity concerns for NBFCs [*non-bank financial companies*] to further calm down in the next few months.

Third, private sector players such as NBFCs are expected to gain further market share at the expense of the Indian state-owned banking sector.

Biotech and healthcare

(compare biotech and healthcare funds [here](#))

Paul Major, Daniel Koller and Brett Darke, investment managers, BB Healthcare:

It would be fair to say this has not been a popular rally amongst investment professionals, being unexpected in both its timing and ferocity. Fund flows and other data from the larger banks suggest that many fund managers have been wrongly positioned (i.e. too defensive or under-exposed to equities) and many more too sceptical that fundamentals are actually okay (or that the Orange One can land a trade deal with China, or even keep the US government functioning). Nothing irks more than the missed opportunity to make money. In our case, being a sector-focused public equity fund with a commitment to being low turnover and fully invested, makes such discussions about gross exposure to equities largely moot. With that noted, our decisions to take on more leverage and 'double down' on what we saw as erroneous relative declines in some of our holdings during the November/December period (which readers hopefully recall we telegraphed ahead of time in an 'ad hoc' Factsheet) has worked out well for overall performance. With the delightful certainty that only hindsight can bring, we would like to have concluded our due diligence processes on a couple of additional investments during those turbulent months. Multitudinous opportunities abounded in respect of companies on our watch list, but we are not prepared to cut corners on our investment process and the strength of the market rebound has meant these opportunities were compelling for far less than our intended 3-5 year holding period. Indeed, one does not have to look very far to find SMID healthcare companies that are already up >50% from their Q4 lows.

If there is one forward-looking view that unites the many professional proselytisers, it is that a cessation of trade hostilities between China and the USA will be good for everyone. Nonetheless, Mr Edwards is correct in his ever-present warning that complacency is an investment risk in itself and it is thus always useful to have commentators considering the downside risks.

Our own thoughts on the wider macro-political situation (don't worry – we'll skip Brexit) is that we think that China cannot afford protracted dispute with the US. Whilst the media carps on about the county's inexorable rise as an economic force and desired world hegemony challenging the US-led system that has dominated the post war era, less attention is paid to its worrisome demographics. These predict a rapidly rising elderly dependency ratio for the next 30 years (from ~17% today to ~45% by 2050). For reference, Europe and the USA have been hovering around the 50% level for the past few decades and the Western ratios are expected to peak in the high 60s around the same time that China does (2070). This naturally presumes such forecasts are reliable; in recent years, the ratio has grown faster than anticipated, as the termination of the one child policy in 2015 has failed to alter the trajectory of the falling birth rate. What impact might these factors have on a rapidly growing economy? There is a country that has gone through a very rapid rise in its dependency ratio over a short period of time (from the low 40s in the 1990s to ~70% today) - Japan. Inevitably, people save more as they age and thus the proportion of the population deemed to be active consumers falls as the dependency ratio rises. You don't need an economics degree to appreciate the negative impact of such a trend. We have seen the gradual fiscal drag effect of rising dependency in the West for a long time, with small improvements in real disposable income as pension costs and healthcare eat up GDP growth. In contrast, Japan's economic slowdown since the halcyon 70's has been profound. Its situation was not helped by its lack of natural resources that made it a net importer of raw materials and energy, thus forcing it to balance this through export-driven growth. Does any of this sound familiar and thus applicable to its neighbour only 500km away? China

remains the world's biggest importer of Oil, Iron Ore and Soy and is a net importer of food. Make no mistake; a globalised world dictates that our fates (i.e. East and West) are intertwined inexorably. However, we would agree with those who argue that the Chinese economy has not yet developed (in terms of productivity and the balance between goods and services) to the extent that it can support such a high dependency ratio. As such, it must remain open to the world and, whether China likes it or not, the most important market in any context is still the United States. Finally, let us also remember that Trump is not really in the driving seat of these negotiations (which must be a good thing) and he needs some 'wins' ahead of the 2020 election cycle.

As we noted at the beginning, repetition is an ever-present risk for regular investment updates. The Chinese authorities in the end want the same thing as democratically elected politicians: a contented population who feel their leaders are doing a good job. Healthcare and living standards lie at the centre of this for us all and, as the population ages everywhere, so the journey toward a more efficient and effective healthcare system must continue. China's economy may well be struggling and this may continue even with a trade agreement. Nonetheless, the expansion of its healthcare system is a commitment its government cannot role back on, nor can it alter the healthcare consumption tailwind that the aforementioned demographic patterns will continue to provide. As such, we find ourselves very much back to where we were in September: the equity market has been strong and we are not far off of highs at a time when wider economic data is mixed.

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Investment adviser and manager, Impact Health Partners: The fundamentals of continuing growth in demand, which is not matched by an increased supply of good quality, well-operated residential and nursing care home beds, persist.

