INVESTOR

Economic & Political Roundup

Monthly roundup | Investment companies | January 2022

Kindly sponsored by Allianz

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	31/12/21	Change on month %
GBP / USD	1.3532	1.8
USD / EUR	0.8793	-0.3
USD / JPY	115.08	1.7
USD / CHF	0.9129	-0.7
USD / CNY	6.3561	-0.1

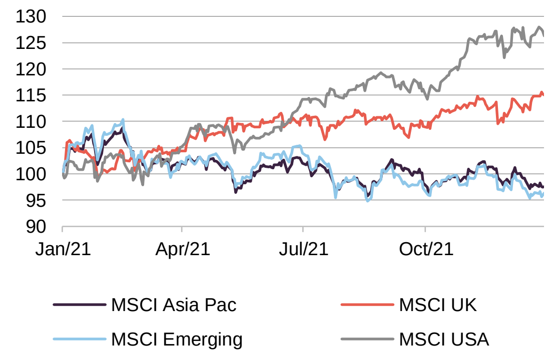
Source: Bloomberg, Marten & Co

Roundup

The arrival of Omicron – the latest COVID-19 variant – to wrap up what was already a tough year for many, saw further restrictions and lockdowns enforced in December across the world. While this had a knock-on effect on some markets, this was much smaller than previously seen in the face of new variants – perhaps because the shock factor is no longer applicable two years on since the virus was first discovered, or maybe because consumer spending has been high in the run-up to the holiday period and New Year celebrations. The good news is that this variant appears to be milder than its predecessors and with more than 60% of the world having received at least one dose of vaccine (according to Our World In Data), perhaps the end is in sight. This may provide a brief respite in market volatility but concerns over supply chains, inflation and rising interest rates promise 2022 certainly won't be dull.

MSCI Indices rebased to 100

Time period 01/01/2021 to 31/12/2021



Source: Bloomberg, Marten & Co

Global highlights

End of the year, but no end to concerns

Alasdair McKinnon, manager of Scottish Investment Trust, notes that investors have become concerned that economic stimulus could be scaled back due to increasing inflation.

The chair of Majedie also believes inflation is the biggest question on investors' minds at the moment.

Manager of BMO Global Smaller Companies, Peter Ewins, highlights ongoing supply chain challenges as a result of the surge in demand.

Indicator	31/12/21	Change on month %
Oil (Brent)	77.78	10.2
Gold	1829.2	3.1
US Tsy 10 yr yield	1.5101	4.6
UK Gilt 10 yr yield	0.971	20.0
Bund 10 yr yield	-0.182	-48.1

Source: Bloomberg, Marten & Co

QuotedData
BY MARTEN & Co

Contents

Analysts

Jayna Rana
jr@martendandco.com
James Carthew
jc@martenandco.com
Matthew Read
mr@martenandco.com
Richard Williams
rw@martendandco.com

December's highlights

Global (cont.)

Signs suggest markets are becoming fundamentals-led

Securities Trust of Scotland manager, James Harries, believes interest rates cannot rise too much as there is simply too much debt.

Henry Strutt, chair of Edinburgh Worldwide, says there are now signs that markets are becoming more fundamentals-led rather than momentum driven.

The team at Monks says the pandemic has triggered an avalanche of change and that there will be structural consequences not yet fully understood or appreciated.

UK

The managers of Artemis Alpha highlight the themes which have influenced the macroeconomic environment over some of 2021.

Miton UK Microcap's managers mull the lack of institutional interest in microcap stocks.

Mark White, chair of Aberdeen Standard Equity Income says a number of uncertainties remain on the horizon, from new COVID-19 variants to energy shortages.

Ultra-low interest rates may turn around as inflationary pressures build

The managers of Lowland think the era of ultra-low interest rates might be ending as inflationary pressures build.

Gresham House Strategic (now Rockwood Realisation) manager, Laurence Hulse, says monetary policy failure remains a key market risk and which could mean increased volatility over the next year.

BMO UK High Income chair, John Evans, highlights the uncertain macro background created by central banks scaling back support.

Asia Pacific

The chair of Aberdeen New Dawn remains positive on the long-term prospects for Asia, and says the region is now home to innovative businesses at the forefront of emergent trends.

Cost pressures are causing a concern in some parts of Asia

The managers of Schroder AsiaPacific note lack of supply combined with rising costs in some parts of Asia, therefore increasing cost pressures for certain companies.

The JPMorgan Asia Growth & Income team say the biggest opportunities – as well as the biggest risks – over the next 12 months lie in China.

Renewable Energy Infrastructure

SDCL Energy Efficiency Income chair, Tony Roper, explains why the US is one of the largest and most dynamic markets for investment in clean energy and energy efficiency.

Jonathan Parr of Triple Point Energy Efficiency Infrastructure says it is a good time to be investing in energy efficiency projects with increasing government support and the drive towards net-zero.

Other

We have also included comments on **Europe** from JPMorgan European Discovery and Henderson European Focus; **Japan** from JPMorgan Japan Small Cap Growth & Income and JPMorgan Japanese; **China** from JPMorgan China Growth and Income; **India** from JPMorgan Indian; **flexible investment** from MIGO Global Opportunities, Aberdeen Diversified Income and Growth and Momentum Multi-Asset Value **biotechnology & healthcare** from Polar Capital Global Healthcare; **environmental** from Jupiter Green; **technology & media** from Polar Capital Technology; **private equity** from Seed Innovations; **debt** from Henderson Diversified Income; **leasing** from Amedeo Air Four Plus and Doric Nimrod Air Two; **Infrastructure** from GCP Infrastructure; and **property** from Ediston Property Investment Company, Civitas Social Housing, Residential Secure Income, Tritax EuroBox, Schroder European REIT and Industrials REIT.

Global

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

Alasdair McKinnon, manager of Scottish Investment Trust - 20 December

This year represented a microcosm of the longer term fortunes of our [*value-style*] investment strategy. Relative to wider markets our results were not as strong as we would have hoped, although the portfolio did record an absolute gain. Our holdings enjoyed a brief but notable period of strong returns as confidence built in the prospects for 'reopening' which raised our hopes of a sustained turn in market leadership. We have applied our contrarian philosophy consistently over the last five years in the belief that, when cycles ultimately change, it would prove rewarding. However, we were, once again, left jilted at the metaphorical altar as the prospects for economic growth slowed in the summer.

The scale of economic stimulus remained extraordinary but investors became concerned that this stimulus was likely to be scaled back due to a pronounced pick up in the rate of inflation. A wall of money has been created which had been largely confined to speculative activities but has now clearly filtered into the 'real' world. How this issue is addressed will have an important bearing on markets in future years.

. . . .

R David C Henderson, chair of Majedie - 14 December

In the aftermath of the pandemic and its consequences, opinions on the Global economy vary in the extreme. The most obvious questions relate to Inflation: muted for 20 years, but it is now rising and there is considerable debate whether this is of a transient nature or the beginning of something more persistent. Interest rates remain at historically low levels but are expected to rise.

. . . .

Peter Ewins, manager of BMO Global Smaller Companies - 14 December

The last financial year was heavily influenced by news in relation to the pandemic, with sector leadership changing as investors sought to factor in the latest news in relation to it. The gradual lifting of restrictions in the main developed economies earlier in 2021 led to a strong recovery in stocks that had been hit hardest in the early stages of the crisis. Market performance in the new financial year has to an extent reverted to a more normal fashion, with less focus on the pandemic and more on company specific news-flow, which in many ways is a relief. There was something of a reverse in sentiment towards the most speculative growth stocks in the markets, with investors becoming more discerning around valuations, perhaps in part due to higher long term market interest rates; this is something we welcome too.

Better than expected corporate earnings came through over the summer as the global economy accelerated, with higher profits not surprisingly welcomed by stock market investors. Consumer spending surged as some of the savings accrued during 2020 were spent. Real estate and housing markets were further boosted by interest rates remaining close to zero in most places. Fiscal policy up to this point continued to be supportive as governments have sought to support the recovery and lift spending on core priority areas locally, with the US administration recently having passed a 1.2 trillion dollar package for infrastructure investment.

Less positively, progressively more companies have been impacted by supply chain challenges as a result of the surge in demand with, for example, automotive sector suppliers early casualties of this in dealing with a shortage of key semiconductor components. A sharp rise in the cost of gas, electricity and a range of other commodities, started to exert pressure on profit margins, contributing to the pick-up in inflation. In addition, labour shortages in certain sectors including transportation and food are also creating challenges for individual companies.

Geo-political tensions between the US, China and Russia persist, while the UK/EU relationship too remains fractious to say the least. Investors appear to be treating these spats sanguinely for now, seemingly having more of an eye on the outlook for monetary policy given the evidently increased inflationary pressures. Companies perceived to lack pricing power in the present environment are falling out of favour given this backdrop.

Stock markets have started the financial year well, supported by the global economic recovery and corporate earnings rebound. With inflation hitting multi-year highs, looking forward, investors need to consider the potential risk to equity valuations from tighter monetary policy, especially in the US. It seems likely however, that interest rates will remain very low compared to prevailing rates of inflation in the main developed markets, providing support for the case to continue to hold on to high quality equities. Having said this, the recent acceleration in Covid case numbers in Europe, the emergence of a new variant of the virus in South Africa and reimposed restrictions are clearly unwelcome developments ahead of the Christmas period.

While recent supply chain and logistical issues are causing disruption to the operations of some businesses, we remain encouraged by the performance of most of the companies in the portfolio. Demonstrating effective cost management and the ability to move up pricing will be important drivers in the near term for company management teams.

. . . .

James Harries, manager of Securities Trust of Scotland - 13 December

We live in a world where income is scarce and valuations across capital markets are rich, implying low expected returns and putting capital at risk of material, if not permanent, loss. Further technological and, increasingly, environmental disruption is undermining many businesses which historically were fertile ground for income investing but which we believe should now be avoided.

This combination of scarce income and low expected returns means Troy's focus on absolute returns and the quality of the underlying businesses in which we invest is more important than ever. We are acutely aware that many of our underlying investors have irreplaceable capital and are dependent, in part, on the income we provide. They are keen to avoid substantial drawdowns.

Our concerns relate to such things as a better competing product, a loss of a patent, a lack of visibility or certainty of demand, regulatory risk if not priced in, underinvestment, an insufficient focus on returns on capital and poor management incentives or capital allocation.

Equally, there are other factors that we worry less about such as tracking error - or positioning and performance relative to a benchmark, missing out on the latest fad or short term macro-economic or speculative noise.

We do however consider the overall valuation of markets which themselves can impact on the prospects for particular businesses as well as, of course, expected returns.

The jury is still out as to whether the trauma and related policy response of COVID-19 has kickstarted a new cycle rather than extended the current one. Our view is given that we have not seen a credit event we are still in the same cycle that started in 2008/9 and continues to this day. Our relative performance tends to be best at times of stress and we may need to wait until this cycle completes to fully demonstrate the value of our approach.

Inflation has also become a concern. We are keeping an open mind as to whether or not these worries are misplaced. We acknowledge that demand is currently strong driven by both policy and pockets of pent-up spending at a time when supply is struggling to respond. Balanced against this are the structural factors that have kept inflation low. These have intensified; debt levels have exploded, populations have aged further and technological disruption continues apace.

It is impossible to know the outcome of this complex conundrum. As such we are not managing the portfolio based upon an inflation forecast.

What we can be more convinced about is that interest rates cannot rise too much as there is simply too much debt. This leaves us with two possible outcomes. Either inflation dissipates or it remains persistent, but in both cases interest rates remain low. In the first instance, as supply disruptions normalise and inflation expectations peak, input costs will likely moderate. This will benefit our portfolio

In the second instance, if inflation is more persistent, but interest rates remain low, we will face an ongoing negative real interest rate environment (as inflation continues to exceed the level of interest rates). This favours an index-linked security or, dare I say it, a portfolio of high quality businesses that will likely be able to raise prices over the longer term.

This ability to raise prices stems from the same competitive advantages that allow for high returns on capital. In this scenario we believe that we are once again well placed. Although many of the sorts of businesses in which we invest are considered nominal bond proxies, in the sense that over short periods they are correlated with interest rates, over the longer term they are much more akin to an index-linked bond.

. . . .

Henry Strutt, chair of Edinburgh Worldwide - 10 December

Markets continued to rise notably until the tail end of the first quarter of 2021 and subsequently declined due in part to concerns regarding future inflation and dislocated supply, largely as a result of Covid-19 and the measures put in place to curb its impact on businesses. More recently, market sentiment has been pushed and pulled by attempts at 'normality' against a backdrop of new virus variants and a Chinese regulatory clampdown. However, there are now signs that markets are becoming more fundamentals-led rather than momentum driven.

. . . .

Managers of Monks - 7 December

The pandemic has triggered an avalanche of change and we believe that there will be structural consequences we do not yet fully understand or appreciate. Innovation is speeding up and spreading across the economy. In this regard, we believe that we are closer to the beginning of this process than the end. We embrace this change - accepting that growth in revenues, earnings and cash flows can be delivered in different ways.

. . . .

UK

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

John Dodd and Kartik Kumar, managers of Artemis Alpha - 16 December

The macroeconomic environment during the six months under review was influenced by the following factors:

- Inflation - rising energy costs and mismatches in the labour market have created shortages and higher-than-expected inflation. Although some factors are proving transitory, uncertainty remains over the persistency of higher inflation.
- Interest rates - strong economies and supply-side bottlenecks have brought forward expectations for interest-rate rises with the potential to impact asset prices and consumer incomes. Central bankers have (so far) demonstrated reluctance to act.
- Pandemic - the Delta variant delayed the reopening of many economies and caused disruption to supply chains and labour mobility. Booster roll-outs and the embracing of "endemic" policies suggest that economies remain on a path towards normality.
- Chinese economy - slowed due to the adoption of 'zero-Covid' policies and a regulatory shift that has had an impact on a number of sectors, including real-estate and technology.
- Corporate profitability - has remained strong; robust demand has been an enabler of pricing power and efficiency improvements have offset higher costs.

It was a challenging six-month period for performance. Overall, we believe the portfolio is well-positioned with its mix of exposure to beneficiaries of reopening, UK consumption plays, structural growth plays and idiosyncratic recovery stories. Together, we think they trade at a significant discount to their intrinsic value.

. . . .

Gervais Williams and Martin Turner, managers of Miton UK Microcap - 14 December

Prior to a sustained period of globalisation, returns on mainstream stock markets were not very different from that of underlying inflation. At this time, institutions often included a capital allocation into UK-quoted small and microcaps because of the commercial pressures to access the premium returns they offered.

