Economic & Political Roundup

Monthly roundup | Investment companies | November 2021

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A collation of recent insights on markets and economies taken from the comments made by chairs and investment managers of investment companies – have a read and make your own minds up. Please remember that nothing in this note is designed to encourage you to buy or sell any of the companies mentioned.

Exchange rate	31/10/21	Change on month %
GBP / USD	1.3682	1.5
USD / EUR	0.8650	0.1
USD / JPY	113.95	2.4
USD / CHF	0.9161	-1.7
USD / CNY	6.4056	-0.6

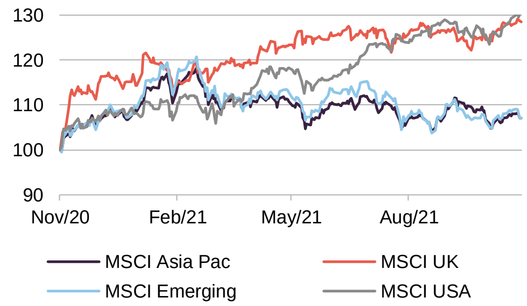
Source: Bloomberg, Marten & Co

Roundup

All eyes remain on vaccination levels across the world and the hope that as they reach more people, countries operating below their capacity can finally catch up and recover. Soaring energy prices continue to rock sentiment closer to home but have of course been good news for commodity and natural resources funds which, after months of underperformance, topped returns in October. Meanwhile in the Far East, investors are still concerned about China's changing regulatory environment, which has had a knock-on effect on the MSCI Asia Pacific and MSCI Emerging Markets indices.

MSCI Indices rebased to 100

Time period 01/11/2020 to 31/10/2021



Source: Bloomberg, Marten & Co

Global

Ben Lofthouse, manager of Henderson International Income, highlights a number of themes that have materialised since COVID, and which could be drivers of ongoing change and investment.

Indicator	31/10/21	Change on month %
Oil (Brent)	84.38	7.5
Gold	1783.38	1.5
US Tsy 10 yr yield	1.5521	4.4
UK Gilt 10 yr yield	1.034	1.2
Bund 10 yr yield	-0.107	-46.5

Source: Bloomberg, Marten & Co

UK

Mercantile managers, Guy Anderson and Anthony Lynch, highlight challenges on the supply-side and a surge in inflation – headwinds which will need to be monitored, as they feel that prolonged disruption could threaten demand and ultimately damage the recovery.

Georgina Brittain and Katen Patel of JPMorgan UK Smaller Companies remain positive on the thesis of a strong UK recovery, heightened by the on-going strength in trading as shown during results season.

QuotedData

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November's highlights

UK (cont.)

Jane Lewis, chair of Invesco Perpetual UK Smaller Companies, says that while uncertainties appear to be lifting and there is greater visibility in how companies are navigating the recovery, changes in operating and economic environments may affect them in ways not yet fully understood.

Asia Pacific

Innovation, technology and entrepreneurship will be key in the Far East

John Russell, chair of Henderson Far East Income, says the post-industrial world in the Far East will be driven by innovation, technology and entrepreneurship, with success depending on entrepreneurial drive, an open-minded population and a strong domestic consumer base.

The managers of Asia Dragon are cautiously optimistic about Asia markets as they think corporate earnings will rebound sharply this year and because government and central bank policies are likely to remain supportive.

The managers of Pacific Assets are less positive, unnerved by the headwinds China currently faces such as a greater government scrutiny and political tensions.

Fidelity Asian Values' manager, Nitin Bajaj, believes that small cap valuations are playing catch up with those of larger stocks and that there is more to go for.

Europe

A pick-up in corporate earnings will be supportive for European smaller companies

TR European's chair, Christopher Casey, believes a global backdrop of increasing GDP and a pick-up in corporate earnings will be supportive for European smaller companies, but cautions that, as growth inevitably slows post the COVID-19 recovery, it would be reasonable to expect more modest returns in the medium term.

James Ross highlights the success of cyclical sectors and companies in the face of the pandemic but anticipates a more balanced environment with the recovery 'adequately priced in'.

Other

We have also included comments on **North America** from Brown Advisory US Smaller Companies; **global emerging markets** from Fidelity Emerging Markets; **Japan** from Baillie Gifford Japan and Schroder Japan Growth; **China** from Baillie Gifford China Growth; **country specialist** from VinaCapital Vietnam Opportunity and Vietnam Holding; **flexible investment** from Schroder BSC Social Impact and JPMorgan Multi-Asset Growth & Income; **growth capital** from Schroder British Opportunities; **commodities & natural resources** from CQS Natural Resources Growth and Income; **private equity** from HarbourVest Global Private Equity and ICG Enterprise; **hedge funds** from Gabelli Merger Plus+; **renewable energy infrastructure** from Bluefield Solar Income and **property** from BMO Real Estate Investments, Target Healthcare REIT, GCP Student Living and PRS REIT.

Global

(compare global funds **here**, **here** and **here**)

Ben Lofthouse, manager of Henderson International Income - 26 October

The period under review has been characterised by a sharp relief rally for equities, triggered by the discovery of Covid vaccines. Generally, the best performing sectors in the market and portfolio were those that benefit most from economic recovery. Whilst the financial services sector has been volatile, the lessons of the financial crisis have been learnt and those companies went into the crisis with strong balance sheets, which has allowed them to emerge from this crisis in a much better position than previous recessions.

Whilst in previous economic cycles the technology sector was at times highly cyclical, it has seen a continuation of the structural demand trends that existed pre-pandemic, and in some cases an acceleration of adoption. We have written before about the increasing structural demand for semiconductors and computer memory (increased data storage and processing, artificial intelligence and, more recently, electric and self-driving vehicle developments) and this theme has continued to drive significant appreciation. A common theme that has stood out in company meetings is that many companies are investing more in technological innovation.

As the result of the pandemic, many countries are still operating below their potential capacity. Hopefully, as vaccines reach more of the world's population, this situation should improve. Government support has meant that employment levels are much higher than expected and appear to have recovered more quickly than during previous recessions. On the face of it, consumers have significant accumulated savings that could be spent. There are some themes materialising in the post Covid world that could be drivers of ongoing change and investment, including onshoring of supply chains, infrastructure plans and electrification of transport. Whilst this consumer and capital investment support might be needed to help offset the withdrawal of government support, we expect the broadening out of growth discussed earlier to be reflected in a narrowing of some of the valuation discrepancies in the market.

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UK

(compare UK funds **here**, **here**, **here** and **here**)

Guy Anderson and Anthony Lynch, managers of Mercantile - 15 October

The first half of this year was in all likelihood the period of most rapid and substantial economic growth that will be experienced in this cycle. This has led to a number of challenges on the supply-side as well as the surge in inflation. These emerging headwinds will need to be monitored, as prolonged disruption could threaten demand and ultimately damage the recovery. In addition, financial markets may also need to contend with changes to monetary and fiscal policy, both of which have been supportive through the pandemic but are likely to be less accommodative in the future.

While we would therefore expect the pace of growth to moderate from this point, barring another substantial demand shock - which could arise as a result of new

COVID variants or as a result of prolonged supply disruption or inflation - we would still expect continued economic expansion.

Despite a number of uncertainties that will forever linger on the horizon and which could always impact the short-term performance of the portfolio, we maintain a positive outlook.

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Georgina Brittain and Katen Patel, managers of JPMorgan UK Smaller Companies - 12 October

To date the economic recovery has been even stronger than we expected, the vaccination roll-out has been impressive, and the British public have shown a willingness to return to a more normal way of life. Government support towards UK companies over the last 18 months has been well designed and we believe this has contributed to the pace of recovery. In addition, current unemployment levels are much lower than feared. Other positives include the strong purchasing managers' data (a good lead indicator), rock bottom interest rates, and the growing propensity of the stalwart UK consumer to spend again. Recent Barclaycard consumer spending data indicated that non-essential spending in August recorded its fourth consecutive month of growth, and was 16% ahead of spending in August 2019. This had been part of our thesis on the roadmap to recovery. UK households significantly increased their savings last year, to the tune of over £150 billion excess savings, and this led us to tilt the portfolio to a significant overweight to the UK domestic economy and the UK consumer in particular.

As a counter to this positivity, first and foremost in all of our minds are the mutating strains of COVID-19, which have seen case numbers rise again in the UK and elsewhere in recent months. However, the link between cases and hospitalisations has decoupled significantly compared to the peak in the UK, due to the 80% of the adult population that have been double-vaccinated. Looking at the most recent statistics, some of the euphoria post lockdowns and Freedom Day has waned, and there have been a few signs of the recovery in the UK economy slowing somewhat. It is our view that this was to be expected. Global and local headwinds are evident, ranging from the current inflationary pressures, both domestically and globally, semi-conductor chip shortages, other supply chain and logistics issues, to the magnitude of the UK's debt, and at some point the inevitable end of Central Banks' asset purchases and the normalisation of interest rates.

While we continue to take these risks into account, our thesis of a strong UK recovery remains intact. We continue to remain very positive on the outlook for our companies and the recent results season demonstrates the on-going strength in current trading that they are enjoying. It is our view that the smaller companies area of the market remains undervalued, despite the very strong rise in the index over the last year. The index is now on a P/E ratio of 14.1 x for 2022. However, median earnings are forecast to grow 18% this year and 19% next as the recovery continues to come through - and we believe this growth is not being fully valued.

Normality beckons, and is coming closer. A stronger economic rebound than expected, a consumer willing to spend, better than expected results from a large number of our portfolio companies, (largely) repaired balance sheets, all provide a strong platform for growth and we expect this to lead to continued strong performance from our companies.

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Jane Lewis, chair of Invesco Perpetual UK Smaller Companies - 12 October

Uncertainties, particularly those relating to Covid-19, appear to be lifting. The UK economic recovery is expected to continue through the second half of the year, however, the strength of gains is unlikely to match those experienced over the recent past. Policy makers now have the difficult task of managing the return to normality, the repayment of debt incurred during the Pandemic while at the same time making sure economic recovery is not stifled.

The current inflationary environment is cause for concern as economic recovery continues and input prices rise. Our Portfolio Managers are watchful as to how this might affect the companies they invest in, as well as any opportunities it creates.

While there is greater visibility, changes in the operating and economic environments may affect investee companies in ways that are not yet fully understood. The Company's diversified portfolio continues to provide shareholders with an investment in good quality businesses which over the longer term should be able to provide attractive total returns and balance the opportunities and risks of investing in UK smaller companies.

