Economic & Political Roundup

Monthly roundup | Investment companies | March 2022

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

Exchange rate	28/02/22	Change on month %
GBP / USD	1.342	-0.2
USD / EUR	0.8914	0.1
USD / JPY	115	-0.1
USD / CHF	0.9168	-1.1
USD / CNY	6.3093	-0.1

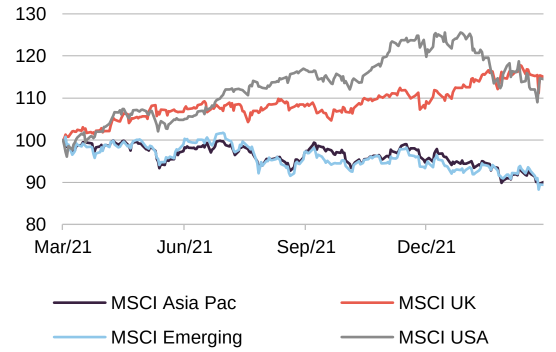
Source: Bloomberg, Marten & Co

Roundup

Just as the coronavirus pandemic appears to be subsiding, February ended on a sombre tone as Russia began its invasion of Ukraine. Some markets have been impacted worse than others, with those depending on its exports suffering the most. Unsurprisingly, some investment trusts have also been negatively impacted, particularly those exposed to Russia, which has had a number of sanctions imposed on it – you can read more on this in our investment companies roundup. As expected, investors have rushed to traditional safe havens such as gold, while energy prices have soared even further. Government bond yields also increased on the whole in February.

MSCI Indices rebased to 100

Time period 01/03/2021 to 28/02/2022



Source: Bloomberg, Marten & Co

Indicator	28/02/22	Change on month %
Oil (Brent)	100.99	10.7
Gold	1908.99	6.2
US Tsy 10 yr yield	1.825	2.7
UK Gilt 10 yr yield	1.41	8.3
Bund 10 yr yield	0.132	1366.7

Source: Bloomberg, Marten & Co

Global highlights

Sentiment hurting markets

Alliance Trust's manager says it has been hit by market-driven sentiment but that it is excited about its portfolio's fundamentals and holdings with strong long-term credentials.

Herald's chair says geopolitics are an increasing concern, added to soaring energy prices and supply-chain inflation, which will lead to inevitable fiscal tightening.

Carolan Dobson, chair of Brunner, believes we are at a turning point in global stock markets with regards to inflation and interest rates. She says the ride will be bumpy, but investors should be patient.

Scottish American's managers also note inflation concerns but say they don't believe in shuffling the portfolio to 'macro music'.