During the period of globalisation, asset returns of all kinds have been widespread, so institutional allocations into quoted small and microcap stocks have been crowded out by larger weightings in assets such as US technology. Indeed, over recent decades most quoted microcap stock markets around the world have been closed for lack of institutional interest.

In contrast to others, the UK government has sustained the support for a quoted small and microcap exchange via dedicated tax exemptions, as quoted microcaps often generate additional skilled employment and increased productivity, which ultimately contribute to additional tax take for the Exchequer.

Generally, we believe that the prospects for the UK economy may not differ much from other developed economies. The UK stock exchange however, differs from others in having retained a vibrant universe of UK quoted microcaps with all the advantages this has brought, particularly in the decades prior to globalisation. It is worth noting that, even now, the number of listed stocks with a market capitalisation of less than £150m is not dissimilar to the number of stocks with market capitalisations above this metric. If ultra-low yields on bonds and renewed inflation depress prospective returns on mainstream assets, then the strong returns on quoted microcaps can be expected to lead to renewed interest from institutional investors.

. . . .

Mark White, chair of Aberdeen Standard Equity Income - 10 December

This time last year we had only just received news of the successful vaccine trials that offered the prospect of an eventual return to more normal life. A year on, we have seen tremendous strides in this direction with the vaccine rollout in the UK representing one of the Government's successes in their response to the pandemic.

A number of major uncertainties remain. On the one hand, there is the possibility that new variants will set back the recovery while on the other there is concern that strong demand in the face of supply side constraints and energy shortages will cause more permanent inflationary conditions.

. . . .

James Henderson and Laura Foll, managers of Lowland - 8 December

There are large structural changes happening in the economy. The move away from fossil fuels, the changes in work practices brought about by COVID and the long-term consequences of the UK leaving the EU will lead to fundamental changes in the UK economy. For companies these changes present both challenges and opportunities. It is a very exciting time to observe business models being rethought. As investors in this time of extreme change we need to keep with a relatively long list of diverse holdings in large, medium and small companies. The speed of change is such that some companies will fail to adapt fast enough, while others will grow into substantial businesses if they are supplying excellent and required goods or services.

As well as the large structural changes, the era of ultra-low interest rates might be ending as inflationary pressures build. For instance, the move to a lower carbon economy will require substantial investment across much of the economy. During this period there will be transitional costs as new technologies reach commercial scale. These inflationary pressures will be a challenge for economic policy makers for the foreseeable future. The companies that succeed in a period of rising inflation are those that have a differentiated offering that allows them to increase prices, so as to counter supply price increases and preserve margins. Companies that can do this are a very good hedge against inflation.

Laurence Hulse, manager of Gresham House Strategic (now Rockwood Realisation) - 8 December

The interim reporting period was a tale of two halves for equity markets. Indices coursed higher through the second quarter of 2021 as they further re-calibrated to earnings expectations, valuations and Covid-19 government policy, reflecting the truly unprecedented scale of fiscal stimulus, ease of monetary conditions and how well economies reacted to the crisis. 18 months ago, it would have been remarkable to expect record equity valuations and for the UK to witness, more or less, a full return to normality thanks to the successes of the vaccination programme. Markets entered the third quarter gravitating around three key themes: material GDP growth, 'transitory' inflation, and ever-supportive central banks, extending the clear direction of markets and sentiment.

However, over the summer genuine concerns emerged from a chorus of respected economists and market participants about an increased monetary policy failure risk, and this is a view the team sympathised with. The transitory versus systemic inflation debate and central banks' responses is the key theme that will have implications for equity markets for the rest of 2021 and beyond. This narrative, combined with current record measures for manufacturing, purchasing and other macroeconomic metrics leave us cautious about how the next year for equities will compare to the previous year. Indeed, equity markets meandered through the third quarter of 2021 as expectations for earnings, inflation and monetary policy diverged, ending the quarter on a weak note. This was despite record breaking levels of M&A driving up the ratings of various targets and their peers. We have previously commented on the remarkable position of markets and macroeconomics vs. the depths of the pandemic. The third quarter certainly saw cause for moderation which was reflected in equity markets. It was particularly notable to see supply side issues feeding through to domestic and global energy markets and some of the first rate-hikes or 'taper talk' at various central banks.

We remain of the belief that monetary policy failure remains a key market risk and our caution over the next year (now nine months) for equities as there is certainly potential for increased volatility. Value is increasingly hard to find but, we believe, company forecasting is now in uncharted waters and that ought to provide our active small cap strategy with further pipeline opportunities in the months ahead as supply issues bite - we have previously discussed the inflationary blind spot facing companies.

John Evans, chair of BMO UK High Income - 2 December

Stock markets anticipated the economic recovery from the dislocation caused by the COVID-19 pandemic and this was reflected in the high capital returns generated by markets in the second half of calendar year 2020 and in the first half of 2021. The recent period has seen focus shift to the issues created by a rapid resurgence of industrial and commercial activity around the world. This coupled with the added confusion of Brexit related issues has, in the UK, been reflected in much publicised supply bottlenecks, rapidly rising energy prices, inflation reaching recent high levels and much speculation about interest rates rising from all-time lows.

In addition, the need for Central Banks around the world to scale back the level of support provided via the various forms of Quantitative Easing creates an uncertain macro background.

The rate of inflation in the UK and in most developed economies is challenging, not least because it remains unclear as to whether this is a short-term factor caused by shortages, or the beginnings of a prolonged spell of price adjustment. Policy response to these scenarios would be different and as yet unclear- a further cause of uncertainty.

Overarching all of these economic and market developments is the fact that the course of the pandemic remains uncertain and the virus has the capacity continually to surprise. The course of the economic recovery is likely to be smoother than that of stock markets. Set against this is the evidence of a strong recovery in corporate profits and with it, dividends.

Asia Pacific

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

Donald Workman, chair of Aberdeen New Dawn - 16 December

Over the period under review, the coronavirus pandemic remained very present. With an uneven vaccine rollout, the spread of the Delta strain of the virus hit parts of Asia especially hard. India suffered a devastating wave, with daily cases exceeding 400,000 at its peak. Previous virus-management exemplars, including Australia, New Zealand, Singapore and Vietnam, were forced to backpedal, re-introducing more stringent restrictions as infections spiked. Some governments also drew on experience from earlier phases of the pandemic, imposing more nuanced measures that lessened the economic fallout. Although the situation had begun to stabilise, with the help of faster inoculation rates, concerns have grown again following the emergence of the Omicron variant.

In addition to the resurgence of Covid-19, inflation was another issue that influenced the market. Broadly, global price pressures increased due to higher energy costs and worsening production chain bottlenecks, amid widely spread disruption to labour, manufacturing and logistics. In response, major central banks began to move away from the loose monetary policies that had positively impacted asset prices. Notably, the US Federal Reserve signalled that it would slow its asset purchases, with interest rate increases expected from 2022. In Asia, South Korea and Singapore have already tightened their monetary policies. Fortunately, inflationary pressures in other parts of the region still look fairly benign. Other central banks are, therefore, keeping borrowing costs low for now to support the economic recovery.

A third theme fuelling market volatility was the series of regulatory developments in China. Starting with internet platforms, these rule changes swiftly widened out to other areas, including education, gaming and online entertainment. The authorities imposed fines on Alibaba and Meituan Dianping with fines for alleged breaches of anti-monopoly rules, and ordered private tutoring providers to become non-profit enterprises. Compounding these issues were growing worries that property group Evergrande's potential debt default would cause contagion across the real estate sector. Ultimately, the Investment Manager believes that the policy changes should be viewed within the context of Beijing's desire to push "common prosperity". This includes alleviating income inequality by encouraging socially-responsible businesses, fairer competition and more wealth-redistributive policies. If executed well, the campaign could create a broader-based consumer-led economy, while encouraging more sustainable development over the long term.

Just as the world seemed to be turning a corner on the pandemic, the discovery of the new Omicron variant underscores the fragility of the situation. The news has impacted financial markets, while many countries are already re-imposing restrictions. Whilst the situation is worrying, , vaccination rates today are far higher than when the Delta variant surfaced, which should help keep severe case counts low. Moreover, in Asia, most governments are evolving their strategies and are starting to treat Covid-19 as just another endemic disease. This should support a further easing of curbs and the cautious resumption of cross-border travel, which will strengthen the economic recovery and boost corporate earnings.

China's changing regulatory landscape will likely be an overhang for markets there for some time. However, the government will be sensitive to the need to support the economy, given signs that growth may be moderating. Meanwhile, the country's ongoing tensions with the US will further drive its push towards self-sufficiency, especially in high-tech areas, such as semiconductors, indicating that investing in China still presents tremendous opportunities. Segments that are closely aligned to key policy goals, which include domestic consumption, green technology and healthcare, should be well-positioned for long-term growth, despite the near-term uncertainties.

More broadly, the long-term appeal of Asia's investment landscape is undimmed. Dynamic and increasingly affluent populations can be expected to drive demand for a range of products, services and infrastructure. The region is now home to innovative businesses at the forefront of emergent trends, including cloud computing, fintech, electric vehicles, block chain and more advanced virtual reality technologies. Investing in quality companies remains a sound way to access these exciting opportunities.

....

Abbas Barkhordar and Richard Sennitt, managers of Schroder AsiaPacific - 9 December

Equity markets made strong progress through the latter part of 2020 and the start of 2021, buoyed by improving earnings revisions, expectations of greater fiscal stimulus following the US elections, strong liquidity, a weakening dollar and progress on the development of a number of vaccines for COVID-19. However, in the second half of the period Asian markets lagged global markets. This was in large part due to a significant increase in regulatory announcements coming out of China. Further outbreaks of COVID-19 across the region added to volatility given the relatively low levels of vaccinations compared to some Western economies.

The divergence of returns across the regional markets continued to be high with technology-heavy Korea and Taiwan both up strongly over the period, benefiting from upward earnings revisions driven by ongoing strong export demand for semiconductors and technology products. India though was the top performing market as it recovered from the severe first wave of COVID-19. Easy monetary policy and the announcement of some structural reforms in areas such as the labour market helped boost investor sentiment with both foreign investors and retail shareholders increasing market participation. Domestic cyclical and interest rate sensitive sectors such as materials, industrials, real estate and financials performed particularly well. Singapore also performed solidly, aided by a strong recovery in the financial and real estate sectors.

Of the larger markets, China was the clear underperformer. The market was unsettled by a marked increase in new regulations introduced including as part of President Xi's focus on 'Common Prosperity'. These initiatives are designed, in part, to help address growing inequality by rebalancing the benefits of economic growth towards labour and smaller businesses and reducing basic costs for the working population. Although the biggest market impact was felt by the internet names, the number of sectors covered by policy announcements expanded to include education, gaming and property, which led to a broad-based sell-off.

Smaller ASEAN markets continued to lag for most of the period, hampered by concerns over further outbreaks of COVID-19, given their relatively low vaccination rates. However these markets started to do better towards the end of the period in response to higher vaccination rates and improved prospects for reopening.

Sector returns across the region also diverged widely, in part reflecting the recovery in growth seen globally. More economically-sensitive sectors such as materials, information technology, and industrials as well as some financials did well. Although some of the defensive stocks in sectors such as healthcare and staples did lag, towards the end of the period we did see some of the more thematic growth stocks do well as people questioned whether global growth had peaked. The consumer discretionary sector was the worst performing sector in large part due to its heavy weighting in some of the Chinese e-commerce names which were at the forefront of new regulatory announcements.

Outlook

Asian markets have lagged global ones over the last year. In part this has been driven by what's going on in China both from a regulatory and economic perspective. Regulatory announcements have accelerated to encompass more and more areas of the economy with the mention of 'common prosperity' becoming increasingly common in speeches and the press. This is being driven by concerns over growing inequality being seen across China, where growth may have all but eliminated 'extreme poverty', but the spoils of that growth are not being shared equally. Many of the measures that have been announced are looking to address this and in particular rebalance the benefits of growth towards labour and smaller businesses and reduce the 'costs' of property, education and healthcare for ordinary people. Although many of these objectives are understandable, for us as investors, the increased regulatory uncertainty makes it harder to assess the future returns that a business can potentially make and, therefore, what valuation we should attach to it. Although we don't believe that the authorities are seeking to eliminate the profitability of the private sector or indeed stop foreign investment into China, it does leave us circumspect in our approach there until we get greater clarity. We are of course still looking for new opportunities that are relatively unaffected by the regulatory changes but have been unfairly caught up in its fallout.

Outside of regulation in China there continue to be concerns over the indebtedness of some property companies, especially the residential developer Evergrande. Given the closed capital account and that the state effectively controls the banks and state owned developers, we believe the issue is manageable. However, policy error remains a risk given the importance of an already slowing property market to GDP and that, unlike many other countries, China has been deliberately keeping policy relatively tight post the COVID-19 crisis. Therefore, given China's economy is slowing, we would expect to see some easing going forward.

Elsewhere in the region there continue to be signs of shortages and rising costs, so a company's ability to pass through cost pressures is key. With price rises being seen globally in many areas, the question of whether inflation will be transitory or more structural remains and it is likely that we see renewed concerns over tightening and tapering going forward. Although most economies in Asia remain better placed than in 2013 when we last saw a prolonged tapering episode, and corporate balance sheets are generally strong versus other regions, valuations in some 'high growth' areas may come under scrutiny. Perhaps the biggest risk of rising prices, especially energy costs, is that they have a greater impact on consumer spending than currently expected thus reducing demand for Asian products. In the information technology sector we continue to see some strong long term drivers for growth around digitisation and the roll out of 5G and 'Internet of Things', but in the near term some areas have disproportionately benefited from increased demand for product in areas such as work from home.

Whilst vaccination rates for many Asian countries have lagged those of the likes of the UK, we have more recently seen rates increase materially and in some cases surpass that of the UK. This hopefully will allow economies to increasingly open up as we go into next year which, aside from the humanitarian benefit, should reduce the number of lockdowns and lost output as well as bringing benefits to countries more dependent on tourism, such as Thailand.

To conclude, markets have recovered materially from their COVID-19 lows in part due to the recovery that has been seen in global growth. So although markets are trading above their long-term average aggregate historic valuations this premium has come down reflecting the fact that earnings have been revised up significantly during the course of 2021.