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North America

(compare north American funds **here** and **here**)

Managers of Brown Advisory US Smaller Companies - 28 October

We believe the investment environment we currently inhabit is absolutely extraordinary. The unprecedented economic uncertainty of the past 18 months has had an enormous impact on public equity markets. We are fascinated by the "risk-on, risk-off" dynamics, "meme" stocks (whereby stocks have gained viral exposure online, drawing the attention of retail investors), the explosion of the US Federal Reserve's balance sheet, the erratic movement of the 10-year Treasury yield, and the eye-popping headline (and underlying) inflation data being witnessed.

We believe there is no better indicator as to what is happening in the small-cap market of late than the sizeable waves of retail investment in stocks such as AMC Entertainment and others. Their surge corresponded almost perfectly with the broad change in market leadership from high-quality to low-quality in the middle of May. We have seen, or better yet endured, these manic swings over the better part of the last twelve months. Whilst it is less-than-smooth sailing, we still believe economist, professor and investor Benjamin Graham - widely known as the "father of value investing" - was correct. He noted that "in the short term, the market is a voting machine," underscoring the success of firms that are popular versus unpopular. However, in the long term it is a weighing machine, meaning that it assesses the value, substance and worth of a company.

Focusing on high-quality companies is an ever more important consideration amid the deterioration in the overall quality of the small-cap universe. Market dislocations, such as the ones experienced over the past year, can generate an environment that is typically favourable to our style of investing.

Fortunately, it does appear that "quality" may be due for a rebound and we have started to see this trend play out early in the third quarter of 2021. Whether it is sustainable or a temporary direction in our yo-yo market is an open question. It would appear that only time, and possibly inflation, will tell. As Warren Buffett stated in his 1981 'Berkshire Hathaway Letter to Shareholders': "Punishment is inflicted by an inflationary environment upon the owners of the 'bad' businesses". This is one of the many reasons why we believe rigorously following our long-term oriented philosophy and process remain the best route to generating solid risk-adjusted returns over time.

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Asia Pacific

(compare Asia Pacific funds **here**, **here** and **here**)

John Russell, chair of Henderson Far East Income - 29 October

The world can be a puzzling place and a challenge for investors at the best of times. Events over the last few years have been particularly trying, with increased volatility, and uncertainty sometimes leading investors to push the panic button.

The post-industrial world will be driven by innovation, technology and entrepreneurship. Success in this new paradigm requires three preconditions. Firstly, a successful economy must have entrepreneurial drive and best in class technology. Secondly, it must have a population ready and willing to take up new ideas and products and, finally, it must have a strong domestic consumer base.

China is well positioned on all three counts. While some of its technology may have initially been acquired by dubious means, over the past twenty years it has been mostly homegrown. The speed of technology take up is high as visitors to China soon discover. China's consumer base is already enormous and still growing with the urbanisation process continuing.

A recent report from Morgan Stanley forecasts that Chinese consumption will double to US$12.7 trillion per annum by 2030 which is the same as the US today.

There are risks to this apparent nirvana. The decoupling of the global technology supply chain (in particular with the US centred around Huawei) will negatively impact China's development at least in the short run. Property prices are unaffordable for many and developers are over leveraged; some face the prospect of financial failure. With the fertility rate at 1.3, China is facing an ageing population and a rising dependency ratio. This poses risks to economic growth and the government's often stated objective of achieving European standards of living by 2049. Some fear that wealth disparity might lead to social instability. This is reinforced by the astronomical cost of rearing children when measured against middle class income levels.

These problems have been well flagged to investors. The Chinese government has decided now is the time to introduce a more interventionist stance to tackle these problems. This has alarmed investors. However, the private sector will survive and continue to be the main engine of growth, but businesses will have to factor in government policy and work towards its aims rather than against them. This can provide significant opportunities as well as risk because of the clarity of the policy direction and the capacity of the Chinese state to implement its strategies.

China will continue to face pushback from the West particularly from the US due to concerns over its increasing assertiveness, rapidly rising military spending, disregard for the special status of Hong Kong and the stated intention of reunification with Taiwan. Thus, the geopolitical environment will remain tense for the foreseeable future.

From an investor's perspective, the outlook for China and the Asia Pacific remains attractive. The Henderson Far East Income Limited Asia Pacific Dividend Index 2021, which we published in June this year, highlighted the outlook for the two key investment components - profits and dividends - by noting that:

'Since 2010 pre-tax earnings (in Asia Pacific ex Japan) have risen 80% compared to just 2% for the rest of the world driving a significant increase in the region's share of the global profit pie.'

On dividends the report had this to say: *'Looking at income, dividend growth in the region has also been significantly faster than the global average, up 139% over the last 10 years compared to 109% for the rest of the world.'*

China, South Korea and Taiwan have weathered the Covid-19 crisis well whilst south and south east Asia have suffered. But even there the outlook for growth is encouraging. Vietnam, Indonesia, Thailand and the Philippines are benefiting from supply chain adjustments as companies relocate to avoid western sanctions on China.

The strong dividend growth coming from Asia Pacific is well supported by the fundamentals of robust profit growth, cash flow and low net debt. Currently dividend cover is 2.4x compared with 1.6x in the rest of the world.

Asia is where the growth is and will continue to be. As an example of the disparity in growth rates, in 2010 the UK produced 5% of global pre-tax profits while China produced 9%. By 2020 the contribution from the UK declined to just 1% while China contributed 20%.

It is understandable that anxiety about the impact of climate change is widespread and growing. The results of fossil fuel emissions are clear for all to see. What is not clear is the path to the target of 'net zero by 2050', which we are told is necessary in order to limit temperature gains to 1.5 degrees centigrade or near to it. Hopefully, the next UN Climate Change Conference, COP26, to be held in Glasgow in November 2021 will find practical ways forward.

The need for global cooperation on climate change is clear. The US, EU, China and India will have to work together by sharing information and technology and developing solutions that work for all. Different countries are in different stages of development with different energy mixes. China and India combined account for 65% of global thermal coal use while the Asia Pacific region, as a whole, accounts for approximately 80%. The idea that abundant clean energy is available to all at the flick of a switch is unfortunately a fantasy. While a great deal of progress has been made in reducing the cost of alternatives, particularly solar and wind, the roll out takes time. As we can already see from signs in China and India, without sufficient energy the global economy will stall. Economic growth is critical to climate change solutions. It is growth that will supply the trillions of dollars needed to install the necessary infrastructure and undertake experiments with all the other energy alternatives. The right balance needs to be found so it is difficult to understand why some banks, insurance companies and investor groups are using their power to limit coal production. This has just resulted in pushing up the coal price to a new high, increasing costs for all businesses in countries where coal is a large part of the energy mix and lowering economic growth. There is a similar story with oil and gas.

We need properly thought-out solutions, when it is clear that the energy created by fossil fuels is vital to short term stability and will play a significant part in creating the wealth to fund the climate change solution. And we need better leadership on this issue from these institutions.

I believe we have every reason to expect that Asia Pacific will continue to provide ample opportunities for income generating investment.

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Managers of Asia Dragon - 29 October

Looking ahead, we remain cautiously optimistic about Asian markets in spite of the challenging operating environment, including fresh Covid-19 outbreaks caused by the delta variant, the intense regulatory scrutiny in China, and a build-up of inflationary pressures that could precipitate higher interest rates globally.

Notwithstanding these uncertainties, corporate earnings growth across Asia is likely to rebound sharply this year, led by the technology hardware sector. This is due in part to low-base effects, with some estimates as high as 30%. At the same time, government and central bank policies are likely to remain supportive. Notably, the bounce in earnings so far has been confined to the more developed Asian markets, with many developing ones still coming to grips with the latest spikes in Covid infections. But with vaccination rates now accelerating across the region, restrictions should ease gradually as economies re-open. This could help mitigate cost pressures tied to near-term supply chain bottlenecks. It should also make Asian equities appear more attractive vis-à-vis those in developed markets elsewhere as earnings recover further.

In the longer term, the region's growth drivers remain intact. A burgeoning middle class with rising affluence should continue to drive demand across numerous sectors, such as retail , financial services, healthcare and infrastructure.

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Managers of Pacific Assets - 26 October

During the interim period many equities in China became less popular as political headwinds strengthened against certain areas of the economy. Companies falling foul of greater government scrutiny appeared to possess three main characteristics: prominent stewards deemed capable of challenging higher powers; franchises considered to be misaligned with social development; and foreign investors facilitated by American Depositary Receipt (“ADR”) listings and/or corporate structures containing variable interest entities. American listed education companies were sanctioned heavily. Here, it was decreed that profit from the provision of private tuition was incompatible with social development. By prohibiting these companies from making profit the government effectively confiscated the assets. Shareholders lost more than 90% within a few weeks. Outside China, equities in South East Asia were mostly lacklustre.

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Nitin Bajaj, manager of Fidelity Asian Values - 13 October

I think we are seeing the mean-reversion of what happened between 2016 and 2020 when large cap stocks significantly outperformed small cap stocks (especially small cap value stocks). Over the last few years, the valuation differential between large growth stocks and small value stocks had reached an extreme, last seen in the tech bubble of 1999/2000, and we are starting to see this normalise. However, if you look at valuations even now, they remain very bifurcated with many small cap value stocks at significant discounts to large cap companies; so I believe that we may have quite a way to go on this journey.

The biggest risk continues to be the global economic impact of COVID-19 and the level at which the economy will stabilise once government stimulus programmes are withdrawn. We have seen very extreme monetary and fiscal policies over the last few years, and we are in the realm of the unknown. It will be important to stay vigilant and react quickly if the facts change.

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Europe

(compare European funds **here** and **here**)

Christopher Casey, chair of TR European Growth - 14 October

Equity markets and the Company more specifically have had an excellent year as economies bounced back from the darkest days of the Covid-19 pandemic. Our Fund Manager's investment approach - which emphasises the importance of valuation discipline in addition to seeking future growth - has been very beneficial, particularly when the vaccine roll out seemed to have delivered some semblance of normality. Over the summer, concern over Covid-19 variants and a belief that inflation is merely transitory, led to a fall in bond yields.

A global backdrop of increasing GDP and a pick-up in corporate earnings is supportive for European smaller companies. The Fund Manager and I would caution that, as growth inevitably slows post the Covid-19 recovery and the Central Bank liquidity fuelled re-rating wanes, it would be reasonable to expect more modest returns in the medium term.

With the backdrop outlined above and, we think, the heightened risk of inflation in the coming years, we believe the days of stocks trading on ever-higher valuation multiples, justified by no inflation and low bond yields, are coming to an end. Therefore, we remain supportive of our Fund Manager's valuation approach.