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Pedro Gonzalez de Cosio, co-founder and CEO, Pharmakon (investment manager), BioPharma Credit: The life sciences industry is expected to continue to have substantial capital needs during the coming years as the number of products undergoing clinical trials continues to grow. All else being equal, companies seeking to raise capital are generally more receptive to straight debt financing alternatives at times when equity markets are soft, increasing the number and size of fixed-income investment opportunities, and will be more inclined to issue equity or convertible bonds at times when equity markets are strong. A good indicator of the life sciences equity market is the New York Stock Exchange Biotechnology Index ("BTK Index"). While 2017 was a very strong year with the BTK Index rising by 37 per cent., 2018 proved to be much more volatile. Having increased 28 per cent. through September 2018, the BTK Index saw most of those gains disappear during the last quarter, ending 2018 essentially at the same levels as it started the year.

Global equity issuance by life sciences companies during 2018 was \$54.9 billion, a 0.5 per cent. increase from the \$54.6 billion issued during 2017. US issuance of life sciences convertible bonds increased 52.1 per cent. from \$5.5 billion during 2017 to \$8.3 billion in 2018. The BTK index has recovered some gains during the first few weeks of 2019 but is still well below its September 2018 highs. Given this volatility in the equity markets, we anticipate an increased appetite for fixed income as a source of capital in 2019.

Acquisition financing is a very important driver of capital needs in the life sciences industry in general and a key source of investment opportunities. An active M&A market helps drive opportunities for investors such as the Company, as acquiring companies need capital to fund acquisitions. Global life sciences M&A volume during 2018 was

\$270.2 billion, 41.5 per cent. more than the \$190.9 billion witnessed during 2017, driven by an increase in biotech consolidation. Life sciences M&A was robust compared to the broader market, which saw a 13.0 per cent. decline. It is widely believed that this increase in M&A activity was caused by the uncertainty surrounding US tax reform, which was resolved in December 2017. We are encouraged by the number of M&A opportunities that are starting to build up and should lead to a more active market over the coming year.

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Debt

(compare debt funds [here](#))

Norman Crichton, chairman, RM Secured Direct Lending: The current volatility across markets supports the investment strategy. The Board and the Investment Manager have the view that as we move towards the later stages of the economic cycle, investors should favour higher quality secured debt investments which produce a steady income and offer downside protection. Borrowers are also seeking lenders who can provide flexible funding solutions which are tailored to their needs.

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Rupert Dorey, chairman, NB Global Floating Rate Income: We believe that the outlook for 2019 remains relatively attractive for short duration asset classes such as senior secured floating rate loans. The Investment Manager believes that default rates will stay below historical levels and credit quality is expected to remain favourable with the exception of some identifiable areas, such as within the retail sector.

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Neuberger Berman Investment Advisers, manager, NB Global Floating Rate Income:

Market Environment

Market conditions have been impacted by ongoing trade tensions, corporate margin pressures, weak investor demand and more latterly sharply falling oil prices. Third quarter U.S. GDP growth of 3.4% was below the 4.2% expansion in the second quarter. Market fundamentals have remained stable, as leverage continues to decline and interest coverage remains strong. The vast majority of issuers are growing EBITDA, generating free cash flow, and paying down debt. These positive trends more than offset the more aggressive metrics coming out of the new issue market during the first nine months of the year. During the fourth quarter risk-off sentiment prevailed across capital markets as year-end approached, leading to withdrawals of \$14 billion from retail loan funds across the market. This was a reversal from the previous nine months and resulted in an outflow of \$3.1 billion in the U.S. for full year 2018. The pressure on the secondary market dropped the share of performing loans priced at par or higher to less than 1%, from 36% in October and 75% in early 2018. Despite the significant levels of retail fund withdrawals, market liquidity was deeper than in historic risk-off periods, with experienced market participants taking advantage of the ensuing price dislocation. We see this as encouraging evidence that the leveraged loan market has become more sophisticated in recent years, as it has grown in scale. Larger, more liquid loans, which tend to be higher quality, were negatively affected by retail outflow activity. The largest

loans, measured by the LSTA100 Index, returned (4.41%) in the quarter versus the broader LSTA Index which returned (3.45%).

In the U.S., demand for loans was robust, with over \$128 billion of new collateralized loan obligation ("CLO") creation more than offsetting the modest \$3.1 billion of outflows from retail funds. These figures do not take into account demand from pensions, endowments and other institutional investors in separate account format. For comparison, 2017 saw \$118 billion of CLO creation and \$14.1 billion of inflows from retail funds. Although down 13% from 2017, institutional loan issuance was strong at \$436 billion. The mix of issuance was materially different in the most recent period as Mergers & Acquisitions ("M&A")/Leveraged Buyout ("LBO") activity increased while refinancing activity decreased. The increase in M&A/LBO activity led to growth in the loan market, which ended the year at \$1.12 trillion versus \$959 billion one year ago. The average bid ended the year at a healthy 93.84 while the trailing 12-month U.S. default rate was 1.63%, well below its long-term average of approximately 3%.

In Europe, the S&P European Leveraged Loan Index ("ELLI") returned 1.41% for 2018 (all figures exclude currency impact) and the average bid closed the year at 97.3, down from 99.4 at the end of 2017. Demand for loans continued to be strong and CLO issuance totalled €27.3 billion for the year, a new post crisis high for the European market. The par amount outstanding of the ELLI ended the year at €181 billion, an increase from €139bn one year ago. By principal amount, the trailing 12-month default was 0.11% at the end of December, down from 1.11% at the end of 2017.