In the near term we believe further upside to the market is relatively limited owing to the ongoing regulatory overhang, where valuations sit and given we are at or close to maximum monetary and fiscal accommodation. However, this remains at an aggregate level and when we, as an active stock picker, look across the different industries and sectors there is a much wider range of valuations on offer, as well as a number of companies with attractive growth prospects.

Ayaz Ebrahim and Robert Lloyd, managers of JPMorgan Asia Growth & Income - 7 December

The fiscal year under review proved to be a volatile period, but Asian equities ended the year higher. Economic conditions proved comparatively resilient across Asia, and investor sentiment continued to improve, spurred on by hopes that the recovery is gathering momentum. GDP growth has recovered rapidly from 2020's pandemic-induced slowdown, when most countries posted contractions in economic activity. China was the notable exception, recording GDP growth of 2.3% during 2020.

China and Hong Kong were the centre of attention at the end of calendar year 2020 and during the first quarter of 2021, where domestic Chinese investors' demand for offshore, Hong Kong-listed H shares drove the market to new highs. Onshore Chinese investors purchased record amounts of Hong Kong Dollar issued names under the Stock Connect scheme, a collaboration between the Shanghai, Shenzhen and Hong Kong stock exchanges which facilitates trading across these markets. For the nine months ending September 2021, total stock connect revenue totalled 260mn USD, up 55% YoY and Southbound average daily turnover was nearly 6 billion USD, doubling from the previous year. The percentage of Southbound turnover of the Hong Kong market reached a high of 13.5% in the first quarter of the year compared to 9.3% in 2020.

From March onwards, volatility picked up markedly in response to a series of concerns. As Asian economies began to open up and recover from COVID-related restrictions, investors started to fret about inflation and the associated risk of higher interest rates. These worries were compounded by sharply rising commodity prices and fears of a speculative bubble in China's over-leveraged real estate market. Volatility was further heightened by a series of severe regulatory restrictions imposed by the Chinese government, including on ecommerce, video gaming companies and other activities which the government views as adding little value to society. The crackdown on private tutoring services was particularly harsh, effectively preventing this sector from operating in China. These companies aim to help children succeed in China's very competitive education system. However, their services are only accessible to wealthier families, and thus serve to compound China's very high level of income inequality, which has worsened since the onset of the pandemic. The government has presented the restrictions on this and other industries as part of its push for 'common prosperity', intended to ensure more equitable income distribution. However, the measures have raised fears amongst investors that the government is abandoning its support for growth and private sector activity, in favour of greater social controls.

These concerns meant that after rising sharply in the first half of the Company's financial year, to end March 2021, Asian markets lost some of this ground in the following six months to end September - the Company's benchmark rose by 14.1% in the first half, but retreated by 3.9% in the second half in sterling terms. However, despite this setback, Asian equities still made substantial gains over the review period as a whole, led by the strong performance of the region's best corporates, including Chinese pharmaceutical companies and Taiwanese and South Korean semiconductor manufacturers. In addition, the rapid spread of digitalisation into many aspects of consumers' lives, such as online shopping and banking, social media and entertainment, and a variety of other remote services, is benefiting many businesses in less developed economies such as Indonesia and India.

What should investors expect for the next 12 months?

Undoubtedly the biggest opportunities and risks in Asia at present are located in China. Combined with Hong Kong, the country accounts for around half of the regional index. The largest index weights are no longer China's state-owned enterprises, but rather private companies at the cutting edge of sectors such as ecommerce, gaming, video streaming, drug discovery and electric vehicle production, which are applying software and hardware technology in innovative ways. Simultaneously, the Chinese economy is undergoing significant shifts in consumption, due to the rapid expansion of its middle class, and in manufacturing and investment patterns.

China's rapidly changing regulatory and policy landscape should be considered in this context. Its leadership is looking to control and influence the changes underway in China, and thus mould the country's future, by incentivising investment in sectors which it believes will deliver the most economic and social benefits, and disincentivising less 'desirable' activity. But it is important to note that while the new regulations have resulted in significant challenges to the outlook for companies in various sectors, including consumer finance, ride hailing, online recruitment, ecommerce and private tutoring (mentioned above), over the short term and beyond, other government initiatives are generating investment opportunities in areas such as healthcare and factory automation, which have previously been dominated by companies in Japan, Taiwan, the US and Germany.

Across the broader Asian region, many of the positive changes we are witnessing are occurring at the company level, rather than across the whole economy, as is the case in China. As discussed in the attribution section, companies such as Sea Ltd are rapidly attracting new consumers in places such as Indonesia, and much further afield. As a result, we expect other businesses to benefit from associated increases in demand for credit and data usage and storage requirements, and from widespread, fundamental changes in consumer spending patterns. We are more cautious on the outlook for the Indian market. Although the economy is recovering quickly from a deep economic downturn, India's market levels and valuations have run even faster, suggesting excessive optimism in some sectors.

Overall, we remain broadly optimistic on the long-term outlook for Asian equities. However, recent developments, especially those in China, means it is crucial that we exercise caution. The outlook for the regional economy remains clouded by ongoing COVID-19 restrictions on travel and tourism, supply bottlenecks and inflation pressures, as well as by regulatory risks, whilst the gradual withdrawal of fiscal support programs could rob the recovery of forward momentum. It is also important to highlight that valuations are above averages in some countries and sectors, and that it may become more challenging for companies to exceed market expectations, given that the most obvious earnings upgrades have already been factored into prices.

. . . .

Europe

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

Marc van Gelder, chair of JPMorgan European Discovery - 9 December

Europe's economy recovered strongly over the summer after being severely affected by Covid-19 in the spring. However, supply chain disruption, enormous increases in energy prices, shortage of certain key products and the potential for new variants of Covid-19 to flare up continue to threaten economic growth. European companies have weathered the difficult 2020 well and are generally in good shape. There is substantial fiscal stimulus coming through in Europe and the US as the recovery from Covid-19 takes priority. This will help support equities, as will the measures taken by the European Central Bank. Monetary and fiscal policy remain extremely supportive despite growing inflationary pressures.

. . . .

Tom O'Hara and John Bennett, managers of Henderson European Focus - 8 December

Glancing back at last year's report, one theme we highlighted was the post-pandemic shape of economic recovery. Investors in the Company will know that our analysis in the late spring of 2020, when the first waves of Covid-19 reached the western world, led us to conclude that the ingredients were in place for a 'V-shaped' recovery. We were as sure as we could be that this would be led by the industrial sphere.

As the year progressed our conviction grew that V-shape 1 would give way to V-shape 2. The latter, we concluded, would be led, not by industrial businesses, but by the consumer sector. The quite literal shot in the arm for this came, of course, via the highly successful and game changing vaccines. While politicians do what politicians do - from bumbling to grandstanding to claiming ownership of success - we can be grateful for the one pattern, the one constant that has stood throughout history: science and technology via human ingenuity ensures that we prevail.

Thus, our thesis was that millions to billions of shots in the arm, coupled with generous government safety nets, meant that a 'cashed up' consumer was set to emerge from the pandemic. Our conviction was that, released from the horrors of confinement, the armed army was set to do what consumers do: travel, spend, live life.

Aside from the macro debate surrounding inflation and associated interest rates, the near-term outlook is likely to be shaped by the many and varied supply side constraints to doing business. Thus, we should not be surprised to see a margin squeeze across a wide range of companies and industries. In turn, of course, this means that a year from now we should be lapping such input cost pressure. This is a key point: markets are a discounting mechanism. In other words, very soon, if not already, share prices will have discounted the 'warnings' and will be anticipating normalisation.

. . . .

Japan

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

Eiji Saito, Naohiro Ozawa and Michiko Sakai, managers of JPMorgan Japan Small Cap Growth & Income - 10 December

During the review period, the market advanced in response to surging optimism about the economic outlook, as the vaccination rollout progressed and COVID infection rates showed clear signs of peaking. Japan's state of emergency was lifted at the end of September. Japanese Prime Minister Yoshihide Suga announced his intention to step down and Fumio Kishida was elected as the new president of the ruling Liberal Democrat Party (LDP) at the end of September. He replaced Suga as Prime Minister in October, following the LDP's victory at a general election. The Japanese yen weakened against the US dollar and sterling on expectations that both the US Federal Reserve and the Bank of England would begin raising interest rates to dampen inflation pressures. The yen ended the review period at 111 yen to the US dollar, and 150 yen to sterling and has weakened further since.

COVID-19 and its aftermath continue to cast a shadow over the global economic outlook, with successive waves of the virus generating ongoing uncertainties, fresh rounds of restrictions, and delays to the resumption of international travel to many regions. However, despite these near-term obstacles to recovery, we believe there are good reasons to be optimistic about the longer term outlook. Vaccination programmes are gathering momentum, and global economic activity is recovering from the devastating effects of the pandemic. Furthermore, we expect the pandemic to leave significant and lasting positive changes in its wake, in Japan and elsewhere, including industry consolidation, supply chain diversification, and productivity gains from the more intensive use of digital technologies and flexible working practices.

. . . .

Nicholas Weindling and Miyako Urabe, managers of JPMorgan Japanese - 10 December

Japan has suffered less than many other developed countries during the coronavirus pandemic, although it was forced first to postpone the Olympics and Paralympics for a year and then to hold them without spectators, which dramatically limited their commercial success. Japan's state of emergency has now been lifted, and over 75% of the population is fully vaccinated.

In Japan, as elsewhere, investors greeted news of viable vaccines with enthusiasm, as at the time of writing Japan's vaccination rate is 75.8% (of total population), the highest of the G7 nations (Canada is next with 75.4%). The TOPIX index rose sharply in late 2020 and early 2021, and market sentiment shifted in favour of companies expected to benefit from the vaccine rollout and economic re-opening. As in other major equity markets, there was a rotation into cyclical and value stocks. In the half-year report, we cited as an example the case of department store operators. Shares in these companies rose in anticipation of a surge in business as customers returned to stores to buy household and personal goods they were unable to purchase during lockdowns. But such a one-off, short-lived increase in activity is unlikely to move this sector off its trajectory of long-term structural decline, as consumers embrace online shopping with increasing enthusiasm.

The broader post-pandemic surge in demand will, by its nature, be temporary, and quickly exhausted, and gains in these recovery stocks may prove equally short-lived. Indeed, by the second quarter of this year, the TOPIX's recovery rally appeared to have lost momentum and the index has traded broadly sideways during the second half of the Company's financial year.

Inflation has accelerated sharply in several countries as economic recovery, supply side constraints and energy prices have combined. So far the impact on Japan has been much more muted and we see little sign of wage inflation. While a policy response of rising interest rates elsewhere might slow global demand the impact on the portfolio should be relatively muted given the focus on longer term growth companies. Additionally we believe that premium and quality companies have the pricing power to be able to cope with inflationary pressures. Nevertheless prolonged global inflation may have an impact on equity valuations globally and this may also include Japan.

The arrival and rapid rollout of viable vaccines has greatly improved the global economic outlook, and although its borders are still largely closed, Japan's prospects are significantly better than this time last year. The economic recovery is underway and should gather momentum into next year. Japan's longer-term growth prospects may be supported by government policies encouraging the spread of digitalisation and information technology, which should deliver substantial productivity gains across the economy over time.

It remains our view that Japanese equity markets are much more vibrant than some investors appreciate, with many new and interesting listings on the Tokyo stock exchange each year, especially in the small and mid-cap space. We believe it is an attractive market in which to build a portfolio different from the pack, particularly for active, bottom-up investors like us, supported by a large, Tokyo-based research team.

China

(compare China funds **here**)

Rebecca Jiang, Howard Wang and Shumin Huang, managers of JPMorgan China Growth and Income - 3 December

There is never a dull moment in investing in China and the past financial year was a particularly eventful one. Market sentiment swung from exuberance at the beginning of the year, to caution, and even scepticism, towards the end of it.

In the first half of the year, the Chinese economy recovered strongly, thanks to prompt COVID containment measures, and Chinese manufacturers benefited from a surge in orders from other major economies whose manufacturing sectors were struggling to deal with the impact of the pandemic. As in all other major markets, news of the arrival of viable vaccines in late 2020 saw attention in the Chinese market rotate from growth to value stocks, as investors anticipated a recovery in more economically sensitive, cyclical sectors such as energy, utilities and financials. The MSCI China index (GBP) rose 23.8% between 30th September 2020 and its peak in February 2021, and then tumbled after the Chinese New Year on fears of a tightening in domestic liquidity and rising 10-year US Treasury yields.

China's Manufacturing PMI stood firmly in expansionary territory for most time of the year, thanks in large part to persistent export demand. The strength of the recovery, combined with China's restrained monetary stance, saw the Renminbi appreciate against USD over the year. It touched a three-year high in May 2021. The central bank (PBOC) raised the foreign exchange reserve requirement to dampen speculative activity and the exchange rate has since stabilised at a lower level. More recently, however, the index dropped below 50% in September 2021, signalling contracting activity, due to commodity price inflation, high shipping costs, power rationing and the shortage in tech components, especially semiconductors.

COVID remains a threat to the economic outlook. China approved its first domestic vaccine in December 2020 and well-organised vaccination programmes ensured that by September 2021, 78% of the population had been vaccinated. A few scattered outbreaks of the virus have been quickly contained. However, while China's success in controlling COVID is applaudable, it remains one of the few countries in the world still committed to a COVID-zero policy that has kept external borders closed. It is unclear when borders will re-open to tourists and business travellers and this has cast a shadow over the outlook for the domestic service sector.

Since recovering from the initial shock of the pandemic, China has maintained a neutral monetary policy aimed at stabilising credit expansion. The implementation of strict controls on borrowing by property developers, to curtail speculative activity, is a key part of this policy. These measures, together with restrictions on homebuyers, contributed to the de facto defaults of several developers in September 2021, including Evergrande, one of the country's largest private property companies. The government plans to deal with these problems at the individual project level, rather than via corporate level bailouts, in part to avoid encouraging reckless commercial behaviour by developers. In our view, and that of other local investors, this is not China's 'Lehman Brothers moment', and is unlikely to trigger systemic ructions. Most of the debt is backed by land and does not involve the kind of complex financial derivatives whose high contagion risks sparked the 2008 global financial crisis.

Chinese regulatory crackdowns on other sectors have also been creating headlines around the world. The emphasis of government policy seems to have shifted from growth-centred policies to regulatory crackdowns designed to achieve more balanced growth. The digital economy and other socially sensitive industries such as education and health care have been most impacted. The shift began in November last year with the high-profile suspension of the Ant Group initial public offering (IPO), due to concerns about its capital structure, its ballooning consumer finance business and conflict with regulators. Then, in July 2021, regulators announced a flurry of new restrictions, including on the private tutoring industry, whose business model was essentially destroyed by the crackdown.