The fund management team believes that the growth opportunities offered in the European smaller company space - in areas such as energy transition, companies like Nexans and Friedrich Vorwerk - means that the asset class remains a very attractive investment area with the opportunity to uncover good investments in the years ahead.

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Jamie Ross, manager of Henderson EuroTrust - 11 October

After solid outperformance for a number of years and an especially strong period during the COVID-19 pandemic, this year has seen disappointing relative performance. It is worth pointing out that the relative underperformance all came in the second half of the year, i.e. after we had seen positive efficacy data from the Pfizer vaccine (and vaccines from other companies) and during a period of time when investors were buying companies that they deemed to be “reopening beneficiaries”.

There are many cyclical companies in the index, a majority of which I would be unlikely to own due to my concerns over weak structural features of their business models. A number of these companies have staged extreme recoveries and not owning these companies has been detrimental to performance. A lack of exposure towards areas such as mining, steel, chemicals and capital goods adversely impacted performance relative to the index.

European equity markets have performed exceptionally well since the depths of the COVID-19 crisis. This has created an environment where cyclical companies have fared very well and our investment performance has suffered. I remain confident in my investment process and foresee a market where performance is likely to be a little more balanced; in many cyclical sectors and companies, a strong recovery seems to be at least adequately priced in. I look forward to the next twelve months with confidence and will strive to identify the best investments, maintaining a focus on high quality companies ("Compounders") and those capable of significant improvement ("Improvers").

Global emerging markets

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

Hélène Ploix, chair of Fidelity Emerging Markets - 29 October

We have seen moments of market turbulence caused by China anti-trust laws and regulation and more recently by beleaguered property developer China Evergrande.

China is likely to remain in the spotlight presenting considerable near term risks, however, the new manager's exposure to the most directly impacted areas will be limited.

China Evergrande has amassed significant debts although they have so far been able to stave off collapse and recently averted a costly default with a last-minute bond coupon payment. The impact on the global financial system, should they default, depends to a considerable extent on the response of the Chinese government. Conditions remain precarious across the sector and it remains to be seen how far the Chinese government will be willing to step in to provide stability. Whether they do so or not, there will be significantly less residential construction in China which will result in a negative impact on Chinese GDP.

Beyond China the pandemic has resulted in unprecedented monetary policy; although rates are starting to rise in some emerging markets, Fidelity believes that the developed world will continue with low interest rates.

Emerging markets may have recovered somewhat, but overall, they remain on a wide discount compared to developed markets. This provides good scope to add to high quality stock positions on a selective basis.

Emerging markets have evolved, but commodities continue to play a key role. Today supply constraints are combined with huge stimulus and a transition to a cleaner, greener economy, driving demand up and lending support to prices over the medium to long-term.

The Board is committed to the view that the structural benefits of emerging markets as an asset class remain compelling. It offers the potential for risk reduction through diversification and the prospect of superior economic returns, as emerging countries have higher population growth, and higher per-capita GDP growth with relatively low debt levels, allowing them to outpace the developed world. The emerging markets' rising middle-classes are still getting richer, are still buying more and these countries are investing heavily in their own futures and infrastructure.

Japan

(compare Japan funds **here** and **here**)

Matthew Brett and Praveen Kumar, managers of Baillie Gifford Japan - 27 October

Japan is now making reasonable progress with its vaccination programme, following a slow start, and overall case numbers remain low by global standards. It seems likely that Japan will enter the endemic phase of the coronavirus around the same time as many other developed economies. However, the coronavirus pandemic has been a global issue. For example, many of the suppliers to Japanese companies are based in South-East Asia where there continue, for now, to be significant virus-related problems. Many supply chains are complex and the temporary lack of availability of some parts can have significant knock-on impacts. Also, on the demand side, different parts of the globe have been emerging at varying speeds creating surges in demand for certain products at different times whilst supply is sometimes intermittent. Unsurprisingly this combination is leading to short-term difficulties that may still take some time to resolve. Our meetings with individual companies suggest that many are having to respond by adjusting product schedules, making design modifications, and increasing prices. Capitalism is an effective system for meeting demand but, inevitably, it will take time for all the various problems to be worked through.

Throughout this period corporate Japan has shown admirable resilience, as demonstrated by the continuing increases in dividends being paid by the holdings of your Company. This determination by Japanese management to continue paying dividends is a significant improvement from their actions during the global financial crisis. Coupled with the significant cash positions of many Japanese companies it cements our view that it is quite realistic to expect growth in dividends to exceed growth in earnings, perhaps for another decade.

It is sometimes easier to make long-term predictions than shorter ones. It seems highly likely to us that the novel coronavirus pandemic will fade into being another of the many endemic virus outbreaks that affect humanity. Similarly, it seems highly likely that the current waves of economic disruption that have flowed from it will ebb away over time. However, we do not feel that we can say anything insightful on the detail of the journey to these outcomes.

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Masaki Taketsume, manager of Schroder Japan Growth - 27 October

In yen terms the Japanese market rose by 27.1% across the 12 month period, but the Japanese currency weakened during the year which led to a lower return from the market in sterling terms. Global equity markets were generally strong during the period as investors gained confidence in the post-COVID economic recovery. This environment also provided support for sentiment in the Japanese stock market, despite several short-term negative events in the domestic economy.

In the first half of this 12 month period, investors continued to favour stable growth stocks as the era of zero interest rates was clearly destined to be extended. Stock markets continued to react to global macroeconomic events, together with announcements of stimulus measures, changes in consumer behaviour and vaccine-related news flow. Against this background, investors generally maintained a focus on a relatively narrow group of stocks. Although many markets did see some change in market leadership towards the end of 2020, this effect initially remained very muted in Japan. In addition, small capitalisation stocks in aggregate also lagged the broader market in the early part of the period, with particularly steep underperformance in November 2020.

Moving into the first quarter of 2021, a more meaningful reversal in market leadership in Japan was seen, and a general trend towards stock performance being driven by company specific factors. This has been particularly evident through recent quarterly results announcements, which have seen a high proportion of companies beating expectations.

Throughout the pandemic, Japan has consistently seen a lower infection rate than most developed countries but faced a much more serious test from mid-2021as infections began to rise rapidly. Although the mortality rate remains low, there were growing concerns over hospital capacity. From its previous position of relative strength, Japan found itself in a much clearer race between infection rates and vaccination rates than was anticipated, even a few weeks before.

Public criticism of the government's response therefore ratcheted up again, and the approval rating of Prime Minister Suga and his cabinet declined precipitously. The inconsistencies in government policy were particularly stark in July with successive extensions in the state of emergency, in an attempt to restrict social activity, while simultaneously hosting the Olympic and Paralympic Games. While there is no obvious link between new infections and the Olympics, the mixed messages from the government may have led to a lower level of compliance with social restrictions this time, compared with the previous declarations of states of emergency.

Following the conclusion of the Olympics, a clearer political timetable seemed to emerge, with the ruling Liberal Democratic Party (LDP) announcing its leadership contest would be held on 29 September, to be followed by a general election in October. However, on 3 September, Prime Minister Suga, in a completely unexpected move, announced his intention to resign without contesting the LDP leadership election, which has inevitably led to some short-term political uncertainty.

Although equity investors were still digesting a very positive set of corporate results for the most recent quarter, sentiment was impacted in August by the announcement from Toyota Motor of production cuts over the next two months. This is mainly due to the global shortage of semiconductors. Although not entirely unexpected, the severity of the cuts and the potential impact on the extensive auto supply chain was taken negatively, although little or no impact is expected on Toyota's full year profits. Elsewhere for corporate Japan, order trends and capital expenditure plans look strong, and the initial estimate of GDP has been revised up. Against the global pick-up in inflation, Japan's CPI is currently distorted by significant reductions in mobile phone charges and a change in the base-year used for calculations.

Separate from the noise around economic and political developments, positive changes on structural issues and, in particular, developments in Japanese corporate governance continue. At the end of March 2021, the latest draft of revisions to Japan's Corporate Governance Code were released. The intention is to extend the focus on Board composition and diversity, together with the functioning of Board committees. The revisions also address improved corporate disclosure on ESG issues. These principles were later incorporated into the governance code in mid-2021. Annual updates to the code will continue, which will help to maintain focus on the improvements being seen in governance at the individual company level.

Following the release of corporate results for the fiscal year ending in March 2021, most Japanese companies held their AGMs in late June. The most eagerly anticipated of these was Toshiba, following an independent investigation that concluded the company had colluded with government agencies to restrict the ability of activist shareholders to exercise their votes at previous meetings. In the event, shareholders delivered a stunning blow at the AGM, with the chairman and one director losing their place on the board. Toshiba itself, which is not held in the Company, is now believed to face either a long and difficult period of internal reform and asset sales, or further shareholder pressure to consider some form of private equity buy-out.

These issues within Toshiba may naturally raise some doubts about the real commitment of Japanese management to corporate governance. For investors, however, there are positive aspects to be found in such an unusually high-profile demonstration of shareholder activism in Japan, and in the use of an independent investigation as a catalyst for change.

China

(compare China funds **here**)

Roderick Snell and Sophie Earnshaw, managers of Baillie Gifford China Growth - 13 October

The last six months has been a volatile period for Chinese growth equities. There has been a raft of regulatory announcements that have weighed heavily on market sentiment resulting in valuation multiples contracting across a range of industries. Notable regulatory news includes the following:

- In the US, the Accelerating Holding Foreign Companies Accountable Act was signed by the Senate in June and may effectively reduce the window from 3 years to 2 years whereby Chinese companies who do not allow audit by Public Company Accounting Oversight Board accounting firms are forced to delist from US exchanges.

- In China, the Data Security Law came into effect in June and requires Chinese companies to implement more stringent controls on data or to seek approval before exporting the data overseas if the data pertains to an area of national security.

- The Chinese State Council has opened a period of consultation on Chinese variable interest entities (VIEs).

We believe the regulation above effectively encourages Chinese companies to list domestically, including in Hong Kong, rather than overseas. This has been a long-term aim of the Chinese government. As the Company is agnostic to the listing location of Chinese companies, we do not believe this regulation, taken at face value, is of particular concern. The Company itself has approximately 37% of NAV in VIE companies, including less than 10% of NAV in US ADRs.