We have identified three main areas of market weakness that became more prominent in 2018: (i) a pick-up in lower rated issuance, (ii) an increase in deals with smaller junior cushions and (iii) weaker loan documentation. We view this weakness to be primarily concentrated in new deals issued in 2018, and therefore representing a relatively small portion of the overall loan market, which is now \$1.12 trillion in size. Seasoned loan issuers have demonstrated solid financial performance and improved credit metrics and these issuers have relatively conservative credit agreements.

We believe that loans continue to offer an attractive yield with limited duration risk:

Outlook

We believe fundamentals and valuations, coupled with attractive income characteristics, provide investors with an attractive return potential under a slowing economic landscape. While economic growth is expected to slow, we believe the probability of a near term recession is low. Volatility is likely to persist, however we believe valuations for non-investment grade credit compensate investors for modest default risk. Operating performance of underlying issuers has been stable; revenue and EBITDA growth have improved as leverage has plateaued, and refinancing activity has significantly reduced the amount of loans maturing in the near term. The market's performance continues to be susceptible to a variety of factors, however, including uncertainty around government disruptions, including aggressive rhetoric, trade policy, and the overall regulatory environment. Though retail flows were a headwind in the fourth quarter, recent spread widening and higher loan yields may entice investors back into the market. Despite market expectations for more measured Fed rate policy, the current income profile of the loan asset class is attractive relative to other fixed income asset classes.

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Alex Ohlsson, chairman, GCP Asset Backed Income: Market conditions remain supportive. Mainstream lenders that focus on core established asset classes above a minimum scale, continue to be constrained by regulatory capital requirements. These constraints create a gap in the supply of lending.

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David Conlon, manager, GCP Asset Backed Income: The Investment Manager focuses predominantly on secured investments which seek to deliver attractive risk-adjusted returns over the medium to long term. Notwithstanding the ongoing uncertainties surround Brexit the Investment Manager continues to see a pipeline of attractive asset backed investment opportunities with both new and existing borrowers due to mainstream lenders typically focusing on mature asset classes above a minimum scale, and lenders who are constrained by regulatory capital requirements.

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John Hallam, chairman, NB Distressed Debt: In 2018 the distressed debt market remained resilient against a turbulent political and economic environment in the United States, UK and Continental Europe. Despite this macroeconomic backdrop and the public market downturn in the fourth quarter, the broad credit environment held up, led by recovery in the energy and commodity sectors.

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Infrastructure

(compare infrastructure funds [here](#))

Colin Maltby, chairman, BBGI SICAV: Given our exposure to public sector procurement, the Company cannot be immune to political risk. The UK Labour Party has increased its political scrutiny of the Private Finance Initiative (PFI). Despite our view that wholesale nationalisation of all PFI contracts would be difficult for any government to achieve in practice, we continue to monitor the political situation and policy debate.

In his budget speech on 29 October 2018, the Chancellor of the Exchequer stated that the UK Government will end the use of PFI and its successor, PF2, and will not enter into further PFI projects. However, the Chancellor also confirmed that the UK Government will honour all existing commitments to PFI contracts.

Elsewhere, the pipeline for PPP transactions remains strong with Continental Europe, North America and Australia continuing to provide promising construction and operational investment opportunities.....

Duncan Ball, Frank Schramm, co-CEO's, BBGI SICAV: How is the political environment evolving in BBGI's key markets? Generally, the support for private sector investment in public infrastructure via the PPP procurement model remains strong in Continental Europe, North America and Australia. The political pressure to improve public services that assets like ours deliver helps create a positive investment environment for our clients and their end-users.

In the UK, this sentiment was dampened following recent political scrutiny of historical PFI contracts. However, the certainty that our long-term contractual obligations provide has given important reassurance, and despite the UK Government's intention to abolish general PFI/PF2 procurement, all these existing contracts are expected to be honoured. Taking a long-term view, the UK will continue to be an important market for us, but with approximately a third of our assets in the UK, geographical diversification remains a key strategic pillar irrespective of the shorter-term political sentiment of the day.

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Mike Gerrard, chairman, International Public Partnerships: Since the 1980s, models created in the U.K. for the delivery, management and operation of infrastructure have been copied across the world, from privatisation through the Private Finance Initiative ('PFI') and public-private-partnerships more generally, on to more bespoke structures such as that used on the Tideway project [*the London super sewer*].

The market for the type of assets in which the Company invests remains fundamentally strong, with governments and regulators in the countries in which we invest being committed to the principle of long-term private sector investment, as part of an overall toolkit for public infrastructure delivery.

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Claire Long, James Smith, managers (Premier Fund Managers Limited), Premier Global Infrastructure: 2018 was a difficult year, particularly for emerging markets. However, we take assurance from the very strong earnings growth seen across the portfolio. Although the macro headwinds of 2018 still remain, we hope that 2019 will be a year in which the very encouraging micro picture will be rewarded.