Since then, Chinese regulators have announced tighter controls on anti-competitive behaviour, data security and companies employing gig workers, and non-compliance has been swiftly punished. In the health care sector, we have long championed structural trends such as import substitution and the increasing availability of advance therapeutics, and these are playing out nicely. However, certain sub-sectors such as medical devices and equipment are facing increasing pressure from government procurement policies to cut prices. This is in part intended to reduce corrupt pricing practices which benefit suppliers, distributors and hospital administrators, and should be welcomed by investors. Nonetheless, these regulatory shocks have triggered a selloff in stocks in the property, internet, education and healthcare sectors, all of which are popular with foreign investors.

The crackdowns may seem abrupt and severe, but in our view, controls on many sectors lagged regulations imposed by the EU and US authorities, and China is simply playing catch-up. Some restrictions have also been motivated by the government's recent promotion of 'common prosperity'. This has raised concerns among investors and observers that China is intent on 'soaking the rich', but we disagree with this assessment. On the contrary, China has one of the highest levels of income inequality among the world's major economies, and a more balanced distribution of wealth is critical to ensuring long-term growth.

Environmental regulations are also generating some public concern and criticism. In September 2020, President Xi committed China to achieving 'net zero' carbon emissions by 2060. However, a year on from this pledge, efforts to reduce carbon emissions are being blamed for contributing to recent widespread power shortages. High coal prices and an inflexible power pricing mechanism have also played a role in the shortages, which have been particularly damaging for energy intensive industries such as steelmaking and cement, adding to inflation in basic material prices. The power shortages caused a public outcry that alarmed officials, leading to some retuning of energy policy, although the government remains committed to its net zero target.

Elsewhere, the US Federal Reserve has become increasingly hawkish, due to higher-than-expected inflation, and this has put upward pressure on the US dollar. Trade tensions between China and the US have eased under the Biden administration. However, fundamental differences on trade and other issues persist between the two countries and taking a tough stance against China has bipartisan support in the US.

Outlook

The world is recovering from COVID disruptions and major economies are returning to normal, although some bottlenecks have emerged in global supply chains. A year ago, it was difficult to imagine the world would soon be confronted with supply shortages of an array of products, from semiconductors to clothing, and widespread inflation pressures. We expect inflation to persist in the short term, until pandemic-related obstacles within supply chains are removed and pent-up demand for basic materials and manufactured goods dissipates. Major central banks will gradually wind back the extremely generous monetary stimulus implemented to support activity during the pandemic, but they are still faced with the difficult task of timing future interest rate increases to dampen inflation pressures, without unduly damaging activity.

In China, we believe the recent regulatory crackdowns are ultimately designed to achieve more sustainable and equitable growth. In our view, they do not represent any wavering in the government's commitment to improving living standards, opening the economy and delivering the benefits of technological innovation to consumers and businesses. For example, the government's efforts to limit property prices have wide public support and are essential to achieving a more balanced economy. The drive for common prosperity, if executed well, may lead to greater domestic consumption in the long run.

However, although we agree with the thrust of the regulatory changes, we are not complacent about the associated investment risks. These policies will continue to adversely impact certain companies and industries in the near term and alter the competitive dynamics of some sectors. We will therefore continue to assess regulatory risks on a company-by-company and sector-by-sector basis and review our investment thesis accordingly.

In relation to other aspects of government policy, China has sufficient fiscal and monetary policy head room to support growth if needed, and the recent weakening in manufacturing activity and consumption, if it persists, has increased the chances that some stimulatory measures will be announced in coming quarters. Looking further ahead, the Central Committee of the Communist Party met at the end of 2020 to discuss China's medium and long-term economic strategies. In response to ongoing tensions between China and the US and its western allies, over trade policy and territorial issues, the committee emphasised the need to foster economic self-sufficiency and technological innovation. It also endorsed efforts to boost consumer demand and continuing 'supply-side' structural reforms. We will continue to seek investment opportunities in those sectors best placed to benefit from the government's long-term economic strategies.

The good news for investors in China is that we believe the sharp share price correction seen in the second half of the review period now reflects most of the risks and uncertainties surrounding Chinese equity markets. And despite some near-term concerns, we remain positive about China's prospects. We expect growth to remain underpinned by the drive to digitalise and implement other technological innovations, by the rising aspirations of the expanding middle class, and increasingly, by the need to reduce carbon emissions.

We are also optimistic about the outlook for Chinese equities. We forecast expected annualised returns over a five-year period, as we believe this figure provides a reliable indicator of potential market performance. Over the next five years, we expect annualised returns to approach 20%. This is very close to an all-time high. Five-year return projections last touched this level in late 2018, following the sharp market sell-off sparked by Sino/US trade tensions and slower domestic growth. Equity markets subsequently experienced a rebound that continued virtually unabated until early 2021 and took indices to all-time highs.

If our analysis proves correct, we can look forward to a strong recovery in Chinese equities over the next few years.

India

(compare India funds **here**)

Rajendra Nair and Ayaz Ebrahim, managers of JPMorgan Indian - 17 December

The financial year ending 30th September 2021 was a turbulent one for India, in which the pandemic continued to have a major impact on the country. The year began on a positive note, as the first wave of the pandemic passed, and economic activity began to recover rapidly. However, a vicious second wave significantly impacted the country between February and May 2021. To give context to the severity of the second wave, the number of cases peaked at just over 400,000 cases per day in May, four times higher than at the peak of the first wave in September 2020, making India the worst affected nation in terms of daily case numbers. In response to this crisis, Indian state governments imposed tight restrictions that severely disrupted the economy. However, economic activity began to normalise in the last few months of the financial year, as the second wave receded and restrictions were gradually eased.

Inflation was volatile over the financial year due to the economic disruption caused by the pandemic. It briefly crossed the upper end of the Reserve Bank of India's (RBI) 2-6% target range in late 2020 and mid-2021. However, the RBI's Monetary Policy Committee (MPC) maintained an accommodative stance to support growth, leaving rates unchanged throughout the year.

Indian corporate earnings broadly tracked the trajectory of economic activity, although globally oriented businesses were insulated to some extent from the pandemic-induced shock to the domestic economy. Rising input prices led to margin pressure across several sectors towards the end of the review period and near-term earnings forecasts were downgraded accordingly, although earnings are expected to rebound strongly over the next couple of years, as the economic recovery continues to gather momentum.

As in other major markets, Indian equity investors looked beyond the immediate grim economic and social circumstances towards the prospect of a robust post-pandemic recovery. Share prices rose to all-time highs, supported by abundant liquidity and strong investment inflows, particularly from retail investors. The MSCI India Index's return of 46.8% during the financial year significantly outperformed Asian and emerging market indices. Mid and small cap companies outpaced large caps during this period, again thanks to strong retail demand. The market's exuberant mood encouraged a rise in initial public offerings (IPOs), and the high-profile listing of several internet businesses fuelled the general market euphoria.

Outlook

Following the exceptional performance of Indian equity markets over the past year, some near-term volatility is possible. This could be triggered by any one of several potentially adverse influences. For instance, valuations, on both a price to earnings and price to book basis, are now at 10-year highs in absolute terms and relative to Asian indices and emerging markets more broadly. This implies a limited margin of safety, particularly if high global inflation proves more than transitory and interest rates begin to rise. The Indian economy has always been prone to bouts of high inflation and under such a scenario, the market could be vulnerable to a correction, especially if higher interest rates dampen recovery momentum. Higher than expected inflation could also put pressure on companies' margins in instances where businesses are unable or unwilling to pass on higher costs to consumers. In fact, this is already happening, causing some downgrades in near-term earnings forecasts, although earnings are nonetheless expected to recover strongly over the next couple of years.

There is also the risk of a third wave of COVID-19 inflections, particularly in the wake of the festive season. However, our base case remains that the economic impact of another wave is likely to be limited and short-lived, as a significant part of the adult population is likely to be vaccinated by early next year, and we are looking forward to a year in which the domestically oriented cyclical stocks in our portfolio, including financials, industrials, building materials and auto manufacturers, perform well as economy activity rebounds.

Whatever the possible trigger, long term investors will appreciate that episodes of volatility are inevitable in emerging markets like India, and, in fact, should be welcomed to the extent that they generate attractive entry points to interesting investment opportunities.

. . . .

Flexible investment

(compare flexible investment funds **here**)

Nick Greenwood and Charlotte Cuthbertson, managers of Miton Global Opportunities - 13 December

Markets have been moving steadily higher for some time on a wave of stimulus. At some point the tide will move into reverse and asset values will cease to rise by default. Our portfolio of mispriced special situations has the scope to progress in such a market environment

The closed end sector has rapidly evolved into a home for alternative asset classes. There have recently been a wide range of mandates including accommodation for the homeless, digital infrastructure, hydrogen, forestry and space. The diverse range of trusts available means there will usually be a number of sectors coming into and out of favour. It is when we identify an out of favour asset class which then returns to popularity that we make the greatest returns. Looking forward there will be a greater number of opportunities than there has been in the past.

. . . .

Davina Walter, chair of Aberdeen Diversified Income and Growth - 9 December

Looking back over the 12 month reporting period covered by this Report, it is a huge relief to have experienced a successful vaccine rollout and the strong recovery it has produced in major economies. Whilst it is clearly too soon to say we can resume life as we knew it pre-pandemic, it does give grounds for optimism that we will not have to return to the draconian measures of full lockdown. Unsurprisingly financial markets were mixed over this period as the re-opening economies and the rebound in corporate earnings produced a sharp rise in global equities, whilst the concerns that central banks would now start to increase interest rates caused bond prices to fall.

. . . .

Richard Ramsay, chair of Momentum Multi-Asset Value - 9 December

After the spectacular recovery in stock markets from November 2020, very largely due to the news of vaccine discoveries, it was perhaps to be expected that a period of relative calm would follow. There is an old saying in the investment world that "it is better to travel than to arrive". After the wonderful and life-saving vaccine news, the practicalities of deployment and the realities of COVID-19's evolution have caused some worries, including very recently with the appearance of the Omicron variant. Its severity is still under investigation making it currently difficult to assess the trajectory of the pandemic. As concerns have ebbed and flowed, so have stock markets too. Overall, the corporate sector has dealt with the re-opening of economies very well, but supply chain bottlenecks and labour shortages in some sectors continue to prove problematic. All of us are experiencing these in one way or another, and the result is that the cost of living is rising. We have enjoyed such a long period of very low inflation (or even deflation in many areas) that dealing with resurgent inflation is a challenge for many. How high inflation gets and for how long it lasts are crucial questions without definitive answers at this stage.

The current issues of concern to investors are well known and referred to in my Overview. Will COVID-19's evolution cause economic recovery to stall or reverse, or will the virus be contained and managed by vaccines and improving therapies? Will inflation increase by more, and stay high for longer, than is manageable? History shows that equities generally do not perform particularly well when inflation rises. Not so much because of pressure on earnings but rather because multiples or valuations decline. But history also shows that Growth stocks are much more harshly treated than Value stocks in this kind of environment. Given the particularly elevated valuations currently 'enjoyed' by Growth stocks, the risk of reassessment by investors appears real.

Biotechnology & healthcare

(compare biotech & healthcare funds **here**)

James Douglas and Gareth Powell, managers of Polar Capital Global Healthcare - 17 December

Healthcare facilities, healthcare supplies and life sciences tools and services all performed strongly over the period. The facilities and supplies companies benefitted from returning patient volumes, especially in regions with successful vaccination programmes. The life sciences tools and services sub-sector has been instrumental in not only delivering COVID-19 testing kits but also contributing to the vaccine manufacturing processes. At the other end of the scale, the last 12 months has been a difficult period for the biotechnology and pharmaceuticals sub-sectors. For biotechnology, it has been a challenging period driven by a number of factors including excessive valuations in certain thematic pockets, disappointing clinical data and regulatory setbacks. We remain optimistic, however, given that the innovation cycle is extremely strong, the sector is well-funded and consolidation remains a distinct possibility. The pharmaceutical sub-sector continues to innovate and invest substantially in research designed to address unmet medical needs, but short-term growth prospects face the challenges of mature margins and patent expiries between now and the end of the decade.

Reflecting on last year's annual report, the focus was very much on six key investment themes, some of which accelerated through the COVID-19 crisis. Disrupting the delivery of healthcare, outsourcing and prevention are key investment themes for the Company, with all three showing signs of gathering momentum. Healthcare systems globally are looking to shift more and more patient volumes to lower cost settings such as ambulatory surgery centres and the home. Outsourcing is also enjoying a period of strong growth and consolidation, with the clinical research organisations especially well-positioned. Prevention, not just vaccination programmes, but early and accurate diagnosis, is also an area that has flourished and should continue to do so in a post-pandemic world given the increased investment in diagnostics infrastructure. The other key themes discussed in last year's annual report, namely emerging markets, innovation and consolidation are no less important, but are perhaps less influenced by the COVID-19 pandemic. Crucially the six themes discussed above will, we believe, continue to be growth drivers for the healthcare industry and should be able to yield some exciting investment opportunities.

US politics, always an important consideration, has been less prominent this year than it was in 2020. Top congressional Democrats are acknowledging for the first time that they will have to scale back their drug pricing ambitions to gain much needed centrist votes for President Joe Biden's social spending bill. As such, direct drug price negotiation by the Federal government feels less likely now, something that would be a big relief for the bio-pharmaceuticals industry. There remains political will to address high out-of-pocket costs for US seniors and to control drug price inflation, but far-reaching legislation remains some way off. With regards to access to healthcare, President Joe Biden continues to be a staunch supporter of the Affordable Care Act, signed in to law by President Barack Obama in early 2010. Indeed, the Administration introduced a special enrolment period during the pandemic to ensure that US citizens that needed access to care got it. Priorities from here could involve making the expansion of the subsidies and eligibility permanent, expanding Medicaid further and adding dental, vision and hearing coverage to the Medicare fee-for-service program.

The key investment themes that the Company focused on in 2020 are very much relevant today and will continue to be so over the medium-term. The COVID-19 pandemic has been hugely challenging for everyone but has also shone a light on a couple of things: firstly, the terrific levels of innovation that the healthcare industry can deliver and, secondly, the acute need for structural change. It is imperative, given the general ageing of populations and the rising costs of healthcare, that patient volumes are directed into lower cost settings, early and accurate diagnoses become routine and that the industry focuses on sustainability, whether that be through improving clinical outcomes, improving affordability and access or improving efficiency. If the healthcare industry can deliver on these objectives, the commercial and financial rewards should be there for investors.