More importantly, the Chinese government has again stipulated its desire to tackle the expansion of social and economic inequality, and to slow or even reverse the country's falling birth rate. Over the past two years we have seen increased regulation in the 'new mountains' of healthcare, education and property. This regulation has sought to reduce the principal costs associated with child rearing and the barriers to consumption growth. The State Council's 'Double Reduce Policy' in the education sector (where the Company has no exposure) is the most severe example of increased regulation. In response to inappropriate advertising by education companies, the government has effectively forced a wholesale restructuring of these businesses resulting in a significant cooling of sentiment towards China. This cooling of sentiment has also affected valuations of the big internet platforms. Here, the government continues to work through anti-monopoly probes at a number of these businesses whilst trying to tackle what it terms the 'disorderly expansion of capital'. The market has largely taken these regulatory moves as an attack on the private sector. We disagree and would note that the vast majority of regulation in the internet space has been remarkably sensible. Weeding out practices such as forced supply exclusivity and differential pricing is a positive for the companies we own. It encourages them to double down on what they do best i.e. building platforms that create significant value for all stakeholders.

As such, we remain happy to own companies such as Alibaba and Tencent at modest overweight positions. We continue to believe that, on balance, Alibaba's business is a strong force for good within Chinese society and therefore likely to continue growing over the next decade. Its ecommerce platform has created millions of jobs within China and continues to bring goods and services to the poorest of consumers. With ecommerce penetration below 30%, we think the growth opportunity and returns for shareholders remain sizeable, particularly given the current valuation. Tencent's social media platform, WeChat, remains the de-facto app via which almost all Chinese consumers organise their lives and via which Chinese corporates increasingly connect with their customers, suppliers and other stakeholders. Comparisons with Facebook do not do this business justice. Whilst the market obsesses over regulation which affects less than 10% of Tencent's business (namely restrictions on gaming time spent by under 18s), our attention lies elsewhere.

Out with the internet space, the government continues to show support for sectors which will be key for China's next decade of growth, namely, advanced manufacturing, industrial upgrading and the renewables industry, all of which present sizeable opportunities for long term growth investors. It is here that we are increasingly focusing our investment research.

Baillie Gifford has been investing in China for over two decades. As such, we have experienced numerous regulatory cycles, significant volatility and, at times, painful periods of adjustment. However, whilst investment in China may prove volatile over a short term time horizon, we continue to believe that a combination of a vast and growing domestic market, significant investment in research and development, and private and public equity markets that are poorly understood and very short term, give long-term growth investors like ourselves a real opportunity to generate returns for our shareholders.

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Country specialist

(compare country specialist funds **here**)

Andy Ho, chief investment officer and managing director of VinaCapital Vietnam Opportunity - 26 October

As we enter the second year of the global health pandemic, we remain cautiously optimistic that there are signs of green shoots pointing the way to a recovery. The

Vietnamese economy, while deeply integrated with the global economy which was hit by the ongoing COVID-19 pandemic, nevertheless still showed remarkable resilience posting GDP growth of 2.9% in 2020.

In last year's update, we lauded Vietnam's early efforts to control the COVID-19 outbreak within its borders, which enabled it to re-open its domestic economy within a month of restricted movement orders imposed during April 2020. In fact, we specifically wrote: "…it is important that we view Vietnam's success in containing the pandemic's impact as a commendable short-term achievement, but that the long-term health of the economy requires all nations to have COVID-19 under control and a vaccine to become widely available. This will help significantly to stabilise the economic uncertainty that we are facing today."

Fast forward twelve months and the situation is different. By the end of June 2021, Vietnam had for two months been struggling with a rampant outbreak of the highly contagious Delta-variant of the virus, which caused infection and mortality numbers to increase, and the government re-introduced restricted movement orders similar to those a year earlier. By August 2021, these lockdown measures had escalated, particularly in Ho Chi Minh City ("HCMC"), the economic centre of the south, where overnight citywide curfews and a sharp lockdown of the city extended through to the end of September, saw one of the strictest measures introduced in South-East Asia. The objective is to stop the community spread, while an aggressive vaccination program is rolled out.

As of 1 October, HCMC began to lift many of these strict lockdown measures that were putting a stranglehold on economic growth. Vietnam's GDP contracted by 6.17% during the third quarter of 2021 from a year earlier, the sharpest quarterly decline on record according to Vietnam's General Statistics Office. Importantly, the government has recently acknowledged that Vietnam could no longer pursue a "zero-COVID" strategy and would instead embrace a "new normal" that moves toward living safely with the virus while adopting guidelines that allow for flexibility and effective control of the disease.

Like many other emerging countries, Vietnam is trying to source the appropriate quantum of vaccines whether they be from the USA, Europe, Russia, Cuba and China, to allow society to return to normality or at least live with COVID-19. Vaccination levels across the country have risen, and specifically in HCMC have improved considerably, from close to nil at the start of June 2021 to almost 100% of the adult population having received at least one dose by mid-October 2021 (and almost 80% being fully vaccinated). This gives us confidence that there will be a return to some semblance of normal economic and social activity in the fourth quarter of the calendar year, a welcome relief for all.

While we started the calendar year with a solid 6.5% GDP growth forecast from the government, the disruptions to manufacturing, supply chains and logistics from the extended lockdown has prompted Vietnam's Ministry of Planning and Investment to recently revise their estimates for the country's GDP growth in 2021 to 3-3.5%. We note that this estimate is based on some optimistic assumptions for fourth quarter growth and our in-house research team estimate that achieving last year's 2.9% GDP growth rate may be challenging for 2021. While Vietnam is in a far better place than most countries, we must acknowledge how highly integrated it is with the global economy, as evidenced by one of the highest trade-to-GDP ratios in the world. As a predominantly export-focused economy, Vietnam relies heavily on the stability and growth of other economies like the United States, China, and Europe to sustain its own economic growth in the long term.

The economy, although facing headwinds from the fourth wave of COVID-19 infection, is still showing signs of strength and growth, but there are risks on the horizon for us to keep an eye on. The biggest risk is that Vietnam remains in a state of uncertainty because of the growing COVID-19 communal infection rate and as a result continues to significantly restrict commercial activities and travel. This will certainly dampen GDP growth for 2021 and maybe even 2022.

Vietnam's GDP grew 5.6% year-on-year (y-o-y) during the first half of the calendar year, from January to June 2021, which was quite a strong performance given that the country's fourth COVID outbreak emerged at the end of April 2021, prompting stringent social distancing measures, especially in HCMC.

Three factors supported GDP growth in the first half of this year:

1. Resilient domestic consumption;
2. Strong manufacturing growth; and
3. The base effects caused by the very weak economic conditions at the peak of Vietnam's first COVID outbreak in April 2020.

These factors led to an acceleration in the country's quarterly GDP growth rate from 4.7% y-o-y in 1Q21 to 6.6% in 2Q21 despite the above-mentioned fourth COVID outbreak during 2Q21. However, 3Q21 saw GDP contract by 6.17% y-o-y as the strict lockdown measures that gripped the country severely hampered economic activity. We remain hopeful that the easing of lockdown measures starting 1 October in HCMC will continue to lift nationwide, and as social mobility improves, we will see a recovery in growth.

The current Delta variant COVID outbreak is having a major impact on consumption (~ 66% of GDP), and a modest impact on manufacturing (~20% of GDP), prompting foreign investment banks to revise down their 2021 GDP growth forecasts. Vexing quarantine and social distancing rules continued to bear down on economic activity during August and September, and 3Q21 economic data is shaping up to be disappointing. Nevertheless, a surprisingly strong domestic currency (despite a widening trade deficit) and better-than-expected manufacturing data for 8M21 (vs 8M20) hint at a possible manufacturing-led recovery. Current and new FDI projects continue to flow into Vietnam, notwithstanding some recent negative headlines in the international media regarding the country's handling of the latest COVID outbreak.

Furthermore, vaccination rates have steadily improved, with priority given to HCMC as it continues to aggressively roll-out the first dose of vaccines, with an increasing number of people receiving a second dose. Complementing this vaccine roll-out is the adoption of electronic vaccine passports, which will be useful as part of the reopening strategy. Overall, these measures, while perhaps a little late, seek to restore Vietnam's regional and global competitiveness, and not lag in economic recovery.

Although trade will still be recovering in 2021, Vietnam is expected to remain one of the fastest-growing ASEAN economies over the long term. The country has succeeded in positioning itself as the main low-cost regional alternative to China for export-oriented manufacturing. This should also ensure that investment growth remains strong in the coming years despite current disruptions to supply chain and manufacturing capabilities for low-cost products. Importantly, Vietnam is also expected to continue to gain ground in higher value-added manufacturing, such as electronics. Meanwhile, the country's participation in several major free trade agreements will help to slow the erosion of its competitiveness against other countries in the region in some longer established industries, such as footwear and garment production. This will drive growth in exports and investment throughout the forecast period. Medium-term gross fixed investment will be boosted by government-funded construction of new infrastructure that will be needed to support the expansion of new export-oriented manufacturing industries.

When investing in Vietnam, global investors will look for returns commensurate with the development of the economy and the associated macro and micro risks, while accounting for the limited liquidity available. VOF provides access to investors who seek the best of both worlds - access to a diversified portfolio invested across the capital structure in attractive private and public companies, while offering a highly liquid and substantial London listed investment trust. Furthermore, the active share buyback programme that has been in place since 2011, as well as the Board's commitment to maintain an ongoing, semi-annual dividend pay-out, are other strong differentiators for investors to consider amongst available Vietnam-focused funds.

While the outlook for global stock markets will remain volatile influenced by sluggish economic growth and highly uncertain prospects, we believe that private deal sourcing will be important in generating attractive returns to shareholders.

These are indeed interesting times, but we remain resilient, steadfast, and focused on delivering on our strategy. We believe VOF's medium to long term investment perspective enables us to weather the current challenging environment and, with your support, hopefully we will see brighter days to come. We aim to keep shareholders regularly informed and therefore please refer to our website for further updates.

Vu Thinh and Craig Martin, managers of Vietnam Holding - 1 October

Vietnam's macro performance was outstanding in 2020. The country was one of the few in the world to post positive GDP growth (at around 2.91%), and it outperformed all of its ASEAN neighbours. Having successfully navigated the first waves of COVID-19, Vietnam ended 2020 on a very high note and entered into several noteworthy bilateral and multilateral trade arrangements during the last year. This included free trade agreements with the European Union and the UK, as well as the regional comprehensive economic partnership ("RCEP"). Its economy expanded by 5.64% in the first half of 2021 and GDP growth for the full year of 2021 is forecast to be 3.5% - 4%, almost back on track with its standout 30-year growth record.