QuotedData
BY MARTEN & CO

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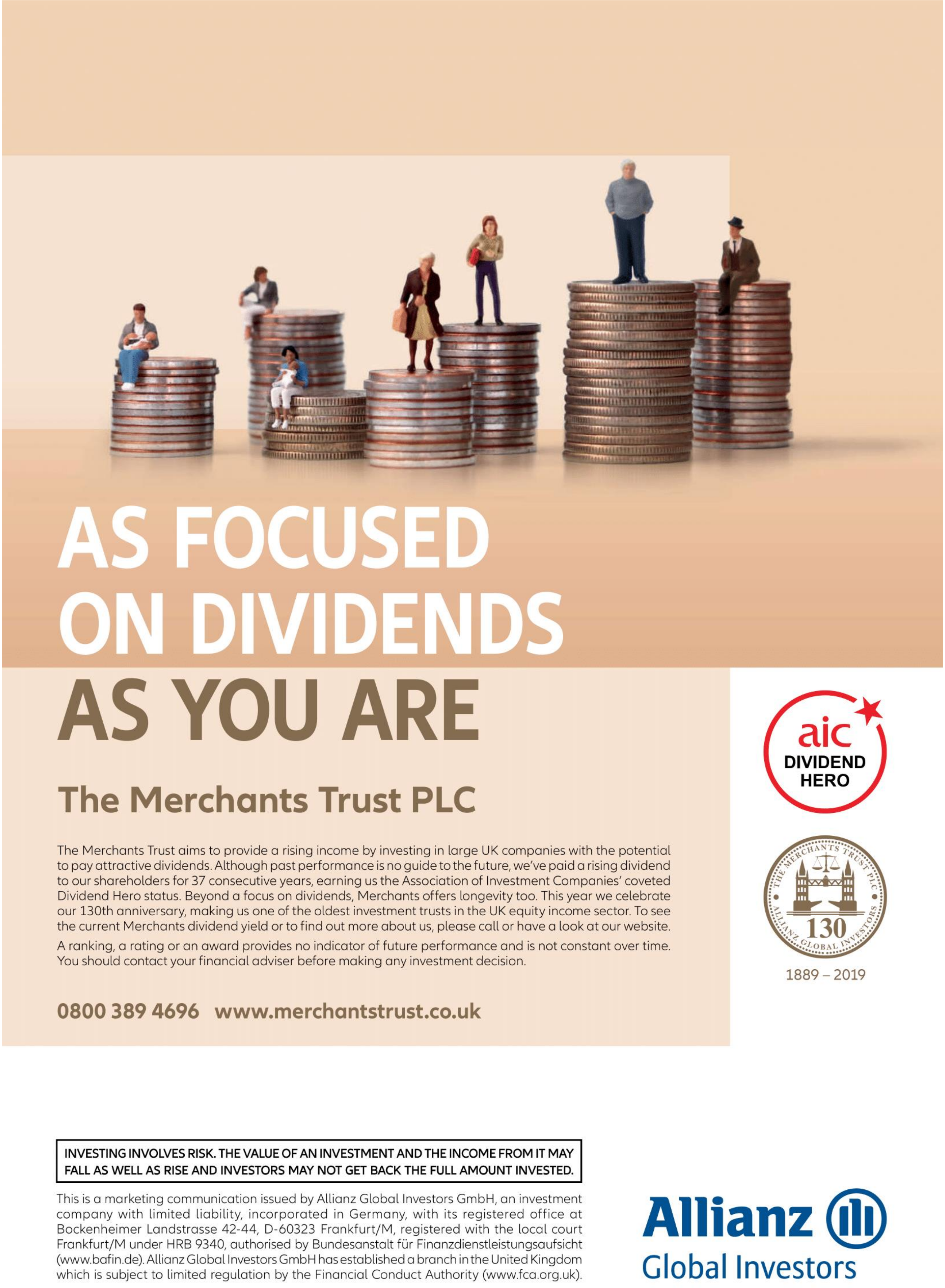
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Global Investors

February's highlights

UK

Invesco Select UK Equity's chair says despite the current challenging backdrop, she sees encouraging signs of countries beginning to learn with COVID-19 as a reason to remain optimistic.

The chief executive of Law Debenture says the market for its expanding range of pension governance services will continue to increase steadily over time.

Rising inflation is an issue for market levels

Murray Income's managers are taking comfort that the valuations of UK-listed companies remain attractive on a relative basis despite current market volatility.

The managers of abrdn UK Smaller Companies Growth note rising inflation is an issue for market levels and is likely to result in policy changes at central banks, making interest rate rises a racing certainty in the next few months.

City of London's chair does not expect anything worse than a slowdown in economic growth is expected and thinks therefore that corporate profits and dividends should continue to increase during the trust's current financial year.

Diverse Income's managers think that if the returns on many mainstream stock markets disappoint in future, then the ongoing advantages of UK quoted smaller companies could lead to renewed institutional interest.

The manager of BlackRock Throgmorton highlights the difficult start to 2022 that equity markets have experienced.

Rapid changes within the economy are creating real opportunities for some companies

Henderson Opportunities' managers explain why it is an exciting time to be investing in the UK. Rapid changes within the economy are creating real opportunities for those companies with the ability to grasp them.

Commenting on inflation concerns, Aberforth Smaller Companies' chair says with the rhetoric from the central banks evolving, it does appear likely that the coming year will bring some form of resolution.

The managers of Aberforth Split Level Income say markets appear to be anticipating economic and financial conditions little changed from those that have pervaded since the global financial crisis: low real economic growth, low inflation, low interest rates and low bond yields.

North America

The BlackRock Sustainable American Income team says its concerns centre on inflation's potential to squeeze corporate profit margins, particularly if consumers grow less willing to pay up for goods and services.

2022 is likely to be a 'VUCA' world.