Healthcare delivery disruption, outsourcing and prevention: Starting to accelerate

The COVID-19 pandemic has been a real catalyst for positive change, highlighting the need for healthcare systems globally to adopt new products, technologies and services designed to drive efficiencies without compromising quality of care. One critical area is disrupting the healthcare delivery pathway to ensure greater access to care. Virtual care platforms and remote monitoring tools are excellent examples of enabling technologies that can drive the agenda. Virtual care platforms are being used not just to expand and improve access to mental health services, for example, but also to connect patients to licensed behavioural health providers. Sadly, these sorts of services will be in high demand as we navigate our way through the COVID-19 pandemic. Remote monitoring tools can be used to support patient care by providing clinicians with patient data that allows for proactive health care interventions that can ultimately lead to reduced hospital readmissions.

Out-patient surgeries and services will also grow in importance in the coming years. Medical care provided at alternative sites of care that meet quality and cost-efficiency criteria can lead to better outcomes at a lower cost for the consumer. Ambulatory surgery centres and stand-alone imaging centres, for example, can provide the same or higher quality care at a lower cost compared to hospitals. UnitedHealth Group estimates that the average price for routine diagnostic imaging at a hospital out-patient department can be 165% more than the price of a test performed at a stand-alone imaging centre or physician's office. UnitedHealth Group has also calculated that conducting more joint replacement surgeries in ambulatory surgery centres could save the US health systems $3 billion annually by achieving 500,000 fewer hospitalisations.

Outsourcing is also accelerating, with the COVID-19 pandemic offering a substantial boost to both clinical trial activity and to contract manufacturing. We anticipate that this rate of growth will be sustained as the pace of innovation in the biotechnology and pharmaceuticals industries gathers momentum. The biotechnology industry is especially well capitalised at present and will look to deploy that capital through clinical trial development and, hopefully, through to commercialisation. The greatest, near-term beneficiaries of this trend are the contract research organisations which provide a multitude of services including pre-clinical research, clinical research, clinical trial management and pharmacovigilance. The sector has also experienced some consolidation during the reporting period with life sciences tools and services company Thermo Fisher looking to acquire PPD and Icon looking to acquire PRA Health Sciences.

Whilst the benefits of safe and effective vaccination programmes should never be understated, it is perhaps the potential impact of effective diagnostics that could be more important for healthcare systems in the long run. Advanced diagnostic solutions enable clinicians to make critical decisions for their patients earlier, more accurately, and with greater confidence. Improved decision-making benefits not only individual patients but also society as a whole. Healthcare systems, under increasing pressure to control costs, can use limited resources more efficiently while, at the same time, increasing access and driving better outcomes. Encouragingly, COVID-19 has accelerated the investment in diagnostics infrastructure, with labour-efficient automated machines at the forefront. With greater infrastructure in place, it is hoped that testing menus will expand and that we will see broader adoption of diagnostics globally.

The remaining three themes of innovation, consolidation and emerging markets are no less important than the three discussed above, but possibly less influenced by the COVID-19 pandemic. The healthcare industry is highly innovative, is well capitalised and will continue to push scientific boundaries in the search for novel solutions to meet unmet medical needs. The contribution to science and society from the COVID-19 vaccines based on mRNA technology is clear, the big question now becomes, "how widely can the technology be used?". 2021 also witnessed two other potentially game-changing breakthroughs: the first in the field of gene editing with US company, Intellia Therapeutics, disclosing the first ever clinical data supporting the safety and efficacy of in vivo CRISPR genome editing in humans; the second in the field of obesity, with NovoNordisk's Wegovy enjoying a phenomenal early launch. The drug works by mimicking a hormone called glucagon-like peptide-

1, or GLP-1, which delays gastric emptying, increases gastric volumes and suppresses appetite.

In a highly fragmented industry, with strong balance sheets and low costs of debt, consolidation is likely to continue to be an important theme for the healthcare industry. Management teams are looking to augment their internal assets with complementary assets and technologies.

We expect emerging markets to continue to be an important source of growth for a number of sub-sectors including biopharmaceuticals, life sciences tools and services, medical devices and contract research organisations. Many emerging markets are not just investing heavily in ensuring widespread access to healthcare but are also changing the way they think about regulatory approvals, pricing and reimbursement. Innovation is critical, but so is local manufacturing and a sales reach that can access volumes during inevitable periods of pricing pressure.

Outlook for healthcare in a post COVID-pandemic world

The impact of the COVID-19 pandemic on healthcare will be felt for many years, on top of the fact that the virus is likely to become endemic. In terms of structural changes, there has been a big pick-up in R&D in pharmaceutical and biotech companies, not just on infectious diseases, but across other areas in response to the innovation and progress that has been witnessed over the last five years. The enormous amount of money that has moved into life sciences venture capital over the last two years is evidence of the enthusiasm around the industry and the benefits that it can bring through the discovery of new drugs that can dramatically change patients' lives. The impact of vaccine development against COVID-19 has been the accelerant for greater R&D spend and there will be many companies that benefit, particularly those focused in life sciences tools and services, clinical research organisations and contract manufacturers.

In the shorter term, the impact on supply chains is an issue as much for the healthcare sector as it is for other industries, with costs having jumped considerably since before the pandemic. Also on the labour side, the pandemic has driven a sea change in what employees want and expect from their jobs, which is having a significant impact on healthcare. A recently published survey highlighted that 18% of US healthcare workers quit their jobs during the pandemic, with 79% of healthcare professionals saying that the national employee shortage has affected them and their place of work. Not only are positions being left vacant, but providers are also seeing a significant spike in wages. This is likely to remain a challenge for many organisations for the next 12 to 18 months.

The disruption in healthcare delivery that started several years ago has been another area that has seen an acceleration driven by the pandemic. The shift of care to lower cost settings and away from the large in-patient hospitals is a must if healthcare systems are to become more efficient. With hospitals being at the centre of managing patients affected by COVID-19, care for other conditions has naturally moved away from the hospital with other providers such as ambulatory care, outpatient and home healthcare experiencing a significant boost in demand. This trend will continue, but many of the companies in these areas are being impacted by the wage inflation and employee shortages, a situation that needs to improve if they are to cope with the acceleration in demand.

Backlogs have increased dramatically due to the pressure of the pandemic on healthcare system, most visibly on the elective side for procedures such as hips and knees. Here in the UK, for example, the British Medical Association estimates that between April 2020 and July 2021, there were 3.79 million fewer elective procedures and 26.02 million fewer outpatient attendances. Further, the total waiting list currently sits at an alarming, record high of 5.61 million, and continues to grow. The "invisible" backlog is perhaps more concerning, and is the consequence of the lack of screening and testing for diseases such as cancer during the last 18 months which, sadly, will likely cause an increase in more serious and later stage disease in the months and years ahead. An article published in the Journal of Clinical Pathology referenced that cancer diagnoses fell by 39% in 2020 compared with the average number recorded in 2018 and 2019. Prostate cancer (-75%), bladder cancer (-66%), and colorectal cancer (-62%) had the greatest decreases. This is of course very concerning for the patients involved but will effectively lead to high levels of demand for healthcare services for many years to come.

Conclusion

Whilst we do have some sympathy with the view that the near-term outlook for healthcare, and indeed the broader markets, is carrying some uncertainty due to the COVID-19 virus, we have a high level of conviction that the healthcare industry will continue to find innovative solutions, will continue to work on improving access to care and will look to drive efficiencies across the healthcare continuum. If successful, an optimistic stance about the medium-term prospects for the sector is the right one.

Environmental

(compare environmental funds **here**)

Jon Wallace, manager of Jupiter Green - 14 December

The continued rollout of vaccines across the world, in an attempt to outpace the spread of new COVID-19 variants, contributed to the global equity market rally during the second quarter. This rally was initially characterised by a rebound in cyclical stocks which benefitted from the prospect of improving economic conditions. As the period progressed, investors focussed more on companies with strong quality and growth characteristics.

A feature of the period was the continued rise in global inflation, with surging energy costs in September adding to the upward pressure on prices. In response central banks signalled that monetary policy was likely to be tightened. Widely-followed global business surveys painted a picture of strong end demand but also difficulties in sourcing components and filling job vacancies due to the lingering impact of COVID-19 on supply chains and labour markets, putting upward pressure on prices and wages.

Within the environmental solutions investment universe, underlying performance trends were healthy although not without volatility. While all investment themes contributed positively to performance, companies in the Clean energy theme, for example, rebounded following an initial period of weakness.

Outlook

Despite a healthy long-term growth backdrop for environmental solutions themes we are mindful that the coming months may see a continuation of the recent volatility we have seen within broader global equity markets.

In this environment, we see the current market volatility as a buying opportunity. We have a conviction that energy security concerns will embolden, not diminish, the long-term case for accelerating the energy transition. We also note that the recent IPCC report highlighted not just the effects of burning all types of fossil fuels 'downstream' for energy, but also the damaging effects of fossil fuels sectors in contributing to methane emissions from their exploration and production 'upstream'. Methane is a potent greenhouse gas that itself has contributed to about one quarter of the rise in global temperatures since the Industrial Revolution.

Meanwhile we continue to see a broadening of the opportunity set of 'enabling' solutions capable of tackling not just climate change but other, closely linked, environmental challenges such as biodiversity loss and wider forms of degradation to the natural world. Looking ahead, we expect this encouraging trend to continue, providing a healthy stock-picking landscape of companies focussed on environmental solutions.

Technology & media

(compare technology & media funds **here**)

Ben Rogoff, manager of Polar Capital Technology - 14 December

Market Outlook

The official covid death toll passed 5m at the start of November, although a measure based on 'excess deaths' rather than official statistics suggests a number closer to 17m may have died as a direct and indirect result of the virus. The shape of the public health recovery into a post-covid world remains steeped in uncertainty, driven by the rate of worldwide vaccination uptake and its efficacy, potential further virus mutations, and the success of ongoing public health measures and restrictions on activity. We remain hopeful the virus moves from the pandemic to endemic phase , although the recent emergence of the highly-mutated Omicron variant has raised fresh doubts about this. The heavily mutated spike protein present in the Omicron variant could bring increased transmissibility and reduce current vaccine efficacy (as the Moderna CEO expects), but should still hopefully be effective in preventing hospitalizations, according to the BioNTech and Pfizer CEOs. Pre-Omicron, the WHO had already warned covid may kill another 500k Europeans by February as vaccination rates remain low and case numbers could rebound over the winter. Rapid vaccination campaigns in developed countries have (for now) broken the link between case numbers - which remain elevated but manageable in many parts of the world - and hospitalizations and deaths. The Omicron variant itself serves as a sobering reminder of the inherent unpredictability of macroeconomic (and market) conditions, and a reminder of the need for a highly liquid and well-diversified portfolio. After the stunning speed and success of vaccine development and proliferation, therapies have recently shown meaningful progress as Pfizer announced very positive interim Phase 2 and 3 data for Paxlovid. This demonstrated an 89% reduction in the risk of hospitalization or death (and 0 deaths) in non-hospitalized, high-risk covid patients, improving markedly on the ~50% reduction demonstrated by Merck's Molnupiravir. What excites us is the role technology has played underpinning more rapid vaccine and anti-viral drug development; a fantastic example of the accelerating pace of innovation occurring, enhanced by artificial intelligence, in the real world.

The ramifications from the covid crisis continue to have an impact on global growth even as the risk of widespread national lockdowns diminishes. Goldman Sachs research suggests from now until the end of 2022 the 'global protection rate' (share of the population with some covid immunity via vaccination or prior infection) should move from 70% today to 85% on a GDP-weighted basis. This should support the economic recovery. The IMF now projects global GDP growth to be 5.9% in 2021 and 4.9% in 2022, up from expectations this time last year of +5.2% for 2021, although this has moderated slightly from expectations for 6.0% 2021 global growth as recently as July. This recent tempering of growth expectations reflects the impact of supply chain disruptions on developed markets and the ongoing impact of covid in developing ones (impeded by slower vaccine rollouts). The balance of risks to growth is tilted to the downside given Chinese growth is likely to remain relatively weak due to deleveraging in the property sector, government spending and consumption. This is partly a function of Chinese government efforts to engineer a reduction in macroeconomic risk around excess leverage (especially in the property sector), but also indicates the government's shifting focus from supporting GDP growth to an emphasis on income (re)distribution, stability and decarbonization.

The equity market collapse at the outset of the covid crisis and the recovery since have been quicker than historical market cycles. This must partly reflect the unique nature of the crisis and the overwhelming fiscal and monetary response to it (which has both supported real demand and inflated asset prices), but also a robust economic recovery and the impact of a very supportive rates environment for valuation multiples. It is possible that just as the decline and rebound in markets around covid took place on a compressed timescale versus history, so the entire market cycle may follow a 'shorter, sharper' trajectory. Following the Q1'20 collapse which saw MSCI World Index P/E multiples compress by a third in six weeks, the 'rebound' or 'hope' phase over the following ten months saw multiples more than double from their lows as investors anticipated a strong rebound in earnings. 2021 has seen the global market move into a 'growth' phase - more classically mid-cycle - as returns have been delivered by strong EPS growth and modest multiple contraction. In the US in particular, companies have been able to deliver upside against conservative expectations as the median S&P 500 earnings 'beat rate' between 2Q20 and 2Q21 was ~19%, against a more typical ~4-5%. Q3'21 S&P earnings remained strong with index-level earnings growth of +39% y/y, although the beat rate declined substantially to ~10%. Somewhat surprisingly, reported net margins (ex-Financials) continued to expand +150bps q/q in the third quarter despite well-publicised cost inflation from labour, inputs and logistics. It is possible that as with the late-cycle collapse and early-cycle rebound of global equity markets, the timeline for the mid-cycle 'growth' phase (not yet a year old) will also be compressed, although typically these have lasted 4-5 years.

Another major factor likely to drive market returns is the fate of the mega cap technology companies (Apple, Amazon, Microsoft, Alphabet, Facebook), which now represent a combined market capitalization around c$9tn - similar to the combined GDP of Germany and Japan. Each company has idiosyncratic drivers of performance, but as a group have benefitted from strong equity inflows, perceived 'safe-haven' status (despite intensifying regulatory scrutiny) and strong growth. They also trade on a two-year forward P/E ratio in the high-20s which - while hardly cheap - reflects strong long-term growth prospects. While their aggregate valuation multiple remains meaningfully different from the 5 largest tech companies in 2000 (which traded in the mid-50s forward PE), more aggressive regulatory scrutiny could pressure valuations, with the recent Chinese experience a pertinent warning. We believe the risk of comparable draconian Western government actions remains very low given the difference in legal and political systems, but such is the dominance of the large players on the market that it will be hard for the overall index to perform should investors have concerns that it is even a possibility. Furthermore, it is worth highlighting the concentration risk inherent with building a portfolio around a market-cap weighted index.