The Foreign Direct Investment ("FDI") trend also continues, with more than USD 20bn disbursed in 2020 and a further USD 10bn disbursed in the six months to 30 June 2021. Much of this is for manufacturing export production playing to Vietnam's increasing competitive advantages across several sectors, including garments, agriculture, aquaculture and increasingly more hi-tech. The government is keen to increase the value-added level of Vietnam's manufacturing sector and has already helped cement the country as a leading hub for the manufacture of mobile phones, tablets and lap-top computers. As part of the government's initiatives to be a modern industrialised economy, it is also showing growing support for new technologies, such as Electric Vehicles ("EV"). VinFast, a local car manufacturer, has invested USD 3.5bn in an EV assembly plant. FoxCon, a significant investor in Vietnam for the assembly of components of Apple iPhones and accessories, also has aspirations in the EV space. It is possible that Vietnam could focus on creating hubs of specialised production for these and other growth sectors to complement the areas in which it has built up both capability and scale advantages over many years.

2020 saw a record full year trade surplus of USD 20bn. Exports grew by 28.4% year-on-year ("YoY") in the first six months of 2021, but were eclipsed by the 36.1% YoY increase in imports. This led to a USD 1.47bn trade deficit as at 30 June 2021. The full calendar year is expected to see the country back in surplus mode, even though the Delta wave of COVID-19 has disrupted the country's manufacturing base with ongoing impacts on its supply chains. The country hopes to achieve greater levels of vaccination by September and is focusing on getting two thirds of the population jabbed by the end of 2021. The balance of payments remains strong and the country is forecast to maintain about USD 100bn in foreign reserves by the year-end.

Impact of COVID-19 Delta Variant

Vietnam attracted worldwide attention for its commendable coordination and swift response to limit the spread of the first waves of COVID-19. It successfully curtailed transport with those countries affected, putting people in well-organised quarantine and extending the school holidays with firm and transparent plans. Authorities also were proactive and innovative in the use of traditional and social media to inform the public. As a result, the initial outbreaks of COVID-19 in 2020 were put under tight control.

In April 2021, much of Asia experienced the start of the fourth wave of COVID-19 with the virulent Delta variant spreading rapidly. This time Vietnam was unable to avoid significant levels of infections and has seen cases rise to close to 630,000, with sadly more than 15,000 deaths to date. This is still much lower than countries of similar size in Europe but is a stark reminder of the difficulties in eradicating the threat of COVID-19 until large parts of the world are double vaccinated.

Ho Chi Minh City and Hanoi were put into periods of lockdown, and most of Vietnam's provinces faced disruptions. This has impacted manufacturing capability and factory productivity, with a knock-on effect in the region's supply chains. Unlike the US and the UK, where large volumes of vaccination doses were immediately procured, Vietnam initially had to rely on smaller volumes from COVAX and other direct donations from countries. Nevertheless, in the long-term, it hopes to be self-sufficient in vaccine production with manufacturing under licence and its own home-grown vaccine, which is undergoing late-stage trials. Currently, approximately 30% of the population has been vaccinated, in Ho Chi Minh City more than 90% of the adult population have received one dose, and 11% two doses. For much of the last year Vietnam has put in place strict quarantine measures on incoming travellers. Not only has this severely impacted the country's USD 20bn3 tourism industry, it has also delayed, and in some cases prevented, completion of M&A investments. This was the part of the reason for the delay in the refinancing of our investment in ABA. We do expect M&A to pick up significantly when the quarantine restrictions are eventually eased, though this could be some time away.

Outlook

COVID-19 remains as a significant risk to Vietnam in the short-term, particularly as the vaccination rollout is in the early stages. Increasing numbers of infections will lead to further restrictions that may limit certain activities, curtail industrial productivity and contribute to supply-chain imbalances. International tourism has clearly evaporated over the last year and in recent months domestic tourism has also been significantly impacted. Success in getting a significant part of the population vaccinated will be a key determinant in maintaining rapid economic growth and further boosting domestic consumer confidence, which was very high at the start of 2021 but has deteriorated as the fourth wave took hold in Q2 2021.

We think the stubborn nature of the Delta variant will mean that Q3 and Q4 2021 corporate earnings are inevitably weakened. That said, we expect Vietnam to bounce back strongly in 2022, and think domestic consumption will drive the growth of the economy moving forward. The portfolio in 2022 may be different to that in 2021 in terms of some of the key names and themes, but we are targeting EPS growth of more than 20% across the portfolio and remain committed to maintaining our significantly lower carbon footprint than the equivalent index.

As mentioned in last year's annual report, while our focus remains on industrialisation, urbanisation, and domestic consumption, we also will be eyeing emerging themes coming out of the pandemic, for example, opportunities stemming from shifts in consumer behaviour, rapid digital transformation and Vietnam's fast-growing e-commerce environment.

Flexible investment

(compare flexible investment funds **here**)

Managers of Schroder BSC Social Impact - 26 October

The social issues we set out to address with the Company are as pressing as ever. Although the economic recovery from COVID-19 is under way, the pandemic has exacerbated the underlying structural challenges of UK society. Since the start of the pandemic, people in the lowest pay quintile are more than twice as likely as those in the highest to have lost their job, been furloughed or had hours and pay reduced. NHS waiting lists recently reached 4.7 million people, a 14-year high. At the end of 2020, over 95,000 UK households, including over 121,000 children, were living in temporary accommodation; double the number ten years ago.

Social impact investment, and the areas that we focus on specifically for the Company's portfolio, are one part of the solution to such growing challenges. While we are aware that social impact investment is not a universal solution for social challenges, we are encouraged to see an increasing number of organisations developing investable models that provide successful solutions. There is an expanding universe of opportunities for the Company to make successful investments with a deep impact.

The global impact investing market is made up of diverse investments across a range of asset classes, in both private and publicly listed markets. When the Company was launched, the Global Impact Investing Network had estimated the value of this market at US$715bn.

The Company is exclusively focused on the social impact investment segment in the UK. Over the last decade, this segment has grown significantly, with an annual growth rate of 25 per cent since 2011, the year before Big Society Capital was established. Big Society Capital estimates the total market size has grown from £5.1bn in 2019 to £6.4bn in 2020, an increase of 26% over the year. In late 2020, we estimated, based on underlying market demand and current growth rates, the investable high-impact segment of the UK market would be approximately £10 to £15bn by 2025. From what we have seen so far in 2021, we are confident that this forecast is on track. New funds have come to market and existing ones have raised further capital, because of the coming together of investor demand and an increasing opportunity set of investable high impact enterprises tackling issues such as housing, health & social care and education.

Covid-19's impact on portfolio

The Company's portfolio has shown its structural resilience during the pandemic, with revenue stable and increasing in some areas with increased demand. The Company's investments are helping to tackle significant social issues across the UK, with a substantial proportion of revenues (79%) coming from government sources. The pandemic has exacerbated many social issues and providing solutions has become a political priority. An example was the Everyone In initiative in the early stages of the pandemic, which was designed to help protect rough sleepers from Covid and was supported by emergency government funding. More generally, we have seen revenues increase in response to greater social needs, such as addressing homelessness and domestic violence.

The portfolio's underlying fund managers have actively supported their portfolio companies and worked with regulators and industry bodies to support their resilience in extraordinary times. In particular in the social outcomes contract segment, BSC worked with Bridges and commissioners to convert outcomes contracts to payment on the basis of fee for service, during a period when certain face-to-face services could not be delivered or were being transitioned to remote delivery. This ensured that services for vulnerable beneficiaries could continue at a time when they were most needed, while the organisations delivering those services continued to be paid for their delivery and for adapting their model to a remote setting.

In high-impact housing, revenues for the majority of our portfolio companies are government backed and demand for high-impact housing has remained elevated during the pandemic with stable rents. This contrasts to private rental and commercial real estate, which have experienced high volumes of voids, arrears and rent defaults. The Company's high-impact housing investments are diversified across affordable and social housing for key workers, social rent and homes for vulnerable people, such as asylum seekers, homeless people and women experiencing domestic violence.

Outlook

Looking ahead to 2022, we see continued strong potential. The social impact of the COVID-19 pandemic will take much longer to address than the immediate economic impact of the lockdown measures. The UK government faces a tight fiscal situation, with the Institute for Fiscal Studies saying in July that "the Chancellor is likely to have very little room for manoeuvre in his forthcoming Spending Review". We believe that this fiscal position will make social impact investments a continued important part of the solution, allowing the government to leverage outside capital and deliver services that can create government savings alongside significant social impact.

In addition, wider markets have been affected this year by the increased uncertainty over the future path of inflation. We expect this will make the inflation-linked or inflation-correlated aspect of our approach an even more valuable part of investor portfolios in the coming period.

Within this overall picture of a dynamic and growing market, the Company will remain focused on three specific areas. These are debt for social enterprises, high-impact housing and social outcomes contracts.

These three asset classes were selected to give a diversified set of opportunities that have low correlation, both with one another and with mainstream financial markets. BSC has been investing across these three asset classes since we launched in 2012. There are established models and managers with a track record of delivering high social impact alongside a financial return, whilst also being areas with significant opportunity for future investment. They are also investment areas which are generally inaccessible or present liquidity challenges for most investors.

Katy Thorneycroft and Gareth Witcomb, managers of JPMorgan Multi-Asset Growth & Income - 18 October

Global equity markets rallied in March driven by massive US fiscal stimulus and the success of the vaccine rollout in the US and UK. The USD 1.9 trillion 'Biden Stimulus Package' was signed into law and real GDP in the US accelerated in the first quarter, recording an annualized increase of 6.4%. The Eurozone's economy shrank 0.6% during the first quarter of the year as countries extended lockdowns and restrictions to contain a third wave of infections. With the economic recovery gaining strength, US inflation in April accelerated at its fastest pace in more than 12 years which measured by the consumer price index (CPI)* rose to 5.3% on a year-on-year basis. US private sector firms signalled an unprecedented expansion in business activities with manufacturing and service sectors accelerating on stronger consumer demand.

The earnings season for the first quarter of 2021 was strong as the majority of companies reported earnings growth well ahead of expectations. Eurozone consumer confidence increased in May, beating expectations. In the UK, the labour market indicated strengthening demand and a brighter outlook.

Global equities continued to rally in June supported by an accelerated pace of vaccine rollouts and further re-opening of economies from virus-related restrictions. Though fears of higher interest rates and the more contagious 'Delta strain' of the novel coronavirus affected investor sentiment, markets took solace in the encouraging economic recovery data. The Federal Reserve acknowledged that tapering was now being discussed but reaffirmed the Fed's commitment to maintain asset purchases until substantial further progress has been made towards its inflation and employment goals. In the Eurozone, business activity continued its strong growth and consumer confidence increased. The European Central Bank made no changes to its policy and opted to keep language in its statement around the significantly higher pace of asset purchases relative to the start of the year. In the UK, the labour market continued to improve and the Bank of England kept its policy unchanged.