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Private equity

(compare private equity funds [here](#))

Tim Breedon OBE, chairman, Apax Global Alpha: Much of the outlook for 2019 will depend on how trade talks between the US and China (and subsequently possibly between the US and Europe) progress. Brexit is just one of a number of political uncertainties worldwide which also have the potential to have an impact on markets and currencies. As such, the economic outlook is harder to predict than in previous periods. It is likely that public-to-private deals will figure more prominently in sourcing private equity deals.

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Ralph Gruss, COO, Apax Partners:

Q: Markets corrected significantly at the end of 2018. What is your outlook for 2019?

A: On the Private Equity side, I would expect public-to-privates to play a larger role going forward than in the past two years. The correction in many public markets allows entry at levels - including take-out premiums - that are lower than in private transactions.

For Derived Investments, the correction opens a larger opportunity set, too. In credit, junior loans and high yield bonds are now easily reaching double digit yields, as both credit spreads and US base rates have increased significantly in the past six months. Overall, this has improved risk- reward profiles and thus we expect to see more attractive deal flow in Derived Debt Investments.

For listed equities, clearly some valuation levels have decreased recently, but the number of risk factors has risen. The trade war between China and the US, Brexit, and political uncertainties in Europe weigh on market sentiment and the macro outlook. The potentially biggest area of risk is China - not just in connection with the trade war but, more importantly, through the economic slowdown and the ever-increasing pile of public and private debt.

While we believe that the number of international risks is substantial, we feel that they are more equity than credit risks - at least in the Western world.

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Hamish Mair, manager, BMO Private Equity: The rise in the price of private equity deals internationally is well documented but, based on the deals done by our investment partners, it does seem possible to find attractively priced companies in the lower mid-market across a range of sectors and geographies. There are several threats to economic growth as we enter the second quarter of 2019.

2018 saw a bullish start to the year, notably in US markets, followed by a correction and return of volatility in February as markets reacted to rising inflation, the prospect of rising interest rates and the threat of increased tariffs. The domestic environment has been dominated by Brexit throughout the year. It was an unnerving and at times volatile end to the year for global equity markets. An emerging global recessionary narrative coupled with Brexit negotiations in the UK, drove most equity indices into bear market territory - the UK AIM and Small-cap indices for example ended the year 22.5% and 14.4% respectively off their 52-week highs. A number of economic indicators have turned sluggish. On quoted markets declines were initially led by the technology sector, however this has now passed on to consumer discretionary and ultimately across all sectors, highlighting growing investor concerns about the state of the UK economy in the run up to Brexit. This negative outlook may continue during 2019 and investors may face continued market volatility until there is greater clarity around the outcome of UK Brexit negotiations and whether the Federal Reserve's implied rate-rise path shallows or even ends.

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Gresham House Management, manager, LMS Capital: We continue to believe there are significant inefficiencies at the smaller end of the market, focusing on established smaller private companies below £50 million enterprise value where there can be less competition for deals and valuations are more attractive. This segment of the market tends to be off radar for venture and early stage funding providers and sub-threshold for mid-market private equity investors, creating an opportunity to generate superior long-term returns.

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Property - UK

(compare UK Property funds [here](#))

Martin Moore, chairman, Secure Income: 2019 has so far seen financial markets rebound but most of the risks remain. For now, the US and China edge towards averting a damaging trade war, but without resolving many of their fundamental differences and there is always a chance that a capricious US President may have a change of heart. Meanwhile, global growth is slowing - indeed we think the catalyst for the stock market recovery can be traced back to the Federal Reserve's decision to suspend further interest rate rises in light of increased global economic uncertainty. In turn we have seen Government bond yields fall, with 10-year gilts yielding 1.2%, and continuation of the challenge faced by UK savers to secure a reasonable income return without going materially up the risk curve. At the same time, inflation protection remains eye-wateringly expensive with the gross redemption yield on 20-year inflation-linked gilts at minus 1.8%.

Whilst the ultimate path of Brexit remains unknown, a delay now seems probable albeit a no-deal Brexit is yet to be ruled out either on 29 March or at some later point. Until agreement is reached uncertainty will prevail, which will continue to suppress economic growth and business investment. Assuming an agreement is eventually reached, we would expect any relief rally to be short-lived as the reality of the much more difficult phase of negotiating new trade terms sinks in and the next chapter in the battle for the Tory leadership commences. The turmoil within both the Conservative and Labour parties has the potential to yield unpredictable outcomes, ranging from an early general election to a much larger schism within either party. Although we can't know how events will unfold, we do hold a clear view that uncertainty is likely to persist in the UK well beyond 29 March and quite possibly for a number of years.

In our view this is likely to perpetuate the "lower for longer" interest rate environment in the UK and the search for yield that has helped underpin the demand for well-let index-linked property assets, even if the US resumes its quantitative tightening. This is reflected in the property market with the demand for well-let index-linked property in defensive sectors remaining intensely competitive with the volume of capital seeking deals well in excess of available investment stock. Indeed, it is not unusual to see investors joining a queue of a year or more to get into dedicated institutional long lease funds. This is at the opposite end of the spectrum from the commercial property retail funds where the liquidity concerns relate to getting money out rather than in, especially if another Brexit shock were to provide a repeat of the 2016 redemptions.