The potential for persistent inflation and the magnitude of the global central bank response it may necessitate and/or the demand destruction it may induce represent a material risk to global equity markets in the near term. The US 5-year breakeven reached 3% during November - for the first time based on data going back to 2002 - and the yield curve flattened materially due to a move higher in 2-year rates as investors become more concerned about tighter Fed policies. Short-dated rates moves were even more acute in Canada, Australia and New Zealand and there is a concern that central banks (including the Fed and ECB) will need to scramble to catch up in their response to upward pressure on inflation expectations (earlier tapering and rate hikes).

Whether inflation is transitory will depend on whether supply chain blockages remain as acute and, on the willingness, and ability of central banks to respond effectively to it. US core CPI inflation were running at a 4.6% annualized rate in October (the highest since 1991), although US consumer spending remains strong, and the US savings rate is relatively high (7.5% in September) despite the cessation of extended unemployment benefits. The labour market could continue to exert upwards inflationary pressure (US wages rose 4.2% y/y in the third quarter, the highest growth since 2001) as the 'Great Resignation' makes it challenging for companies to hire and retain staff as demand recovers. There are 10.4m US job openings but 5m fewer people on payrolls than there were pre-pandemic, and a recent Fed study found more than 3m Americans retired early during the covid period. There remains ~$2.4tn in pent-up US savings, financial obligations near record lows and low household debt levels which suggests that in the near-term the economy may be able to absorb inflation and support persistent consumer spending in the face of higher prices, although consumer confidence is waning by some measures.

Our view is that inflation is more likely to remain 'transitory' in the sense that central banks will ultimately still prove willing and able to respond to it effectively (long-dated yields suggest the market is still broadly accepting of this), and that some moderation in the price of goods and services will meet a similar moderation in demand as excess savings are spent down and the fiscal impulse wanes. There are also longer-term deflationary pressures which leave us circumspect about a regime change in the inflation environment given aging global populations, excess savings and (of course) the impact of technology. We concur with Microsoft CEO Satya Nadella's recent comment that "Digital technology is a deflationary force in an inflationary economy".

We remain alive, however, to the fact that we may be wrong and that inflation expectations could continue to rise and eventually become 'de-anchored' should supply and demand not evolve in this manner, or if doubts emerge about central banks' willingness or ability to take effective action to contain inflation. The mechanism for such a regime shift might involve: a policy error (central banks move too slowly, too late or too softly to curtail a upwards price-expectations spiral); a change in the political economy which makes sufficient action impossible (are central bankers and governments willing to stomach sparking a recession to control inflation?); or force majeure in the form of an exogenous threat (perhaps a full-blown energy crisis, a pre-emptive strike on Iran by Israel as it continues to make progress towards nuclear weapons, or a climate change-related crisis) which brings a fresh inflationary impetus to the economy. It is notable that analyst expectations for a cumulative 'green capex' splurge over the next decade are already in the order of ~$12tn versus the ~$4tn China capex wave in the 2000s, while increases in extreme weather events, combined with public support for green initiatives could provide further momentum. The move from a fundamentally low-inflation/deflationary regime to a fundamentally high-inflation/inflationary regime would have a major impact on the value of all financial assets, especially in the growth equity space in which we invest.

Despite the increasingly inflationary backdrop valuations remain elevated by historic standards as the S&P 500 continues to make all-time highs. EV/Sales, EV/EBITDA and Price/Book multiples all sit higher than the 90th percentile versus history. The S&P 500 is trading at ~21.5x on a forward P/E basis, although based on an Equity Risk Premium model with the 10-year yield at ~1.55%, this is not egregious. Animal spirits remain buoyant with elevated call buying, hedge fund net leverage in the 95th percentile, retail investor equity allocations at record highs and cash holdings at record lows. Equities as a percentage of financial assets reached 34.5% at the end of Q2 - the highest level since 1955. March 2000 was 30.8%. There are other signs of late-cycle exuberance such as SPAC issuance, buoyant crypto asset prices, pre-revenue companies like Rivian coming public at remarkable valuations. Private technology markets remain incredibly robust with more than 890 'unicorns' (private companies with a valuation > $1bn), and more than 50 'decacorns' (valuation > $10bn), for a combined paper valuation of almost $3tn.

Market leadership has become narrower as 16% of constituents are at 52-week highs compared to ~45% during prior May highs this year. S&P 'equity duration' (a measure of the amount of time to recover an initial investment based on the Dividend Discount Model as calculated by Bank of America) sits near a record of 35 years given the index shift to longer duration companies (often technology), low dividend yields and high P/E ratios. Longer duration increases the sensitivity of the market to small changes in cost of capital. One of the unusual features of the recovery has been the failure of real yields to rebound from their c (1)% lows even as the economic and earnings recovery has progressed. This environment presents a potential headwind for growth equity investors: research by Bernstein has suggested long-duration stocks are more expensive than ever before - the group of stocks most negatively exposed to a rise in yields are trading around their highest relative multiple ever versus the broader market.

There has been mounting concern around higher corporate tax rates given the likely change in the US statutory tax rate to 25%, higher GILTI tax, the establishment of a 15% global minimum tax rate and a 1% tax on buybacks. The 15% global minimum tax and 1% buyback tax could increase the S&P 500 effective tax rate from 17.8% to 20.9%, which would bring a ~300bps headwind to earnings growth in 2022. We expect tax rates to rise structurally over the coming years as governments are required to pay back the costs of their covid-induced largesse, support the health and social care costs deriving from aging populations and invest in digitizing and decarbonising their economies. US government debt is currently in excess of 120% of GDP, the post-War period being the only other occasion where it was more than two standard deviations higher than average. It is not clear, however, that high government debt burdens are of themselves problematic for equity market returns, but the likely outcome is that a substantial portion of the debt burden will be dealt with by (being transferred to) households and corporates, and this could ultimately impact demand and financial stability.

Political risk has been relatively subdued as covid and climate change -both supranational challenges- took centre stage. With Biden in the White House, US-Sino relations remain becalmed although Taiwan represents a key fault-line, as well as a critical part of the technology supply chain. Following the US/UK withdrawal from Afghanistan there was some concern that this might embolden President Xi to move on Taiwan, prompting Biden to state that the US would defend the island if attacked, a notable departure from its previous policy of 'strategic ambiguity'.

It is also important to note upside risks to our outlook and the potential for a continued post-covid boom as the world transitions successfully to a post-pandemic phase. Stocks still look very attractive versus bonds (especially in a higher inflation environment), real rates remain negative and the S&P 500 dividend yield versus the 10-year bond remains at the 80th percentile. Small caps lagged from late 2013 to March 2020 and have recently broken out of a trading range. Corporate and household balance sheets remain healthy, and the digital revolution remains early in its trajectory.

Technology Outlook

Worldwide IT spending is expected to reach $4.5trn in 2021 in current dollar terms, a 9% y/y increase, and a healthy upgrade to forecasts of c.$4trn at the end of our last financial year. This upward revision has been apparent in corporate results so far this year with the S&P technology sector now expected to deliver revenue and earnings growth of 15.8% and 27.7% in 2021, as compared to earlier estimates of 12.6% and 21.2% respectively. After such a strong rebound (aided by easy comparisons) growth will inevitably slow in 2022 with current forecasts for IT spending + 5.5% y/y commensurate with S&P 500 technology revenue and earnings expectations of 9.5% and 8.4% respectively. Despite this, technology growth should still outpace the S&P 500 which is currently forecast to grow at 6.9% / 8.6% respectively. That said, Q3 reporting season has proved more challenging with less than half of US technology companies raising Q4 guidance - better than the market, but a significant downtick from Q2 when 64% of companies raised Q3 guidance. This likely reflects the combination of weaker global growth and supply chain disruption which looks set to extend into 2022 according to Maersk. Despite these headwinds (especially input cost inflation) the technology sector has continued to demonstrate its criticality and/or inherently better business models by expanding its net profit margin to c.25.4%, well ahead of all other sectors (apart from real estate) and up from 22.2% a year ago.

Having reached a low of c20x early during the crisis, the forward P/E of the technology sector has continued to expand and today, the sector trades at 27.5x - new cycle highs - and well ahead of five (20.8x) and ten-year (17.4x) averages. While absolute valuations remain elevated, technology fundamentals are strong. However, the relative rating has expanded to a c.28% premium to the broader market ignoring its balance sheet strength, up from c.19% at year end. Although this premium is somewhat extended relative to the post Great Financial Crisis (GFC) range of c.0.9-1.1x, it likely reflects lower risk-free rates and a flatter yield curve which has driven the recent performance of growth stocks. The sector is also relatively less exposed to some of the near-term challenges facing the global economy. With average hourly earnings growing at 4.6%, the technology sector has experience of how to manage upward wage pressure and a tight labour market for skills in software development, cybersecurity, semiconductor manufacturing and enterprise sales, among other areas. In addition, digital goods and software are (obviously) not subject to physical supply-chain shortages!

While valuations are a little extended, they remain far from levels seen during the late 1990s bubble when the sector traded more than twice the market multiple. That said, aggregate valuations do not tell the whole story because they are diluted by 'cheap' incumbents such as Cisco, HP and Intel that trade on forward P/Es of 7-17x. Equally, the aggregate metrics fail to fully capture the extraordinary valuation premia enjoyed by a narrow group of high-growth, high multiple stocks even after accounting for their superior growth profiles and scarcity value. These are companies we know well but are unable to underwrite many of their current valuation multiples, which we believe are pricing in defiantly optimistic scenarios. While cognizant of how difficult it is to value technology winners (particularly recurring business models that prioritize investment in growth over near-term profits), we suspect that retail participation, concentrated portfolios and late-cycle exuberance is playing a part. We continue to tread carefully within this cohort of stocks because current valuations appear unsustainable and highly reminiscent of the late 1990s.

There are several other features of today's market that are beginning to rhyme a little more with that earlier period, too, including deteriorating breadth / narrower participation as investors flock to perceived category-winners and retail excitement around new asset classes like cryptocurrency and non-fungible tokens (NFTs). For those unfamiliar with NFTs, they are "unique digital assets represented by lines of code on a decentralized ledger" often associated with art or collectibles. Earlier this year, an NFT created by artist Mike Winklemann, known as "Beeple" and previously unknown to the art world but followed by 1.8m people on Instagram, was bought at Christie's for $69m. The two high bidders for this digital asset (titled 'Everydays: The First 5000 Days') were both hugely successful (and early) cryptocurrency investors. A new digital frontier, or another speculative bubble fueled by an earlier frenzy only time will tell, but the excitement around NFTs feels highly reminiscent of the late 1990s boom in domain name registrations (also 'unique digital assets represented by lines of code') and we know how that ended. Finally, we must reference the IPO market which this year is expected to shatter the record for new deals set in 2000, when 406 companies raised $93bn. According to Renaissance Capital, we will see 875 IPOs this year (comprised of 500 SPACs and 375 traditional deals) set to raise $250bn - nearly 3x that achieved in 2000 with the NASDAQ a little more than 3x higher than where it stood when that earlier record was set.

Despite these 'amber flags', we remain constructive about our sector and its medium-term prospects. After all, we cautioned about late-cycle exuberance in our last annual report, highlighting SPAC issuance, retail participation and concentrated portfolios. Since then, our benchmark has advanced 14% while SPAC issuance has moderated, the price of Dogecoin has more than halved, the Robinhood IPO came and went, and ARK Innovation - the actively managed ETF that perfectly captures the zeitgeist of TAM (total addressable market) investing - has fallen modestly while remaining c.25% off its March highs. In other words, exuberance can be contained and/or worked off without derailing the market. This is particularly true when fundamentals are strong and where asset prices are supported by a flood of liquidity looking for a haven from negative real rates. As public market investors, we are also encouraged by the quality and scale of many of the companies choosing to come to market, mitigating some concerns around the declining relevance of public markets in recent years as the number of listed companies almost halved in the US between 1996 and 2018.

Our own enthusiasm remains rooted in technology disruption and pervasion which underpins our view that technology outperformance does not have to end with the pandemic. Instead, we believe that the pandemic acted as a forcing function for companies to adopt the cloud and digitally transform to support vast numbers of remote workers and customers alike. This acceleration and broadening of technology adoption should continue to provide a powerful tailwind for our sector. A Q2'21 survey by Morgan Stanley revealed that 46% of CIOs expect to increase their IT spend as a percentage of revenues in the three years, up from 26% in Q4'19 . Furthermore, the survey revealed that the largest increases from pre- to post-

COVID-19 came from non-tech sectors such as retail, education, healthcare, financial services, and industrials, supportive of our thesis that the rate of technology diffusion is accelerating. Over the coming years we expect every industry to be transformed digitally and we expect artificial intelligence / machine learning (AI/ML) and cloud computing to be central to this.

The advent of a new work modality (hybrid work) will also continue to drive technology transformation, even if reopening and supply chain travails have recently challenged this view. Despite this near-term buffeting, our conviction remains undimmed as the pandemic has been a unique proving ground for the technologies necessary to support a new work modality that represents the best of both worlds - the efficiencies and focus of a remote working model as well as the social and cultural benefits of working in an office. More importantly, the pandemic allowed work to be abstracted from the workplace which prosaically has obsoleted many traditional workflows such as paper-based record keeping. However, in time it is likely to transform the nature of work in much the same way that virtualisation enabled new cloud applications impossible before computing was abstracted from on-premise servers. As such, we expect hybrid work to presage a wave of technology-enabled process automation and digitalisation which will become the norm. As the CEO of DocuSign puts it, "once businesses transform their business processes, they simply don't go back".