Brown Advisory US Smaller Companies' managers say as we look ahead to 2022, we will probably confront a volatile, uncertain, complex, and ambiguous ('VUCA') world.

Renewable Energy Infrastructure

Greencoat Renewables' managers explain the long term, national scale drivers for expansion and value enhancement that they see in the Irish wind market.

> Volatility within power markets has shown that power forecasters have underestimated near term future electricity prices

The chair of Bluefield Solar Income highlights that volatility within the power markets has shown that power forecasters have underestimated near term future electricity prices.

The Renewables Infrastructure Group's chair notes that as the investable universe expands, so too has the volume of capital seeking to invest in this sector.

Other

We have also included comments on **global emerging markets** from Mobius and Gulf Investment Fund; **Europe** from European Opportunities; **Japan** from CC Japan Income & Growth; **China** from abrdn China; **flexible investment** from Ruffer; **biotechnology & healthcare** from BB Healthcare; **growth capital** from Seraphim Space; **private equity** from Pantheon International; **hedge funds** from Gabelli Merger Plus+; **debt** from CQS New City High Yield; **financials** from Polar Capital Global Financials; and **property** from Custodian REIT, UK Commercial Property REIT, Standard Life Investments Property Income, Derwent London, SEGRO, Primary Health Properties, Unite Group and Irish Residential Properties REIT.

Global

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

Investment manager of Alliance Trust - 25 February

Despite disappointing relative returns in the fourth quarter of 2021, we are very excited by the current portfolio's fundamentals and how these are helping to position the portfolio for 2022. As of the end of 2021, the portfolio looks better value than the benchmark, with stronger and more stable earnings growth. Although long-term fundamentals were less of a focus in 2021, we believe they will come back into the limelight, as they are the driver of long-term equity returns.

Some of our stocks have been hurt on a relative basis by the sentiment-driven market, being overly penalised by short-term considerations despite maintaining very strong long-term credentials. Our Stock Pickers stand by these firms. They include names such as Booking.com, other consumer discretionary names such as Adidas, or payments companies such as MasterCard or Visa. These companies were all hit by the Omicron variant-related uncertainty as well as occasional idiosyncratic concerns. Despite the short-term impacts of the Omicron variant, companies such as Booking.com, with dominant market positions, should flourish over the long term.

With the threat of persistent inflation now present, those growth companies with particularly lofty valuations are most vulnerable to the associated impact of tightening financial conditions, particularly once Omicron fears recede, and as longer-term fundamentals come back into focus. We have already seen volatility in the early part of 2022 as markets weigh up the impact of rising inflation and increasing costs of capital.

We believe the overall growth rate of corporate profits is set to slow in 2022, relative to the recovery levels of growth seen in 2021, returning to pre-pandemic trend growth perhaps as early as the end of 2022. While the outcome is uncertain, we expect inflation rates to slow as commodity prices stabilise, workers continue to return to the workforce after Covid pressures abate; and some of the global supply constraints currently disrupting industry continue to ease.

However, there are risks to the upside in terms of inflation trends and equity market returns. The increased geopolitical tensions surrounding Ukraine and Russia's recent actions are further fuelling volatility and compounding concerns around inflationary impacts on energy prices associated with this escalating conflict. We could also see elevated price pressures persisting for longer given continued risks of supply-side constraints and the impact of very tight labour markets. As such, a fundamental bottom-up analysis of the resiliency of each company to inflationary pressures is required. Valuations continue to compress driven by rising discount rates and continued recovery in earnings for Covid-hit sectors. We expect margins to be the deciding factor for equity returns (particularly in the US where the economy is further along in the business cycle). Companies best able to pass on (or avoid) rising input prices whilst navigating the impact of rising yields across many developed markets may be set to navigate this environment well. Our Stock Pickers have been actively evaluating the impacts of higher inflation on their companies to ensure they can weather that storm.

Regarding China, recent regulatory changes have dominated 2021 for the region. Navigating these changes may be the main challenge for investors in the short term against a global backdrop of rising inflation in the West and prevailing US-China tensions. Overall, whilst uncertainty does cloud the region, we continue to believe the long-term case for Chinese equities remains and the region provides selective investment opportunities, potentially broadening sources of diversity available to investors.

As current global constraints start to ease, and concerns over the Omicron variant continue to dissipate, we believe we will see a continuation of market recovery, providing great opportunities.