Capital discipline is of paramount importance in a world where competing buyers are often financially incentivised merely to grow assets under management. Large deals are keenly fought over and rarely attractively priced in a highly competitive market.

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Stephen Inglis, CEO of London & Scottish Investments (the manager), Regional REIT: Investment in the UK commercial property market reached £61.8bn in 2018, according to research from Lambert Smith Hampton ("LSH"), 3% higher than 2017 volumes and 4% above the five-year average, resulting in the second largest annual figure in a decade (after 2015). Although investment in the final quarter of 2018 was slightly lower than Q3 2018 volumes, investment in H2 2018 reached £33.6 billion, indicating an increase of 19% when compared to H1 2018, which helped boost overall investment figures for 2018. 2018 proved to be another strong year for investment in portfolio deals, with investment totalling £14.0 billion in 2018, up 3% on 2017. Investment in portfolios was particularly strong in the final quarter of 2018, reaching £4.0 billion, 10% higher than the five-year quarterly average.

Following a strong start to the year, investment in the regional markets continued at pace in the second half of 2018. In the final quarter of 2018, investment volumes in the regions outside of London reached £5.6 billion, up 8% on the previous quarter and 13% above the quarterly average. This brought total investment in the regional markets in 2018 to £21.3 billion, the highest figure recorded since 2006. LSH research notes that annual investment in 2018 was above the average volume in each of the UK's regional markets, with the largest increase in regional investment occurring in the North East and the East Midlands, with 2018 investment volumes 61% and 52% above average, respectively.

The previous evidence of strong regional investment throughout 2018 has been followed by muted investment at the beginning of 2019. The expected pre-Brexit "rush to market" appears to be followed by the expected period of potential investors taking a "wait and see" position. Provisional figures from Property Data shows a sharp decline of 43% in the volume of UK investment deals in the first two months of 2019 when compared to the same period in 2018. Overall, Property Data recorded £4.29 billion of

deals in the first two months of 2019, with the decline in investment volumes more significant in the central London office market. Additionally, data from Calastone reveals that real estate funds saw an outflow of £1.1 billion in the five months ending February 2019.

Overseas investment in the UK property markets accounted for almost half (49%) of total investment in 2018, according to data from CoStar. Despite ongoing uncertainty surrounding Brexit, overseas investors continued to take advantage of favourable exchange rates, with investment in the final quarter of 2018 reaching £8.1 billion, 16% higher than the five-year average. Figures from CoStar indicate that 2018 was a record year for capital inflows from South Korea and Singapore, which helped support overall Far East investment during the year despite a fall in spend from China/Hong Kong. Conversely, North American investors became net sellers in 2018. LSH estimate that total overseas investment for 2018 reached £27.9 billion, 33% higher than the 10-year average.

Research from CBRE indicates that regional offices have outperformed in comparison to central London offices, delivering superior returns of 11.5% in 2018 in comparison to central London office returns of 5.3% - a trend that has been witnessed over the past three years. Outperformance reflected better capital returns (driven by rental growth) as well as rental growth of 2.2% in the regions, which was above the 1.1% witnessed in the Central London office market.

Savills estimates that take-up of office space across nine regional office markets reached 7 million sq. ft., 3% higher than the 6.8 million sq. ft. recorded in 2017, and 25% above the 10-year average. Occupational demand was driven by the public sector, with another strong year of take-up from Central Government

The Asset Manager believes that the current supply/demand dynamics within the regional office markets will remain unchanged and that the lack of supply for prime stock will continue to drive demand for recently refurbished and good quality core and core plus office space in good locations throughout the regional markets.

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Ian McElroy, Tier One Capital (the manager), TOC Property Backed Lending: The investment advisor continues to see a greater balance of risk and return by providing loan facilities to high quality and experienced property development teams in the regions, as opposed to central London. The North East property market also provides protection against a decline in London property markets, as traditionally the region does not see the boom and bust dynamic created by significantly inflated property prices.

Rightmove house price index for January 2019 shows the average price for a property in the North East at £146,492 which is an annual increase of 3.8% from last year and a rise of 5.0% from December 2016. In comparison, the average price for a property in Greater London now stands at £593,972 in January 2019 which is an annual decrease of 1.2% from the previous year and a fall of 3.7% from December 2016.

The North East had also the highest positive house price growth month to month in England and Wales (+1.8%) after the North West (December 2018 to January 2019).

Generally, Rightmove believes that house prices will increase due to the overall lack of supply of housing, the lack of existing stock coming to the market (especially in the north) and the cheap mortgage rates. They do, however, also see house prices falling due to the stretched levels of affordability in some areas of the country (including London), but buyer affordability and sentiment are in more positive territory in the north than in the south. Savills forecasts a 17.6% increase in North East house prices over the next five years (against 14.8% over the UK and only 4.5% in London) believing that

into the second part of the current housing cycle the Midlands and the North of England will outperform London and the South. Again, Zoopla also believes that regional markets will continue to fend off economic uncertainty and provides the most growth in the UK housing sector. London and south-east England are expected to bear the brunt of Brexit in 2019.