This wave could not be coming at a more critical moment with labour and other shortages threatening the recovery trajectory as well as longer-term potential economic growth. Today, S&P 500 companies are 27% more labour efficient than they were in the 1980s in real terms but there has been little change in this metric since the GFC, while productivity growth (as measured by real output per labour hour) has been just 1.25% pa during the last cycle. However, the acceleration in technological disruption catalysed by the pandemic may also support the creative destruction necessary to reallocate labour and capital to more productive enterprises and areas of the economy. In our last report, we described how we might be on the cusp of another tech-driven productivity boom as automation and hybrid work had the potential to "greatly transform service sector productivity via better stratification of work and the scaling of labour". With worker productivity increasing 4.3% in Q1'21 and 2.3% in Q2'21, our thesis appears to be off to a good start which should be sustained if companies lean on their strong balance sheets to invest aggressively in labour automation and productivity-enhancing technologies. Technology spending as a percentage of GDP is expected to double over the next decade and again, there are already promising signs of this in macroeconomic data. R&D as a percentage of US capex has reached 20% from a low to mid-teens level over the past 20 years while software capex has reached a new high of 16.9% of total US capex from 10-11% pre-GFC and just ~7% in the early 1990s. This has been one of the key drivers of the strongest US capex cycle since the 1940s.

Artificial intelligence (AI) is likely to play a key part in driving these productivity gains, as well as providing the foundation for the next wave of technology disruption. We have already seen what is possible within healthcare as AI was used to accelerate virtual screening of a 1.3bn compound library to identify 1000 quality candidate compounds, helping discover multiple COVID-19 vaccines in just ten months compared to an average vaccine development cycle of 10 years. PwC believe that the potential contribution to the global economy from AI could be as much as $15.7trn by 2030, with labour productivity improvements expected to account for more than half of these gains. While diffusion of AI will take time (as it did with other general-purpose technologies), it may prove the most important technology that humanity will ever develop. As Sundar Pichai (CEO of Alphabet) puts it, "if you think about fire or electricity or the internet, it's like that. But I think even more profound". Cloud companies are well placed to capture this growth with AI forecast to capture as much as 50% of total public cloud services by 2025, while semiconductor companies represent leveraged ways to play ML-related compute which is doubling every 3.4 months. By 2025, AI-related demand is expected to account for 20% of total semiconductor demand representing the best incremental opportunity for the industry in decades.

AI is also likely to play a critical role enabling, populating, and supporting the so-called metaverse - "the convergence of physical, augmented and virtual reality in a shared online space". Coined by writer Neal Stephenson in 1992, the term metaverse became a buzzword this year as the pandemic forced people to migrate to and collaborate in virtual platforms such as Zoom, Teams and Roblox. The recent move by Facebook to rename itself Meta Platforms (and to commit to spending $10bn this year alone on Facebook Reality Labs) reflects the company's excitement about the metaverse, the successor to the mobile internet according to Mark Zuckerberg. Other companies have also staked out early metaverse claims including Microsoft ('Mesh for Teams') and Nvidia, whose Omniverse is touted as "transforming workflows in industries (via) immersive visualization, accurate simulation, and faster reviews and discoveries". While Facebook admits that many of its own efforts will only be realised in 10-15 years, the prize looks enormous; last year c$54bn was spent on virtual goods, skins, and lives, more than the $42bn spent at the movie box office and $30bn on recorded music in 2019. The metaverse also comes at an interesting time given the rise of virtual alternatives to money (crypto) and collectibles / art (NFTs). While the adoption timeline remains highly uncertain, the Trust has a significant amount of metaverse exposure via holdings in Meta (Facebook), Nvidia, Roblox, Unity Software as well as chipmakers, component and cloud companies that should all benefit from the infrastructure required to support the metaverse.

One of the most exciting aspects of the metaverse is what it means for dematerialisation - of physical space, distance, and objects. By continuing the trend of swapping 'bits for atoms' as physical goods and services are replaced with digital alternatives, the metaverse could further challenge the link between GDP growth and environmental impact in developed nations. Dematerialisation is just one way technology will help address the challenges associated with climate change. And, after a year of lockdowns resulted in global emissions only declining by c.6% , it should be even more apparent that only technology - by providing innovation at scale - has the singular capacity to get us to net-zero. Indeed, more than one third of the cumulative CO2 emissions reductions seen in the Sustainable Development Scenario (2070) derive from technologies currently at the prototype or demonstration phase, and a further 40% derive from technologies that have not yet moved beyond early adoption. We look forward to providing investors with more information about the sector's ESG impact and more detail concerning the integration of ESG within our own investment process during the second half of the year.

While the metaverse (and other 'game-changing' technologies such as autonomous vehicles, mRNA, and quantum computing) represent optionality today, our own enthusiasm remains rooted in our ability to assemble an attractively valued, diversified portfolio with exposure to 6-8 core themes that in aggregate should deliver more growth than our benchmark for a modest premium based on a forward EV/sales metric. This approach has served us and our shareholders well over the years, although it has been challenged during 2021 by narrower leadership, elevated next-generation valuations, reopening trends (and unexpected supply chain travails) that have pressured several of our themes, as well as being a little too conservatively positioned. However, we remain confident in our risk adjusted approach which we hope will allow long-term investors to continue to capture the best that the technology cycle has to offer without compromising on diversification, valuation discipline and liquidity.

....

Private equity

(compare private equity funds **here**)

Ian Burns, chair of Seed Innovations - 7 December

Following regulatory guidance at the end of 2020, the UK stock market saw a flurry of activity from cannabis focussed companies during the calendar year. Frustratingly, market sentiment has not remained favourable across sectors in general with a number failing to deliver on the expectations of early investors, and particularly for the cannabis focussed stocks. Whilst the publicly listed cannabis stocks across the globe have seen some price pressure over recent months negatively impacting our net asset value, we continue to be a firm believer in investing in the medical cannabis, health and wellness space. With our access and network in the sector, we are well positioned to capitalise on this growth in the short, medium and long term, whilst continuing to seek investments in other disruptive technologies that we believe will create significant shareholder value.

....

Royalties

(compare royalties funds **here**)

Mark Mercuriadis, founder of Hipgnosis Songs - 16 December

The time lag between the consumption of songs and the royalty statements being processed, which is the point at which we recognise revenues, means that the impact of COVID-19 is now being fully felt. In particular, and along with the wider music industry, the closure of live music venues, pubs, bars and restaurants during various lockdowns has impacted the like-for-like performance earnings of our Catalogues during this period. Our vintage Catalogues have made up for a fall in their performance earnings with outstanding streaming performance earnings as consumers turned to classics during lockdown.

As we look forward, despite the emergence of the Omicron variant of COVID-19, we continue to see a promising outlook for the music industry and our Catalogues. Over the last 6 months we have seen live venues are fully booked until 2023, pubs, bars and restaurants are full and streaming growth continues to exceed expectations. This optimism in growth is shared by our independent valuer who has increased the future earnings trajectory for our Catalogues in their valuation models resulting in 3% growth in the fair value of our Catalogues.

However, we must be proactive and not take this recovery for granted, something highlighted by the continued uncertainty caused by the Omicron variant of COVID-19. Therefore, in order to ensure our Catalogues outperform, no matter the wider market conditions, we continue to increase our Song Management efforts. We have hired experts in all parts of Song Management as we explore every opportunity to innovate and maximise earnings from our songs. Our focused and conscientious model provides the bandwidth to be able to manage great songs responsibly, as we maximise their revenues while enhancing their long-term legacies.

. . . .

Debt

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

John Pattullo, Jenna Barnard and Nicholas Ware, managers of Henderson Diversified Income - 14 December

The period under review was remarkably benign. We described the period a year ago as idyllic and it continues to be so. Credit is not the villain here and continues to be remarkably well behaved. The period was broadly about "clipping the coupon" and being neither heroic nor greedy. As we discussed in the last annual review, credit spreads were quick to re-price to the post COVID world. Credit spreads are again reassuringly expensive, reflecting suppressed volatility and exceptionally low default rates. Thus, there was limited opportunity for capital appreciation. The market feels late cycle and credit has lagged the strength of equity markets. We expect this benign environment to evolve given the economic recovery. This will of course present different challenges for bond investors. The period we are entering is understandably a tougher regime - we have very tight credit spreads, and we are at the beginning of a rising interest rate cycle. Bond returns are often lumpy, and this cycle feels no different.

This inevitable and encouraging changing of the guard reflects the post COVID outlook. Inflation is the major focus of central banks today. Inflation had previously slumped into the demand shock of lockdown and was always going to surge back into a re-opening supply shock. This was further compounded by numerous bottleneck problems from semiconductors and containers, to HGV drivers. Although we are broadly understanding of the base effects and bottleneck supply side arguments for cyclical inflation, we have been surprised by the forecasting error regarding inflation by most commentators. We feel it is reasonable to expect the goods, services, and commodity markets to sort themselves out with time. Unless there is a persistent and sustained uptick in the demand for credit, we do not believe consumers are permanently going to be buying more "stuff". Many consumers have excess savings and time will tell whether is it the roaring twenties or perhaps an environment of a more precautionary approach to savings and consumption? We are sympathetic to the idea that people have re-appraised lifestyles and working practices. Indeed, given the rapid digitalisation of many industries we would broadly suggest a more dis-inflationary economy longer term. We have spoken at length about how COVID has simply accelerated existing structural trends which were already apparent to see. We have also favoured structural digital winners over cyclical analogue losers - for example, favouring data centres over shopping centres and similarly Netflix over cinema chains!

However, against this background two important themes remain; firstly, how central banks react over the larger and less transitory inflation surge, and secondly, the bizarre tightness of the labour market. We are very focused on these two issues and cannot get too tied up in the team transitory versus permanence of inflation debate. The swing factor may be the tightness or otherwise of the labour market. Normally, unemployment is a significant issue coming out of a recession. The furlough scheme has preserved millions of jobs around the world at a considerable cost. But now many western economies have too few workers! America has approximately 5m fewer workers than pre COVID; the UK has 900,000 fewer. The great resignation or the great re-set describes the fall off in people participating in employment. Many older, wealthier people have prospered during COVID and have retired early; many students have extended their studies whilst others have simply re-appraised their work/life balance. These issues have been compounded by restricted migration and in the UK's case, an exodus of EU nationals. This is all crucially important because "normal" participation levels would suggest US unemployment levels of 8%+, whilst new participation levels would suggest levels nearer 4% and heading lower. These numbers include both cyclical and structural elements evolving over time.

How the unemployment numbers pan out will have a significant bearing on how central banks change monetary policy to fulfil their mandate objectives. A rise in interest rates has already caused yield curves to flatten which, by design, makes risk taking less compelling. This will induce, in time, greater volatility and risk aversion.

Equity markets feel euphoric to us. There are some excesses going on in markets but none of these seem to be of systemic importance. One notable area is the leveraged buyout activity of predominately US private equity purchasing cheap UK businesses. Again, we are by design not exposed to many UK businesses, but we are understandably wary of this trend. The private equity community is awash with cash and seems to be running their slide rule over many cheap European businesses. Elsewhere there are only pockets of excess. We remain vigilant and picky in this late cycle environment.

Credit spreads are tight and bond yields are fairly low. Given where we are in the economic cycle, we do expect an uptick in volatility from the current very low levels. We are very focused on central banks' reaction functions to both their inflation and employment mandates. We remain confident in maintaining the current level of income in the foreseeable future for our shareholders which remains our primary focus.

Leasing

(compare leasing funds here)

Robin Hallam, chair of Amedeo Air Four Plus - 23 December

Industry update

The International Air Transport Association (IATA) announced that the recovery in air travel continued in October 2021 with broad-based improvements in both domestic and international markets. It also warned that the imposition of travel bans by governments, in light of the Omicron variant, could threaten the sector's recovery.

Total demand for air travel in October 2021 (measured in revenue passenger kilometers or RPKs) was down 49.4% compared to October 2019. This was improved over the 53.3% fall recorded in September 2021, compared to two years earlier. Domestic markets were down 21.6% compared to October 2019, bettering the 24.2% decline recorded in September versus September 2019. International passenger demand in October was 65.5% below October 2019, compared to a

69.0% decline for September versus the 2019 period, with all regions showing improvement.

IATA's Director General, Willie Walsh, claims "October's traffic performance reinforces that people will travel when they are permitted to. Unfortunately, government responses to the emergence of the Omicron variant are putting at risk the global connectivity it has taken so long to rebuild". Willie Walsh believes the emergence of the Omicron variant panicked many governments into once again restricting or entirely removing the freedom to travel-even though WHO clearly advised that 'blanket travel bans will not prevent the international spread, and they place a heavy burden on lives and livelihoods.'

IATA released October 2021 data for global air cargo markets showing that demand continued to be well above pre-crisis levels and that the capacity constraints have eased slightly. Global demand, measured in cargo tonne-kilometers (CTKs*), was up 9.4% compared to October 2019 (10.4% for international operations). Capacity constraints have eased slightly but remain 7.2% below pre-COVID-19 levels (October 2019) (-8.0% for international operations). Willie Walsh stated that "October data reflected an overall positive outlook for air cargo. Supply chain congestion continued to push manufacturers towards the speed of air cargo. Demand was up 9.4% in October compared to pre-crisis levels. And capacity constraints were slowly resolving as more passenger travel meant more belly capacity for air cargo. The impact of government reactions to the Omicron variant is a concern. If it dampens travel demand, capacity issues will become more acute.".

Geoffrey Hall of Doric Nimrod Air Two - 16 December

The emergence of the Omicron variant in late November 2021 has significantly increased uncertainty over the path of recovery of global air passenger traffic in the next few months, according to an IATA report from early December, as it may result in countries reimposing more extensive travel restrictions again. Israel and Japan have become the first to shut their borders for foreign travellers.

There are currently 70 A380 Aircraft in service globally of which 57 are being operated by Emirates. Emirates highlighted in late September that plans to restore 70% of its capacity by the end of 2021 are on track with the return to service of more than 50 A380 aircraft. Around the same time Emirates also embarked upon a worldwide campaign to recruit 3,000 cabin crew and 500 airport services employees to join its Dubai hub over the following six months. Pleasingly, several other A380 operators have stated plans to reintroduce the A380 to their fleets including British Airways, Singapore Airlines, Qatar Airways and Qantas Airways.

In its recent half-year results Emirates Airline reported that revenue rose by 86%, supported by increasing passenger demand and continuous strong cargo business. The airline reported EBITDA recovered to USD 1.4 billion but posted an overall loss of USD 1.6 billion. In the first half of 2021-22, the Government of Dubai injected a further USD 681 million into Emirates Group by way of an equity investment and they continue to support the airline on its recovery path. The airline reported a cash position of USD 3.9 billion as at 30 September 2021. His Highness Sheikh Ahmed bin Saeed Al Maktoum, Chairman and Chief Executive, Emirates noted "Our cargo transport and handling businesses continued to perform strongly, providing the bedrock upon which we were able to quickly reinstate passenger services. While there's still some way to go before we restore our operations to pre-Pandemic levels and return to profitability, we are well on the recovery path with healthy revenue and a solid cash balance at the end of our first half of 2021-22."