Global equities extended their strong run of performance in July supported by a strong start to the second-quarter earnings season. We saw volatility in markets as a crackdown on the private tuition market in China rattled the stockmarket there and raised fears of further potential regulatory action in other sectors. As a result, emerging markets, in general, witnessed heightened volatility and selling pressure. The US economy grew at 6.5% in the second quarter, which came in below consensus, but consumer spending growth continued to remain strong. Furthermore, the Fed kept its policy rates unchanged and indicated that the economy was still a good deal away from making substantial further progress towards its inflation and employment goals. In the Eurozone, business activity continued its strong growth as economies continued to open up from Covid-19 related restrictions.

Upward momentum continued in August driven by positive economic data, rising corporate profitability and continued assurance of support from central banks. As pent up demand continued to remain strong for goods and services, the US consumer price index rose 5.4% year-on-year. Additionally, the economy added 943,000 jobs in July, beating expectations and the unemployment rate fell to 5.4%, a new low of the pandemic era. Furthermore, Fed chair, Jerome Powell, indicated that the central bank would continue to be cautious in its approach to tapering its massive pandemic-era stimulus. In the UK, a strong labour market report showed that the economy continues to improve, however, private sector companies continue to report constraints on business activity due to staff shortages and supply chain issues.

Although global growth momentum peaked in the second quarter, strong economic data, policy support and successful vaccine rollout continue to drive fundamentals. While the renewed Covid-19 surge may slow the pace of reopening, it is unlikely to be reversed and the rest of the year should still see a broader recovery across the major developed economies.

Looking ahead, earnings growth should be strong in 2021 but could slow as profit margins come under pressure next year from higher wages, rising commodity prices and increasing corporate taxes. However, for now, a combination of booming demand and surging productivity continues to bolster profits. Though every crisis is different, looking out into the next five years, we expect earnings growth to be substantial, front-loaded and not very dissimilar to the rebound from the global financial crisis. Cyclically geared markets, sectors and companies, which have been in the eye of the storm, are likely to benefit, but it is crucial to differentiate cyclical from structural headwinds and tailwinds as the recovery takes shape. While much of this is priced in, historical experience shows that the potential for growth from a rebounding economy can often be underestimated. While stocks have rallied sharply since the crisis of early 2020, we believe earnings could rise a good bit more.

If there is a concern for equity markets it is understanding how central banks will react to potential further upside surprises on economic growth. We continue to believe that central banks will continue to buy longer dated government bonds, even if purchases are tapered. We expect inflation to remain elevated in 2021 for longer given the rise in commodity prices and ongoing supply side constraints but to return towards target in 2022. As the central banks taper bond purchases, and provided the economy continues on the road to full employment with a winding down of the pandemic, reduced policy uncertainty and still elevated inflation, long-term interest rates should finally move up from extraordinarily low levels. As that occurs, funding for the most speculative investments in financial markets could become harder. This should lead to a compression in valuations, favouring value stocks over growth stocks.

However, we believe that equities should do well in an environment of modestly rising inflation, as rising sales tend to offset higher input prices which can be passed onto customers when demand is strong. We believe that performance across global stockmarkets should mostly follow earnings delivery. The cyclical environment should continue to favour value stocks due to their greater economic exposure and higher operating leverage.

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Hamish Baillie and Duncan MacInnes, managers of Ruffer - 6 October

A new inflationary regime

In previous reports and elsewhere we have argued covid-19 has acted as an accelerant, catapulting the world into a new economic regime. This new regime is characterised by the adoption of more interventionist policies to target explicitly political causes such as climate change or inequality. This blurring of the lines between monetary and fiscal policy will lead to higher economic and inflation volatility and marks a stark contrast to the benign period of the past 40 years.

However, we are currently enjoying an economic boom which may well extend into 2022. What is the recipe? Take one-part unleashed animal spirits as we exit lockdown, mix with accumulated lockdown savings, pour on lashings of stimulus - serve in a supply constrained glass.

The debate du jour is whether the current inflationary spurt we are living through is a symptom of this new economic regime or a transitory hangover from the supply and demand disruptions of the lockdowns. The scale and breadth of the inflationary impulse is stunning.

This is not a US phenomenon: global data is very similar. Wage pressures are everywhere, companies cannot get staff. McDonalds are paying candidates US$50 to attend interviews. Shortages are a key sign of inflation. The US administration has no sympathy for corporates: if you want workers back, pay them more - this is about levelling up and inequality too.

Used car prices, container shipping rates, house prices, hotel rates, the cost of eating out - the trend is clear, and it is up. Yet long term measures of inflation expectations remain anchored, the market is confident this impulse shall recede.

We think this 'transitory debate' misses the point entirely. Of course, house prices will not rise at 10-20% annualised forever. Inflation is simply a measure of the rate of change. If that delicious beer garden pint was £4.50 in 2019 and now it costs £6, it has inflated by 33%. Next year it might cost £6.25. The Bank of England might say "See! Inflation was transitory, it's only 4%, we told you!", but unless wages have risen by 39% since 2019, you should be feeling worse off.

We fully appreciate that due to base effects it is highly likely that as re-opening enthusiasm wanes inflation is likely to be lower next year. Technically, the transitory crew might be correct, but unless the beer reverts to £4.50, we would say it is 1-0 to the inflation hawks in the real world. The price level is what comes out of your pocket not the second derivative.

This is a febrile environment for a wage and demand spiral considering the context of vast ongoing quantitative easing and seemingly endless fiscal stimulus packages.

The big problem is if the inflationary genie is out of the bottle, how might policymakers get it back in?

The textbook response is that the central bank should raise interest rates. Realistically however, this tool is not available to today's cohort of central bankers for multiple reasons. Firstly, the burden of debt in the world is just too great to service at higher interest costs. Secondly, the political pressures to keep financial conditions supportive in aid of activist policy goals such as tackling climate change or inequality have only grown stronger. So, if these inflationary pressures prove more than transitory, we may realise for the first time in a few decades that central bankers are not omnipotent.

What are the portfolio implications of all this? Despite global stock indices finishing the period at all-time highs, bond yields remaining low, credit spreads tight and property prices booming, we must re-emphasise how dangerous we believe the coming environment of inflation and volatility is for conventional portfolios.

Inflation changes the way cross-asset correlations behave. Today, the portfolio role of bonds is spent: their role as a hedge is suspect and they effectively guarantee investors will miss their return targets. Remind me why you own bonds?

We saw a glimpse of the future in Q1 2021 when the 30 year US Treasury, supposedly the safest asset in the world, fell by more than 20% for the first time ever.

Current inflation readings correlate to a US ten year bond yield of 5-6% not the current 1.5%. The evidence is the market is sanguine about any enduring inflation risks.

There is an asymmetry of risk, however. Bonds are a mathematically bounded asset class - returns are certain to be low, a best case of 1.5% over 10 years before any inflation risk. If inflation risks recede, then bond investors will earn a zero or slightly negative after inflation return. If inflation remains elevated, then the risks for bond owners are catastrophic. Heads you don't win much, tails you lose a lot. The US ten year yield moving to just 3% (where it was in 2018) would cause a loss of about 15% to bond holders.

Going further, investment grade credit paradoxically offers record low yields despite record levels of debt outstanding. The mathematics of bonds is such that at lower rates the duration increases. This asset class is vulnerable to even the smallest change in yields in response to a change in inflation, credit or term risk premiums. Just a 1% change in investor's required returns will wipe out seven years of coupon income in capital losses

A note of caution

There are two quotes which keep wandering through our minds.

The first is from nineteenth century titan Lord Rothschild to "buy on the cannons and sell on the trumpets".

One of the great ironies about investing is that the best time to invest in risky assets is when everything seems utterly bleak, like March 2020. A more dangerous time to invest is when everything is going well and it seems obvious. At the end of June 2021, the US market completed seven consecutive days of new all time highs, a feat not completed since the dot.com bubble.

The second quote is Robert Louis Stevenson's accidentally sage investment advice when he acknowledged sometimes "it is better to travel hopefully, than arrive".

Just as the Coinbase IPO marked the recent top in bitcoin, perhaps 'freedom day' will mark the top in markets? That would be delightfully paradoxical. The truth is nobody knows, but we believe caution is warranted.

The Ruffer portfolio was flat when the market was down 30% at the March 2020 lows, we preserved capital in the crisis, and we have made around a 30% return since then. Since November 2020 markets have been pricing in a recovery and re-opening which has yet to fully materialise. There are clearly bubbles of exuberance in the economy and markets, trumpets if you will, that urge prudence and caution.

There is a battle of competing forces. On the one hand we have a spring of economic momentum, government and central bank support for markets and this is all underwritten by a sense that investors earning nothing on cash have no alternative but to invest.

On the other hand, ponder an economy drowning in debt unevenly staggering out of a huge recession with the looming threat of inflation because of a cocktail of supply chain bottlenecks, reduced capacity and trillions of stimulus. And that cocktail, if served up, will be negative for all asset markets.

Growth capital

(compare growth capital funds **here**)

Rory Bateman and Tim Creed, managers of Schroder British Opportunities - 5 October

Recently we have all lived through unprecedented times as the spread of COVID-19 has reached all corners of the globe. After extreme market volatility in early 2020, equity markets made a strong recovery which continued into 2021 as vaccines offered the promise of more normal times ahead. Unfortunately many businesses were unable to survive the pandemic but for many investors the turmoil offered numerous opportunities to invest in great companies at depressed valuations. The UK market was particularly attractive in this regard given negative sentiment around Brexit over recent years had already put UK equities at a discount relative to other global markets.

Given the rapid roll out of vaccines in the first quarter of calendar year 2021, UK consumer confidence grew and despite being in the third lockdown, it was widely believed there would be significant pent up demand in the economy. The market began to price in some recovery in consumer growth companies such as pubs and restaurants, whilst airlines and hotels were less fortunate given ongoing travel restrictions. Meanwhile, UK Purchasing Managers' Index data continued to indicate domestic economic expansion, which was confirmed by the results of companies in the industrial sector in the first half of the calendar year. Materials and labour costs were repetitively cited as headwinds but despite this, a number of companies in the construction and manufacturing sectors were able to increase prices ahead of cost inflation.

Very accommodating monetary and fiscal policy has created an ideal environment for equities as the economic expansion progresses. Foreign investors were quick to notice the economic recovery alongside UK equity valuations which propelled the UK market to one of the best performers in the first half of 2021. Perhaps not surprisingly, the June 2021 Bank of America Merrill Lynch 'Global Fund Manager Survey', showed that allocations to UK equities were at the highest levels since March 2014. The first six months of 2021 saw thirteen buyout bids from private equity firms - the highest figure since 1999, which compared to just four in the same period in 2020 and four in 2019. Meanwhile, the number of companies that listed on the UK stock market continued to be buoyant.