The January 2019 RICS UK Residential Market Survey results continue to signal a subdued backdrop, with enquires, sales and new instructions all falling further over the month. In the near term, contributors sense little prospect of a turnaround, as concerns over the potential impact of Brexit continue to cause hesitancy, alongside affordability constraints in parts of the country. That said, while shorter-term sentiment remains downbeat, expectations at the twelve-month horizon are modestly positive. Simon Rubinsohn, RICS chief economist, said, "Sales expectations for the coming three months remain downbeat, both at the national level and across most parts of the UK with expectations negative in 11 of the 12 regions/countries covered. The outlook over the next 12 months is stronger, however, as a headline net balance of +16% of contributors are expecting sales to rise" According to the report, the North East market is performing in line with the other regions, when London and the South East are excluded.

While evidence is starting to emerge of a weakening housing market, driven largely by the headwinds of an uncertain economic future from Brexit, a squeeze on household incomes due to rising consumer prices and increased tax levels, the Investment Adviser has seen no slowdown in investment opportunities and potential deal flow, the quality of which has been maintained. This is largely driven by the continued dearth in lending to small regional housebuilders from traditional lenders [and] a London-centric credit approach from most major lending institutions.

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Tim Attlee, CEO, Empiric Student Property: Student accommodation is one of the largest alternative real estate sectors in the UK, sustained by strong demand for higher education from domestic and international students. However, the market is polarising as students are attracted to the best universities, meaning that we must remain highly selective about the towns and cities we choose to invest in.

Full-time students are the core customers for Purpose Built Student Accommodation ("PBSA"), since they are most likely to study away from home. There are currently around 1.8 million full-time students in the UK. Of these, 77% are from the UK, 7% are from the EU and 16% are non-EU international students (Source: HESA). There are now almost 630,000 PBSA bed spaces in the UK, which means that the majority of students still live in other forms of accommodation such as houses in multiple occupation ("HMOs"). However, the proportion living in PBSA continues to rise strongly, particularly in the private sector which now makes up almost half of the PBSA provision, reflecting the attractiveness of the buildings and the service and amenities they offer.

Applications for university places are an important leading indicator of demand for PBSA. For the 2018/19 academic year, total applications were down 0.6%. This was driven almost entirely by a fall in the number of people making the maximum of five applications to different universities through the main UCAS scheme before the 30th June deadline. The number of students applying to between one and four universities either increased or was stable, as more students chose not to include lower performing universities on their application list. The number of applications to institutions requiring lower grades fell by 6%, while those to mid-tier institutions fell by 3%. Applications to top-tier institutions increased by 1%. Empiric's portfolio is targeted at the higher performing universities, with 65% of our beds in Russell Group university cities.

UCAS data indicates that the UK continues to be an attractive place to study, with the number of applications from EU students in 2018/19 up over 2%, while non-EU international applications were up over 6%. The Migration Advisory Committee published its report on international students in September 2018. It found that international students bring a clear economic benefit to the UK, citing the 2015 Department for Education estimate of £17.6 billion of export value, as well as the 2018 Higher Education Policy Institute/Kaplan International Pathways estimate of £20.3 billion. The report suggested that there should continue to be no cap on the number of international students and although it did not recommend removing international students from the migration statistics, it did suggest a number of small policy changes to make the UK more welcoming to international students.

While trends in applications from UK, EU and international students are important, overall the number of applications remains well above the number of places available at UK universities. In 2018/19, there were 695,565 undergraduate applicants to UK universities and 533,360 acceptances, with the latter falling by just 0.1% compared to the prior year (Source: UCAS). Analysis of acceptances by tier of university also shows the polarisation of the market, with bottom-tier universities struggling to attract more students.

Early applications for the 2019/20 academic year were promising. Most medicine, dentistry and veterinary science courses, and all courses at Oxford and Cambridge universities, required students to apply by October 2018. UCAS statistics show that 65,870 people applied for these courses, up 7% on last year. Applications from UK students were up 9%, non-EU applications students increased by 6% and demand from the EU was little changed from last year.

There was an 11% rise in the number of 18-year-olds from England applying for October deadline courses, despite the population of young people decreasing by 2.1% this year. This decline is part of a long-term demographic trend which will bottom out in 2020, with the number of 18-year-olds rebounding sharply from 2021. This rebound, coupled with higher participation rates, should further increase demand for higher education and PBSA in future years.

The UCAS statistics cited above only consider undergraduate admissions. Since the introduction of postgraduate loans in the UK in 2016/17, the number of placed postgraduates has grown, with a 5.7% increase in the year after their introduction (Source: HESA). This provides an additional source of demand for PBSA.

A concern for the higher education sector is the Augar review; this is currently low on the government's list of priorities and so most likely will be implemented in the next Parliament. The consensus is that the outcome will be a reduction in fees of around 25% (to c.£6,000 per annum for UK students) which should help to bolster the number of applicants, and the reduction in revenue for universities could give them a further incentive to increase their student numbers. Overall the review should be beneficial for PBSA, but the uncertainty until the publication of its conclusions will remain unhelpful.