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Tom Black, chair of Herald - 22 February

2021 has been a mixed year with an unusually small proportion of the portfolio delivering the returns. More positively we are pleased that the portfolio has proved resilient through the second year of Covid

As ever there is much to worry about geo-politically with uncertainties in Russia/Ukraine, China/Taiwan/US and the US/Iran of particular concern. Added to these, this year we have the new challenge of soaring energy prices which, when combined with supply-chain inflation, and inevitable fiscal tightening, seems bound to put pressure on consumer spending. However, much of the technology sector has become non-discretionary spend for consumers, businesses and governments alike and we still see strong growth prospects in our chosen sector.

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Carolan Dobson, chair of Brunner - 16 February

There is considerable concern that we may be at a turning point in global stock markets. There has been over a decade of falling interest rates which at their low reached a level where many central banks charged an investor for holding money with them. This is unsustainable unless economies never grow again and as we are now seeing positive global economic growth, and some sharp and possibly sustained rises in inflation, central banks are starting to indicate increasing interest rates and a wind down or reversal of their quantitative easing programmes. This is a big change in the background for markets and it remains to be seen how peacefully such a change can be implemented. The way modern stock markets are structured, with short term activity dominating trading, and geared strategies - often focused on quite narrow areas - offering the prospect of sharp volatile stock market price movements often unrelated to underlying company profit fundamentals. This will provide opportunities for the patient, thoughtful investor but it is likely to be bumpy.

In addition, geopolitical tensions with China and Russia may continue to have a significant impact on market sentiment and particularly on supply chains and energy prices. It is difficult to know whether stock markets will be higher or lower this time next year, but the board have confidence that many of the companies in our portfolio will continue to make good business progress.

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James Dow and Toby Ross, managers of Scottish American - 11 February

Over the last year there have been many headlines about inflation. Consumer demand has rapidly recovered after the pandemic, and yet many supply chains have been struggling to operate at full capacity. Some of our logistics holdings, such as freight forwarder Kuehne + Nagel, have benefited from helping customers navigate this disruption, with profits expected to double year on year - but the knock-on impact has been costs going up, for businesses and consumers. At the same time, a common refrain from companies we've spoken to has been that finding skilled labour is increasingly a challenge. Wage expectations in many parts of the economy are rising, as are interest rate expectations.

One school of thought about how to respond to this says: now is the time to go for stocks on low earnings multiples, because their share prices will be less affected if stock markets discount earnings more aggressively. At the end of 2021, such stocks were definitely in vogue, and the textbooks say there's a mathematical method to this.

We don't tend to believe in shuffling the portfolio to try keeping time with the macro music. Our experience has been that the best results come from finding companies that can adapt to different rhythms, and trust them to do the dancing.

In any case, we aren't sure that pivoting to stocks just because of low multiples will serve the long-term income investor well. When we examined the impact of inflation across our companies last Spring, it struck us that two things were very important for protecting and growing earnings. Firstly, genuine pricing power. Often people conflate pricing power with proxies like 'having a known brand'. However, if you talk to any company about how you pass through higher costs in the real world, then the answer is more often "we find a way to give more value to the consumer, and that enables us to charge a bit more for a better product". In other words, they innovate. To our mind real pricing power comes from those companies which are constantly innovating, and solving new needs for customers. It's because of this that Microsoft did not struggle to put through a 10% price increase this year, and neither did chip-maker TSMC.

The second is the importance of having large volume growth opportunities. It is much easier for a business to absorb 5% cost inflation and still grow its earnings if its volumes are growing healthily, and it is in the process of opening up big new markets. It is much harder if it is mature, and struggling to find the next customer. In such businesses, cost pressures are more likely to fall through to the bottom line and, in time, this will fall through to dividends too. We see this in our portfolio too - the companies that have found inflation most challenging have typically been those that have been struggling to deliver meaningful volume growth even in better times (Kimberly-Clark de México being one example).

So we think the better question to ask is not about just the PE multiple, but about the extent to which the business is in control of its destiny, and the scale of its growth opportunity - ie is it large enough that we can be confident of it significantly outpacing inflation, even if inflation is higher for longer? Indeed, these factors may well become even more important and valuable if the world in the next few years experiences a period of persistently higher inflation.