Activity in private equity markets has also been very strong since the time of the IPO in December 2020. We have seen record private equity deal volumes in the UK and are also seeing valuations increase as more capital begins to recognise the value inherent in high quality private equity investments. Deals that had been put on hold in 2020 due to concerns over Brexit and COVID-19 came back strongly as confidence returned. This dynamic was compounded as a different concern began to emerge in relation to potential capital gains tax hikes which inspired more founders and entrepreneurs to consider their options. The number of deals completed in Q1 calendar 2021 were the highest for five years and reflected the fast pace of evolution within the private equity industry in moving to remote due diligence, virtual meetings and digital transactions. The early 2020 phenomenon of private equity managers focusing purely on their existing portfolios transformed into a far more expansive approach to new deals, as healthy firepower and rapidly returning confidence revealed a number of compelling opportunities. We are delighted to have been able to participate in a number of these high quality deals and are excited to be in such a strong position looking forward.

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Commodities & natural resources

(compare Commodities & natural resource funds **here**)

Ian Francis, Keith Watson and Rob Crayfourd, managers of CQS Natural Resources Growth and Income - 27 October

Supply struggling to keep pace with demand surge

Metal prices have benefitted from a release of pent-up demand and a catch-up on deferred work boosted by an increase in consumer spending afforded by a higher savings rate during lockdown. This was aided as working from home became common place and outgoings on services, commuting and holidays were curtailed. Demand was augmented by largescale Covid-19 relief programmes implemented globally and in unison, directed at resource intensive infrastructure programmes with a noticeable tilt towards the green energy transition. In addition to such investment, house sales and home improvements increased worldwide. Even as the balance of consumer spending shifts back towards services, expectations are that infrastructure programs will continue to support demand for resources.

While demand was impacted as economies went through lock-down so was supply with related mine shutdowns, border closures and logistics disruptions all impacting the flow of materials, products and labour. This caused production across most metals to decline. While production is now returning, the recovery in output has lagged booming demand growth and pricing of industrial commodities remains encouraging.

Over the last few years we have previously highlighted the lack of new supply in the pipeline, as shareholders push for dividend returns over expansionary capital expenditure. This is a very powerful tailwind for resources, as supply discipline remains across most parts of the sector. In addition, corporate Environmental, Social and Governance, or ESG matters are also having a significant impact on corporate strategies, requiring companies to thoroughly examine and address any changes necessary to clean-up current operations and ensure sound asset governance at the expense of investing in expansion. This is also relevant in China, where such movement is more socially than shareholder led, as a result of which polluting capacity is being shut or curtailed, effectively reducing domestic supply. This is especially prevalent in smelting, with the likes of energy intensive and predominantly coal powered aluminium amongst one of the most polluting industries.

The environmental theme is perhaps the most powerful trend in commodities today. It is harder than ever to permit a new mine. Of note, China's environmental focus is not driven by a need to win votes over the next election cycle, but by a longer-term drive to the support the general population's health and standard of living. China's prior policies that had focused on growth at any cost are now heavily tilted to cleaning up the environment that their population live in. China has been the factory for the world, but they are now tightening regulations on polluting industry, limiting supply.

These forces are inflationary, for commodities at least. The wider debate on inflation continues, with the US FED claiming these pressures will be largely transitory. To some degree they may be but other aspects are more structural. Transitory drivers include the release of pent-up demand as economies reopen, virus related supply chain disruptions across mining and manufacturing and accommodative and coordinated government stimulus spending. Longer-term drivers focus more on environmental and green energy policies, delays in capacity expansion resulting from under-investment during a near decade long commodity bear market and China's motivation to reduce industrial pollution. These long-term factors are powerful and will continue irrespective of economic conditions. It Is also worth acknowledging that too much inflation in the near-term could be negative for commodities given the potential knock-on effects to the general economy, thus measures to dampen short-term pressures such as the recent release of modest quantities of metals from China's Strategic Reserve Bureau are not unwelcome.

The Drive for Electrification

It is important to differentiate the impact of these factors between commodities. We believe they are particularly positive for the likes of copper, which is key for all forms of electrification. Its properties as an electrical conductor, second only to silver which is prohibitively expensive for general use, with limited alternative substitutes point to an attractive demand growth outlook. Given the lengthening lead time to bring on a newly discovered deposit into production, typically upwards of 10 years, together with a decade of underinvestment, copper market conditions are likely to remain tight and metal prices attractive. Those few groups such as First Quantum or Ero Copper, that have been able to commission or restart new long-life operations during the bear market, which provided a more favourable setting to deliver projects on time and budget given limited competition for construction materials and labour, seem particularly well placed to benefit.

Other commodities such as nickel are often cited as a key inputs for EV batteries, but the fundamentals look notably different. Nickel is currently in a small surplus, whilst its primary source of demand is steel which represents a 90% share of consumption.

Precious metals remain a useful diversifier

Sentiment for gold shifted lower as the global markets focused on post-Covid-19 recovery trades, but there are notable areas of uncertainty. Covid-19 variants so far have not proven excessively resilient to vaccines, but this could change, whilst government borrowing globally has ballooned in order to fund Covid-19 relief programmes, with no clear plan of how we exit this extended period of easy monetary policy. US tapering and ultimately rate rises are now very clearly flagged by the US federal reserve, so arguably priced in. Whilst the market appears to have the US Feds transitory inflation message, the risks of inflation remain clear given current shortages of housing, commodities, gas/ electricity and labour. Inflation driven by supply shortages is bad inflation, and can hurt the global economy which is constructive for gold, given the negative implications to discretionary spend on the global economy. Precious metals remain well positioned as a hedge against this, as rates are ultimately likely to remain historically low, whilst inflation is increasingly a concern.

Outlook

Some banks have been calling for a new super cycle in commodities. We are more cautious on making such claims, but what we can say for sure is that supply looks constrained given years of underinvestment and a continued focus on ESG matters which continues to hinder commodity supply, which tightens markets and supports pricing.

The key question therefore is the level of demand, but absent another global shock the fundamental balances look encouraging. Increased environmental awareness by governments and consumers looks likely to support demand for cleaner energy and electrification while at the same time constraining supply. Continued capex discipline from the major miners is also holding back capacity expansion as they concentrate on investors returns and grapple with tightening regulations on production. Notwithstanding China's moves to cool some commodity prices which it currently views as excessive, such supply side discipline is positive in extending the commodity cycle and also reducing the risk of overexpansion as global demand growth normalises following the rapid recovery.

The recent spike in energy costs is broadly supportive for commodities as supply from smelters is curtailed, whilst commodity intensive investment in the energy transition remains strong, helped by the upcoming COP 26 meeting. Conscious of the broader economic risks this creates, the fund reduced its weighting to copper miners, after a period of strong performance, reallocating more exposure to energy, with a specific focus on gas. We also note this has led to a notable positive sentiment change toward Nuclear as a source of zero carbon power, from investors and governments, supportive for the uranium mining exposure in the fund.

Energy costs are just one input to the current inflationary pressures we are seeing globally. These inflationary pressures more broadly look likely to persist beyond winter, but to what further extent is less clear. Whilst commodities are a major input to these pressures, they also perform well during inflationary periods, given the ability to pass costs through to consumers.

Private equity

(compare private equity funds **here**)

Managers of HarbourVest Global Private Equity - 28 October

The post-COVID-19 recovery has driven a period of strong growth for private markets investors. Developed economies are enjoying an economic rebound, still influenced by policy stimulus. Against this backdrop, while ever mindful of the inflation threat and geopolitical concerns, we believe that the macro picture tilts to the positive, and private markets managers are taking advantage of opportunities to sell and buy actively. Recent exits have been concentrated in the technology sector as managers seek to crystallise value from prescient investments in transformational business models. New investments encompass the next generation of exciting growth companies as well as more mature, traditional businesses with the potential for further development.

Macro Environment

Overall levels of economic activity over the last 12 months have been robust. Rebounding consumer confidence and strong global GDP growth2 have contributed to exceptional earnings performance. While much has been made of the risks this growth could create for inflation, the majority of commentators believe that recent spikes are transitory and will moderate through 2022 and 2023.

For most developed markets, double-dose COVID-19 vaccine rates have risen, weakening the link between infections, hospitalisations and fatalities. Political polarisation remains a concern, and 2021 is no exception, with US/China tension a recurring theme. We note, however, that although the IMF expects growth rates to slow following the dramatic rebound seen this year, GDP in the US and Europe is forecast to grow in 2022 at more than twice the rate it did in 2019, with developing markets growing faster still.2 While all this suggests that underlying positive economic momentum should remain with us in 2022, we also note broader macroeconomic pressures remain, such as elevated inflation and developments in China, and we continue to monitor these.

Private Markets

The last six months have been among the busiest periods - across fundraising, investing, and liquidity - that many private markets managers can recall.

Exits in the first half of 2021 in value terms are already almost 75% of the total amount generated for the whole of 2020. In turn, this remarkable liquidity has helped underpin strong fundraising activity. In the first half of 2021, managers globally had raised 70% of the totals achieved for all of 2020. Europe has grown the fastest, with its share of the global fundraising market having almost doubled from 11% in H1 2020 to 21% in H1 of 2021. We also note that the time between fundraisings is compressing: from 2014 to 2020 we experienced a General Partner ("GP") fundraising cycle time of approximately 3.2 years; in the last 18 months that has decreased to 1.9 years.

Finally, turning to investing, 2021 investment levels are up by "only" 50% in the first half of 2021 compared with 2020 - perhaps in part influenced by the pricing environment - with no geography changing its relative share. One notable dynamic is the dominance of venture; H1 2020 versus H1 2021 has shown significant increases in venture's share of the market across fundraising, investment and exit value.

These trends can be seen clearly elsewhere in this report, as HVPE has benefitted from venture's notably strong performance over the period.

While we have seen robust gains in the public markets this year, private equity continues to outperform across all regions.3 Asia, and in particular China, remains attractive in HarbourVest's view. While regulatory flux remains a challenge, the key in navigating this region is proximity - to policy makers, entrepreneurs and of course to leading managers. HarbourVest is well placed due to its strong and growing presence in the region.

Conclusion and Outlook

Private equity as an industry has consistently proved that it can adapt to changing macro conditions and provide a diverse range of attractive investment opportunities. This is reflected in the evolving sector make-up of the industry over time. Before the Global Financial Crisis, consumer-related businesses dominated the asset class, but today technology represents the largest exposure globally. COVID-19 has served as a trend accelerator, and technology has swept across all aspects of business - not just venture - and we believe this is likely to be a real driver of future investment and returns.