The supply of PBSA has grown rapidly, with a 24% increase in rooms available nationally in the four years to academic year 2018/19, including a 127% increase in the number of studios.

However, the development pipeline for student accommodation is becoming smaller in some city markets as they mature and other land uses out-compete PBSA, such as build to rent.

Attractive development opportunities remain available but site and city selectivity are key, with the cities that are home to the best-performing universities offering the greatest potential.

In addition, the majority of university towns and cities now have Article 4 Directions in place, which prevent local housing stock being converted into HMOs. This means that in locations with rising demand for student housing, new PBSA will be required to meet it. The outlook for student accommodation in the right locations therefore remains healthy.

Investment demand for PBSA continues to be strong. Large volumes of funds are available for the alternative property sectors as investors turn away from major asset classes such as retail and offices. This demand comes from both UK and international investors. Investment volumes in 2018 are expected to be around £3.2 billion. In contrast to previous high-volume years, this is the result of a larger number of smaller transactions rather than fewer but larger portfolio deals. As a result, portfolios continue to attract premiums but there is now also more liquidity for smaller transactions, as the market has matured.

Investment yields for stabilised assets compressed in the first half of 2018 and were broadly stable in the second half. The level of demand and the tightening of yields make it challenging to acquire standing assets, pointing to a maturing PBSA market.

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Property - Europe

(compare European property funds [here](#))

Investment manager, Starwood European Real Estate Finance Partners: In the Group's other key markets of Spain and Ireland growth remains significantly ahead of the rest of Europe. In Dublin, there is low vacancy in prime office, hotels are running at the top occupancy of all cities in Europe and there is a shortage of residential and student stock. This year the Group has financed the development of new student accommodation in central Dublin, residential housing in commuter areas and one of the largest investments of the year for the Group was a loan made to support the acquisition of an Irish hotel. In Spain, unemployment has continued falling and GDP growth remains strong. In the Madrid market, we are seeing a similar pattern in the real estate metrics with a decreasing vacancy rate and rents increasing from a low base as a result. At this stage, we are able to lend against capital values per square metre which are significantly below the previous peak and which represents a discount to replacement cost.

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Glyn Hirsh, CEO, Raven Property: Local [*Russian*] market conditions are improving. Vacancy rates are down, rents are rising and the overall performance of the Russian economy is strengthening. In our own portfolio we have seen occupancy rise.

Rents have firmed consistently through the year and Moscow rents are now at 3,800 - 4,000 Roubles per sqm for standard space. We expect these rates to continue to improve as demand and supply is out of balance and there are exceptionally low levels of speculative development.

In the meantime, the Russian e-commerce sector continues to develop successfully with some impressive players emerging. We anticipate that they will soon start to make a significant impact on the logistics real estate market.

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Renewable energy

(compare Renewable Energy funds [here](#))

Foresight Group CI, manager, Foresight Solar: At the time of going to print, the outcome of Brexit remains unclear. The energy market in the UK is closely aligned with European markets and this is not expected to change over the long term. As an example, the draft political declaration made in November 2018 sets out a desire to “consider cooperation on carbon pricing by linking a United Kingdom national greenhouse gas emissions trading system with the EUs Emissions Trading System”.

An exit from the EU would likely cause volatility in the energy markets, that volatility in itself could lead to slightly higher electricity prices in the short term. Longer term impacts such as weaker economic demand and the availability of unskilled labour are not deemed material to the future operations of the Company.

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Rónán Murphy, chairman, Greencoat Renewables: The Irish wind market remains very attractive with a stable and supportive regulatory regime. Irish wind farms benefit from up to 15 years of inflation-linked floor prices under the REFIT regime, while allowing wind farms to capture prices above the floor. Wind remains the dominant renewable technology and wind [*is becoming*] an increasing proportion of Ireland's generation mix.

Furthermore, the announcement of RESS, a successor scheme to REFIT, has underpinned the further growth opportunity in the Irish renewables market from 2020 onwards. It is expected that over 13,500GWh per annum of additional renewables (which would represent a doubling of the Irish market) will be auctioned between 2020 and 2026. In addition, Ireland is experiencing a substantial growth in the demand for electricity, particularly from the development of a substantial number of data centres. We expect to see a growing number of large corporate entities seeking to enter into long term PPA arrangements to meet their energy needs.

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Technology

(compare technology and media funds [here](#))

Walter Price, manager, Allianz Technology: Since the end of the reporting period, markets have continued to be unpredictable. The slowdown in global economies (with China particularly under the spotlight) remains a concern and markets continue to be influenced by the latest news flow on the US-China trade conflict, with the prospect of some sort of resolution looking more likely at the time of writing.

Weakening global growth will remain a factor, making 2019 a difficult year for investors to navigate. The Company's Managers expect crosscurrents and some weakness in the first half of the year followed by a stronger second half. Significantly, however, the team continues to believe that a carefully chosen portfolio of technology stocks can continue to deliver positive returns over the long term as it has done in the past. And let us not forget that, while there will always be examples of technology stocks that don't deliver on their promised growth, the technology sector as a whole continues to widen its grip on the global economy.