Whilst Emirates do not have a formal credit rating, they have previously issued unsecured USD bonds with maturities in 2023, 2025 and 2028. At the time of writing these instruments are trading at approximately 101, 102.7 and 103 cents respectively, equivalent to USD running yields in the range of roughly 3.8 to 4.4%. Further details on Emirates and the A380 can be found in the Asset Manager's report by Doric.

The redelivery procedure for a widebody aircraft is complex and highly technical and as we move closer to the first lease expiry your Board will provide more details on the high-level considerations and also the implications of the various potential outcomes for Shareholders.

Doric continues to monitor the Leases and is in frequent contact with the Lessee and reports regularly to the Board. Nimrod continues to liaise with Shareholders on behalf of the Board and has provided valuable feedback on the views of Shareholders in the current climate.

Shareholders should note that although the underlying cash flows received and paid during the Period have been received and paid as anticipated and in accordance with contractual obligations; it may not be obvious from the accounts that this is so because of the application of the accounting treatments for foreign exchange, rental income and finance costs mandated by IFRS.

For instance, the entirety of the rental income that is receivable under the 10-year Leases followed by an extension term of 2-years (including advance rental received as part of the initial acquisition of the Assets) is credited evenly over each of the 144 months of the Leases. However, the actual rental income has been received in advance of this uniform pattern in order to match and fund the accelerated payment down of debt. Thus as at 30 September 2021, some 90% of income receivable under the Leases has been received, which has funded the payment down to 86% initial borrowings, whereas under the relevant accounting standard only some 77% may be recognised. This mismatch in timing between the receipt and recognition of rental income results in a deferred income creditor of some £147 million or some 85 pence per share in the 30 September 2021 balance sheet. This is an artificial accounting adjustment in the sense that it does not represent a liability to pay £147 million to third parties. The faster that income is received and debt repaid the larger the resultant creditor, producing a reduction in reported net asset value.

Similarly, the relevant accounting standards require that transactions denominated in currencies other than the presentation currency (including, most importantly, the cost of the Aircraft) are translated into the presentation currency at the exchange rate ruling at the date of the transaction whilst monetary items (including also very significantly, the outstanding borrowings and deferred income creditor) are translated at the rate prevailing on the reporting date. The result is that the figures sometimes show large mismatches which are reported as unrealised foreign exchange differences - although the distortive effect becomes less pronounced over time as debt is paid down.

On an on-going basis and assuming the lease rental is received, and the loan payments are made as anticipated, such exchange differences do not reflect the commercial substance of the situation in the sense that the key transactions denominated in USD are in fact closely matched. Rental income received in USD is used to make loan repayments due which are likewise denominated in USD. Furthermore, the USD lease rentals and loan repayments are fixed at the inception of the respective Leases and are very similar in amount and timing.

Infrastructure

(compare infrastructure funds **here** and **here**)

Ian Reeves, chair of GCP Infrastructure - 14 December

The lead-up to COP26 has brought into sharp focus the risks of accelerated climate change caused by human activity. The conference has seen many countries commit to significant decarbonisation targets and the establishment of global flows of capital investment to finance the associated costs.

The UK, like many of these countries, finds itself at a critical juncture for its infrastructure policy. Infrastructure investment offers a fiscal stimulus to support the necessary recovery from the Covid-19 pandemic. The UK has committed to a legally binding target to decarbonise by 2050 and is targeting the decarbonisation of its electricity generation sector by 2035. Both represent significant shifts in infrastructure policy and will need clear governmental support mechanisms to incentivise the necessary private investment. 'Build back better' is an appropriate, if overused, summary of the opportunity.

At the same time, the cost of government borrowing remains historically low, and public-private procurement models have been ruled out as they are not considered a 'best value-for-money' approach. Infrastructure investment opportunities that may historically have been available to the private sector are therefore being funded directly by central government. Centralised funding for sectors including roads, housing, education, healthcare and community facilities means such investment opportunities are increasingly limited for private investors. The anticipated increase to Bank of England interest rates is unlikely to materially impact this picture.

The material private sector infrastructure investment opportunities therefore arise from the decarbonisation agenda. Mechanisms to attract investment in support of this agenda show some promise. The fourth contract-for-difference auction in December 2021 will, for the first time since 2014, support solar PV and onshore wind. Offshore wind has been allocated its own budget, opening up competition for other less-established technologies to win contracts. The Green Gas Support Scheme, introduced late in 2021, provides support for the decarbonisation of natural gas. During the period, the Government published strategies on the net zero transition, hydrogen and the decarbonisation of transport and industry. Subsequently, after the period end, the Government also published the strategies on heat and buildings.

In addition to the more established decarbonisation sectors, the Company is reviewing opportunities in other sectors that will be fundamental in contributing towards the net zero target, such as forestry, electric vehicles and controlled environment food production.

. . . .

Renewable energy infrastructure

(compare renewable energy infrastructure funds **here**)

Tony Roper, chair of SDCL Energy Efficiency Income - 10 December

SEEIT's target markets are expected to continue to grow. Market drivers include increasing levels of focus on decarbonisation targets in the public and private sector globally, the need for energy security and resilience and relatively high and increasingly volatile energy prices. This continues to drive demand for on-site generation, distribution and demand side reduction solutions that can result in cheaper, cleaner and more reliable energy.

In Europe, we expect that government policies such as the European Commission's Renovation Wave - involving energy efficiency measures in some 35 million buildings across Europe in the coming decade - will help to accelerate the market and translate into project investment opportunities for SEEIT over the medium to long term. In the short term, the Investment Manager's pipeline consists of existing operating projects from an already significant installed base, as well as new projects often sourced organically as follow-on opportunities based on SEEIT's existing portfolio. In the UK, we expect the market to be stimulated by progressive government policies on decarbonisation, not just in the public sector but also in the private sector, as illustrated by new Treasury requirements for UK firms to publish plans for decarbonisation by 2050.

The United States is one of the largest and most dynamic markets for investment in clean energy and energy efficiency and has gained further momentum in the first year of the Biden administration which has put clean energy and infrastructure at the forefront of its climate policies. The most ambitious targets for decarbonisation often come from private companies seeking to achieve decarbonisation or "net zero carbon" by a stated date, which is often decades ahead of national government policies. Where this can be delivered profitably though energy efficiency measures, it drives demand for projects in which SEEIT wishes to invest. Meanwhile at regional government level, cities are taking the lead - over 1,000 cities, many of them in the United States, signed up to the "Cities Race to Zero" involving a goal of reaching net zero emissions by 2050 and cutting their fair share of global emissions in half by 2030.

. . . .

Jonathan Parr, partner and head of energy at Triple Point Energy Efficiency Infrastructure - 2 December

It is a good time to be investing in Energy Efficiency Projects. First, there is the policy imperative, led by government support for energy efficiency measures, and which has been borne out of funding by government for example into heat networks and energy efficiency. Second, there is the sheer size of the opportunity, for example the need to decarbonise buildings across the UK. Third, there is the ever-accelerating drive towards Net-Zero and the requirement to decarbonise and improve efficiency and productivity.

In addition, with the possibility of inflation hanging over the economy as the recovery gathers pace, Energy Efficiency Projects can provide a degree of protection in this environment through contracted and inflation-linked cash flows, which offer investors an attractive yield.

COP26 has focused minds on the importance of mitigating climate change. Energy efficiency is a key lever to use to reduce the impact from the use of energy by making it cleaner, more efficiently used and less expensive. We are having active discussions with a number of technology providers and developers who are seeing a growing demand for carbon reduction and better use of energy both for climate change reasons but also for creating a more robust infrastructure. This includes already widely used technologies such as solar, both ground mounted and rooftop PV, but also for newer technologies such as battery energy storage solutions. The latter is also seeing increasingly large projects being developed in order to take advantage of the need to balance out the growing level of reliance on renewable generation. This is also an opportunity for the Company to grow with the expanding demand for climate change solutions.

The Government continues to be highly committed to achieving its Net-Zero targets and the Company continues to be well positioned to assist in the achievement of those goals. We are also confident in our pipeline, which includes a wide range of low carbon and energy efficient technologies.

. . . .

Property

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

William Hill, chair of Ediston Property Investment Company

There are compelling investment reasons for the retail warehouse sector to recover further and provide ongoing value opportunities. It has proved to have been the most resilient retail sub-sector during the COVID-19 pandemic, with favourable rent collection figures and an active tenant market.

Following the sell down across all retail markets, the investment manager considers the retail warehouse sub-sector to have been oversold, and there is now increasing recognition in the market that is the case. Yields look attractive when compared to other property sub-sectors, often with income secured on high quality tenants. The anticipated recovery in consumer spending will likely favour many of the retailers that trade from retail warehouses. The format also works well alongside on-line retailing, supporting retailers' omnichannel strategies.

. . . .

Civitas Investment Management, investment advisor to Civitas Social Housing – 9 December

The National Housing Federation estimated in September 2020 that there were 8m people in some form of housing need, 1.6m households on official waiting lists and at least 129,000 children living in temporary accommodation. Given the level of supply of new social homes was, in 2020, only 6,338 (social homes at 50% of market rent) this demand will never be met. In addition, supply is further constrained by the demands placed upon existing large housing providers in meeting the costs generated by fire safety measures post Grenfell, remediation of cladding, the cost of reducing carbon emissions and additional consumer regulation proposed in the recent White Paper on social housing "The Charter for Social Housing Residents". This all points to the continued very high demand for private and institutional capital to contribute to meeting the exceptionally high demand for high-quality specialist social housing.

Healthcare being provided as close to the community as possible and in homes or small residential settings is clearly demonstrated to be the focus of government and has considerable cross-party support. The private sector, both in terms of service delivery and investment, has a pivotal and essential role to play in this regard. Civitas is at the forefront of bringing the skills and experience required to work across sectors to further develop its high-quality portfolio and be influential in helping the sector to mature.

. . . .

Rob Whiteman, chairman of Residential Secure Income – 1 December

The UK's structural housing shortfall continues and most of the population lives in areas where home purchase is unaffordable. These twin factors drive the fundamental need for new, long-term investment into this sector. The government continues to support Homes England's Affordable Homes Programme, with total funding of £12.2bn for new affordable housing over five years. However, housing associations, the traditional investors, need to invest huge sums into their existing stock to ensure safety and energy efficiency, which reduces their ability to provide new affordable homes. We remain excited by the opportunity to help housing associations recycle their capital with developers to deliver new affordable homes, helping to meet the critical shortage of affordable homes for independent retirement living and home ownership and in turn delivering inflation-linked income to our investors.

. . . .

Robert Orr, chairman of Tritax EuroBox – 7 December

The [European logistics] occupational market is increasingly favourable and we expect the trends of strong occupier demand, driven by e-commerce and the reinforcement of fragile supply chains, to continue in the long term. When considered alongside limited new supply of logistics space, we expect consistent, sustained rental growth in prime logistics markets. We are confident of being able to extract further value from the existing portfolio through, amongst other initiatives, capturing this rental growth through asset management and development activities.

. . . .

Sir Julian Berney, chairman of Schroder European REIT – 7 December

Confidence within the Eurozone has improved and expectations are for economies to move back to their pre-COVID GDP levels during 2022. Near term, markets are dealing with increasing energy costs and supply constraints, particularly regarding materials and labour, which are collectively heightening inflationary concerns. As a result, there is a risk that the European Central Bank will move to control inflation via an increase in interest rates, albeit we see this risk as modest. Despite this, both the board and the investment manager are confident in the outlook of the company, given the strong cash position, diversification characteristics, exposure to higher growth cities and local management expertise. Whilst we remain committed to scaling the company and are acutely aware of the benefits that this will bring, patience will remain in our critique of new investments to improve income cover and diversification. The company continues to be a unique and compelling proposition for investors and is well placed to benefit from the trends that have accelerated as a result of the pandemic. These include changes in occupier demand, delivering operational excellence and ensuring that sustainability priorities are instilled within the company's investment process.

. . . .

Paul Arenson, chief executive of Industrials REIT – 3 December

The multi-let industrial asset class, together with the ever-diversifying customer base that occupies our space, has continued to demonstrate resilience, performing well against the sustained backdrop of COVID-19 and into the recovery. Moreover, Industrials REIT has seen increasing tenant demand, high levels of occupancy and consistently strong like-for-like rental growth at year-on-year levels of circa 5%.

Rental values continue to improve in the sector and the incentives agreed on leases remain low, driven by strong supply/demand fundamentals and the quality of our product.

As an operating business, we see considerable value in our platform and believe that our ability to manage multi-let industrial assets is best in class. The increasing benefits of our Industrials Hive platform with regards to digital marketing and a fast and effective leasing process are particularly noteworthy. Over time, we see our Industrials Hive platform as the key to creating further efficiencies as we continue to digitise and scale our business.

Notwithstanding the setback in the global fight against COVID-19 with the appearance of Omicron, we remain confident that our multi-let industrial portfolio will prove to be resilient and will continue to deliver strong fundamental performance in the second half of the year.

QuotedData
BY MARTEN & CO

IMPORTANT INFORMATION

This note was prepared by Marten & Co (which is authorised and regulated by the Financial Conduct Authority).

This note is for information purposes only and is not intended to encourage the reader to deal in the security or securities mentioned within it.

Marten & Co is not authorised to give advice to retail clients. The note does not have regard to the specific investment objectives, financial situation and needs of any specific person who may receive it.

Marten & Co may have or may be seeking a contractual relationship with any of the securities mentioned within the note for activities including the provision of sponsored research, investor access or fundraising services.

This note has been compiled from publicly available information. This note is not directed at any person in any jurisdiction where (by reason of that person's nationality, residence or otherwise) the publication or availability of this note is prohibited.

QuotedData is a trading name of Marten & Co, which is authorised and regulated by the Financial Conduct Authority.

123a Kings Road, London SW3 4PL
0203 691 9430

www.QuotedData.com

Registered in England & Wales number 07981621,
2nd Floor Heathmans House,
19 Heathmans Road, London SW6 4TJ

Edward Marten (em@martenandco.com)

David McFadyen (dm@martenandco.com)

Nick Potts (np@martenandco.com)

Colin Edge (ce@martenandco.com)

INVESTMENT COMPANY RESEARCH:

Jayna Rana (jr@martenandco.com)

Matthew Read (mr@martenandco.com)

James Carthew (jc@martenandco.com)

Richard Williams (rw@martenandco.com)