As companies stay private for longer, we believe the private equity model remains attractive and robust. Managers continue to evolve and adapt to the changing environment, identifying opportunities to create value in new ways while also deploying tried-and-tested techniques

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Jane Tufnell, chair of ICG Enterprise - 5 October

The backdrop for private equity investments has been strong during the first half of the year despite continued fall-out from the COVID-19 pandemic and other macro uncertainties. We experienced a record period of deal activity globally, both in terms of deal value and volume. Performance dispersion between sectors continued, with the leisure and travel sectors still heavily impacted by government restrictions. Technology, healthcare, and other more defensive sectors on the whole continued to perform well.

As we look to the second half of the financial year and beyond, significant macro uncertainties persist and, in some cases, are increasing. However, our investment strategy is clear, our track record continues to grow and our Portfolio is robust.

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Hedge funds

(compare hedge funds **here**)

Managers of Gabelli Merger Plus+ - 15 October

Global deal merger and acquisition ("M&A") activity totalled $3.6 trillion in 2020, a 5% year over year decline driven by shutdowns related to COVID-19. However, in the second half of the year, the first half of the Company's fiscal year, merger activity recovered substantially and totalled $2.3 trillion, as countries began phased re-openings and governments instituted accommodative monetary and fiscal policies, marking the strongest second half on record and a 90% increase over the first half of the year. The first half of 2021 saw M&A total $2.8 trillion, a year over year increase of 131% and the best start to a year on record. The second quarter alone saw $1.6 trillion in deals and marked the fourth consecutive quarter to pass $1 trillion. The total number of deals worldwide increased to an all-time high, including twenty-seven deals greater than $10 billion, compared to just 13 in the first half of 2020.

The resurgence of deal activity was largely driven by United States-based targets, which saw $1.3 trillion in deal activity through 30 June 2021, an increase of 249% year over year. Cross-border M&A activity totalled $863 billion during the first half of 2021, an increase of 95% and a three-year high. Similarly, the value of private equity-backed buyouts hit an all-time high of $533 billion, an increase of 76% year over year, accounting for nearly 18% of total M&A activity.

Geographically, during the second half of 2020, Europe and Asia Pacific were bright spots for M&A, increasing 36% and 16% respectively, while deal making in the U.S. declined by 21% to $1.4 trillion as COVID-19 battered major U.S. cities. In the first half of 2021, European M&A tallied $581 billion of transactions, an increase of 39%. Asia Pacific saw an 84% increase, while Japan saw a 12% increase in the first half of the year.

Viewed by sector, deal making in Technology buoyed the overall M&A market in 2020, with volumes totaling $684.3 billion, an all-time high. Financials and Energy & Power were the second and third most active sectors, respectively, accounting for 26% of all deal making. In the first half of 2021, the Technology sector was again the biggest contributor to merger activity, with deals totaling $672 billion, more than triple 2020 levels and accounting for nearly 24% of total announced deal volume. Financials and the Energy and Power sectors were also large contributors, each accounting for 11% of M&A activity.

Renewable energy infrastructure

(compare renewables funds **here**)

John Rennocks, chair of Bluefield Solar Income - 5 October

Power Prices and BREXIT Impact

From the historic lows seen in Q2 2020, as the UK Government placed the country into a nationwide lockdown in response to the Covid-19 pandemic, power prices rose steadily during the second half of 2020 (increasing from £24.18/MWh in April 2020 to £54.98MWh in December 2020).

This increase in pricing has not only accelerated during H1 2021 across both day ahead (£79.21 per MWh in June 2021) and season ahead (Winter 21 baseload reached highs of £95.35 per MWh) and continues to rise at the time of writing.

This increase in baseload pricing from December 2020 has been driven by a combination of factors; easing of national and international restrictions, rising carbon pricing (which returned to pre pandemic levels) and increasing gas prices as re-opening the global economy has coincided with extended outages in the UK on both nuclear and fossil-fuelled generating stations, as well below average winter temperatures.

On 24 December 2020 the UK and EU finally reached a post-Brexit trade deal, one week before the end of the transition period. Whilst the deal provides a framework for future energy market relations between the UK and EU, Great Britain will no longer be part of the Internal Energy Market ("IEM"), and some uncertainty remains over the future of GB carbon pricing and cross border electricity trading across interconnectors.

Whilst plans are in place to develop models to address both of these issues and GB carbon pricing has broadly tracked that of the EU during 2021, the lack of certainty in the short term has led to increased volatility in day ahead and intraday power prices.

At the time of writing, it is clear that the UK economy is experiencing inflationary pressures and that, in the short term, RPI is likely to exceed the 3% level which is embedded in our financial forecasts. Economic commentators are divided on whether this will be a short-lived phenomenon, or whether higher inflation will endure for some time.

Looking beyond the near term and out over the next 20 years, whilst de-carbonisation is expected to drive an increase in demand for electricity, medium to long term power price predictions have been lowered (from predictions in June 2020 and December 2020) as forecasters continue to predict that, despite rising demand for electricity, pricing will be suppressed by falling commodity prices and increased renewable generation post-2030.

Property

(compare UK property funds **here**)

Peter Lowe, investment adviser to BMO Real Estate Investments – 22 October

The UK property market delivered robust returns over the third quarter, with investor sentiment continuing to improve. There was some stabilisation in fortunes for the previously unfavoured areas of the market accompanied by a continuation of the encouraging performance from the more resilient, namely the industrial, logistics, retail warehousing and supermarket subsectors. While headwinds remain in the form of inflationary pressures, staffing shortages and supply chain issues, the expectation of further yield compression and the potential for income growth from selected sectors offer a positive outlook for much of the market.

As the UK's return to the office takes shape, occupational take-up and investment volumes continue to improve. There is however a note of caution with the recovery as yet centred on London and the core cities, with some asset types facing continued uncertainty as occupiers redefine their real estate requirements.

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Target Fund Managers, investment manager to Target Healthcare REIT – 20 October

As [COVID] restrictions eased later in 2020 we saw [investment] activity pick-up, with pricing continuing to respond to significant investment demand in what is a competitive market for the type of assets we acquire and hold. We did not see many acquisition opportunities reflecting distressed circumstances as the sector traded robustly, and would expect sales processes for assets whose trading has been significantly affected by COVID-19 to delay until resident occupancy recovers towards normalised levels.

As well as demand from the typical domestic investors, the main change we have noted in the year has been an uptick in activity from European investors, these are generally larger and less specialist healthcare real estate investors whose home markets are saturated and lower-yielding. Their initial forays were into poorer quality real estate, by way of portfolio acquisitions in recent years, though they are currently more active in their pursuit of the real estate we have been advocating for as fit-for-purpose.

None of this is a surprise in a market where only 28% of beds meet our quality standards, and which needs substantial modernisation overall. The non-cyclical nature of returns, which are still relatively high-yielding, make the investment desirable for the income investor. Whilst we welcome new capital to support development of real estate and operator growth, we would argue that specialist knowledge and a committed long-term holder would be characteristics of the suitable investor.

Occupancy has been depressed from normal levels in the past 18 months, not necessarily through unusually high deaths, but through lack of admissions as families sought to keep their loved ones at home. Many families found more time to care due to furlough and working from home. As lockdowns dissipate and furloughs come to an end, occupancy is on the rise again, for what is a "needs-based" service. We anticipate steady increases as homes cautiously admit new residents in small numbers, ensuring people settle into their new homes with adequate staffing and care plans effected.

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Gravis Capital Management, investment manager to GCP Student Living – 19 October

Applications and acceptances for higher education courses in the UK were at record levels for the 2020/21 academic year. UCAS end-of-cycle data for the 2020/21 academic year showed that 570,475 students had accepted places onto higher education courses in the UK, representing a year-on-year increase on pre-pandemic levels of 5.4%. This growth has been driven by a year on year increase in acceptances of 16.9% for non EU international students to 52,755 and a 4.5% increase in domestic students to 485,400. The number of EU students has also increased by 1.7% to 32,320. The increase in acceptances for domestic students has, in part, been underpinned by record entry rates of 18-year-olds into higher education.

Looking forward, UCAS clearing data published on 7 September 2021 relating to acceptances for the upcoming 2021/22 academic year shows a further increase in students placed onto higher education courses in the UK with a year-on year increase of 5% for non-EU international students. The effect of Brexit is impacting student numbers from the EU due to the obligation to now pay international student rates rather than domestic, with acceptances falling by 56%.

The UCAS data above supports the Investment Manager's view that students will continue to invest in their education and enrol on courses to further their future employment prospects. The continued rise in the number of applications from non-EU international students suggests that students remain willing to travel to study abroad in order to obtain qualifications delivered in the English language and are making applications on the basis that they will do so. However, with the continued global impact on travel caused by the COVID-19 pandemic and the effect of Brexit on student movement from the EU, there remains considerable uncertainty on occupancy levels for at least one further academic year and possibly beyond.

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Sigma PRS Management, investment adviser to PRS REIT – 12 October

The delivery of new homes in the last reported period of 2019/20 fell short of the annual government target of 300,000 homes by 80,000, with 220,000 new build completions in the year. Due to the coronavirus pandemic, it is not anticipated that this shortfall will have been rectified during 2020/21. The supply of rented properties has also reduced following tighter regulation and increased tax burdens, which caused large outflows from the 'Buy-to-let' sector. According to Savills, in 2010, 78% of landlords in the private rented sector owned more than one property, but by 2018, this had reduced to 45%. Latest research by Savills reveals that the number of buy to let mortgage redemptions has reached 180,000 since 2017, suggesting further supply side pressure in the sector.

With the average home in the UK now a multiple of 7.7 times gross average salary (2020), the choices available to those who are too economically active to qualify for affordable housing, but without sufficient savings to pay for a minimum deposit (including to qualify for Help to Buy), are increasingly limited. The Build-to-Rent (BTR) sector can absorb some of this demand, although currently there are only 62,000 operational homes and just 39,500 under construction.

BTR currently accounts for just 2% of all private rented homes in the UK, which when compared to 45% in the US and 55% in Germany, indicates the potential growth in the market. Savills estimates that the sector could expand to nearer £550bn at full maturity.

The UK market continues to focus on high-density flatted developments in city centre locations whilst the PRS REIT has maintained its focus on regional family homes. The relevance of the PRS REIT's housing model has been brought into sharp relief this year with COVID-19 and home-working causing tenants to rethink their space requirements and the need for private outdoor space.

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