It was always unlikely that markets would repeat their performance in 2017, which was characterised by low volatility and high returns. However, few were prepared for the onslaught of 2018, where volatility returned forcefully and some of technology's largest names found themselves vulnerable. In spite of apparently synchronised global economic growth at the start of the year, sentiment soon soured and financial markets struggled.

Initially, the US market managed to resist much of this weakness and the technology sector - where companies were still growing earnings - continued its strength. Partly, this was due to the package of corporate tax cuts brought in by the Trump Administration. Companies started to feel the effects on their cash flows early in 2018. US economic activity increased, with Gross Domestic Product (GDP) rising to a peak of 4.2% in the second quarter of the year.

However, the shine wore off as the US trade war with China escalated. Investors were increasingly troubled about the potential repercussions for the global economy and for US manufacturing. The strong Dollar hurt those emerging markets with significant Dollar denominated debt, precipitating currency crises in Argentina and Turkey. Markets wobbled as the international environment looked increasingly unstable. This tipped in October, with markets - and technology stocks in particular - sliding as much as 20%.

While geopolitics has played a role, the recent volatility must be set against a backdrop of higher bond yields. US interest rates rose four times in 2018, quantitative easing was progressively withdrawn in Europe and the UK also saw a rate rise. Only Japan held out. This withdrew liquidity from the system. At the same time, the gap between shorter- and longer dated bonds narrowed, typically a harbinger of imminent recession. It was this, perhaps more than anything else, that ultimately changed the path of markets over the year.

For the technology sector, there was a notable difference between its performance pre-October and post-October. Before October, technology companies had led the S&P 500 to its longest-ever bull run. There were hints of the problems to come - Facebook's data privacy issues, for example - but companies kept delivering on high earnings expectations and they appeared to be a bright spot for growth.

The catalyst for the sharp reversal was not entirely clear. However, it was sudden and dramatic. Over the month of October, the Nasdaq dropped from 8,025 (3 October) to 7,050 (29 October) - a 12% fall. By 24 December, it was another 12% lower at 6,192. With hindsight, the deciding factor appeared to be the weakness in China. Chinese demand is an important source of growth for technology companies and earnings suffered as the US/China trade war hurt Chinese consumer sentiment. This impacted certain sectors more than others. In particular, hardware and semiconductor names saw a rapid sell-off. Robotics names also suffered.

Rising US interest rates also contributed. In raising the discount rate, technology valuations needed to undergo some reappraisal. Future growth was no longer as valuable and this saw some of the highest growth technology names marked lower.

Earnings growth remained strong across the technology sector. In aggregate, growth rates for the sector are expected to be over 20% for the full year 2018. Amazon continued to grow at just under 30% in the third quarter, but guided markets lower for the fourth quarter. Netflix continued to see growth at a similar level. The problem was that high expectations were embedded into share prices. As such, when forward guidance from some key technology names was not as buoyant as anticipated, markets became troubled.

Taking the year as a whole, the technology sector remains one of the few areas to have seen positive returns, albeit with considerable volatility. Technology stocks remain a strong source of growth in a low growth world.

Despite the recent market volatility, our view is that technology is well-positioned to remain a major driver of market returns. The ongoing digital transformation among corporations should continue to drive growth in IT spending. Feedback from our discussions with company management teams, as well as management surveys from multiple sources, indicate that companies across the economy are turning to technology solutions to increase revenue, improve productivity, and enhance operating efficiency. We believe this is a multi-year transition which is still in the very early stages. While the largest technology companies today will inevitably struggle to grow as rapidly in the future, the broad technology sector should continue to see attractive growth in the future. During the sharp sell-off in the fourth quarter, many high-quality technology companies continued to deliver strong operational execution. With more reasonable valuations and less euphoria in the market, we believe high quality companies should exceed expectations and deliver attractive stock returns in 2019.

Although valuations are elevated for some high growth companies, we continue to see massive addressable markets much larger than the revenues today. However, we have consolidated our exposure to these areas in select companies having the most compelling solutions and whose business models demonstrate a discernible path to deliver strong earnings and cash flow growth over the next few years.

We are also finding excellent investment opportunities among more attractively valued areas of technology. In particular, certain technology incumbents are making compelling progress on their "as-a-service" offerings.

Artificial intelligence (AI) is also becoming a significant trend. From consumer goods, such as the Amazon Echo, to autonomous driving, practical applications of AI are emerging. We expect AI will increasingly be used to make our lives more convenient.

We continue to believe the technology sector can provide some of the best absolute and relative return opportunities in the equity markets - especially for bottom-up stock pickers. The growth in technology is coming from the creation of new markets, rather than simply gross domestic product growth. Investors need to find companies generating organic growth by creating new markets or effecting significant change on old markets. Industries such as automobiles, advertising, security, retail, and manufacturing are all being shaped and transformed by advances in technology.

We are seeing an ongoing wave of innovation in the sector that we believe has the potential to produce attractive returns for companies with best-in-class solutions. We also see a number of companies with present valuations that, in our view, do not fully reflect positive company- and/ or industry-specific tailwinds.

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