Of course, the focus on execution and growth isn't just about inflation. One reflection we've had when looking at our most successful investments over recent years is that they've typically been businesses which delivered very robust earnings and dividend growth over a sustained period. In each case the scale of their opportunity was very large, whether that was in providing access to private investment markets for Partners Group, or the growing Chinese sportswear market for Anta Sports.

The best way, then, to ensure that SAINTS delivers really attractive dividend growth over the next five to ten years is more likely to be by us, as managers, continuing to challenge ourselves on whether we have enough real growth coming through from our holdings. There's no short-cut for delivering this. It means continuing to be demanding when deciding which companies we own; reflecting on lessons we've learned about what makes company cultures succeed and fail; thinking hard about the next industry-wide changes that will open up opportunities for companies; and, when it comes to new idea generation, looking at many frogs in our search for the rare princes.

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UK

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

Victoria Muir, chair of Invesco Select UK Equity - 4 February

At the time of writing, whilst the level of vaccinations in many countries appears to be limiting the severity of the current wave of infections, the prevalence of the virus has had an impact both on health service resources and the broader workforce, which has presented a headwind to the speed of global economic recovery.

Accompanying these trends, the scaling back of central bank stimulus, rising inflation and concerns around the speed and extent of interest rate increases has led to a surge in bond yields and a cost-of-living squeeze. The UK government has already taken the first steps in raising interest rates, with the Fed making similar soundings. Geo-political factors, including Chinese policy and fears around a potential Russian invasion of Ukraine further add to uncertainty.

Despite this challenging backdrop, there are reasons to be optimistic. Latterly, we are seeing encouraging signs of many countries beginning to learn to live with Covid-19 and restrictions being lifted, alongside the expectation of a likely eventual shift in the virus's status from 'pandemic' to 'endemic'. 'This would create a generally more normalised and stable environment to underpin economic growth, albeit there will be differences from country to country.

As I noted in the Company's 2021 Annual Financial Report, the route back out from restricted economies across the globe is likely to experience road-bumps; investors and portfolio managers will have to navigate these and other factors as the year proceeds but they should provide attractive investment opportunities along the way of which the four portfolios of your Company can take advantage. The Company's two equity portfolios have a bottom-up stock-picking approach that is not constrained by a rigid target benchmark. The equity managers also have the additional tool of gearing that they can employ (within overall parameters set by your Board) to reflect their view of the attractiveness of the asset class. Your UK Equity portfolio managers continue to run a balanced portfolio, positioned to make the most of recovery situations, whilst having some ballast to help insulate against further market shocks. Your Global Equity Income portfolio manager has the unfettered ability to search globally for idiosyncratic stock specific opportunities. The Balanced Risk Allocation portfolio's strategy is to allocate a risk budget across the asset classes of bonds, equities and commodities and aims to provide attractive total returns regardless of the economic or inflationary backdrop. Lastly, the Managed Liquidity portfolio should be a beneficiary of interest rate rises.

In an environment such as this, the Company's multi-portfolio structure, with its range of investment strategies and quarterly conversion facility, provides a flexible asset allocation tool for shareholders, or their advisors, to reflect their future market expectations. I believe your Company's structure and portfolios remain well positioned to traverse a variety of market conditions over the long term.

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Denis Jackson, CEO of Law Debenture - 25 February

The increasing governance burden for UK pension schemes means that there are more opportunities for providing independent professional support to schemes of all sizes. For example:

- The Pensions Act 2021 contains more powers for the Regulator which introduces new duties for those sponsoring and running pension schemes
- Schemes moving towards full de-risking solutions
- Trustees face new reporting requirements intended to improve the quality of governance and reporting as they address climate-related risks and opportunities.

At the same time, sponsors of pension schemes are finding it harder to find volunteers to become trustees as well as desiring a focused business-to-business conversation with their trustee board - this is true whatever the size and complexity of the scheme.

We see opportunities for working with new clients who will be appointing their first ever professional trustee as well as other schemes who will be looking to add further professional expertise to their existing board. Working with schemes of all sizes as the pensions landscape evolves, we are well placed to provide value to smaller schemes leveraging insights from our wider portfolio for their benefit.

Many sponsors of pension schemes will also be facing resourcing issues, for example:

- If in-house administration is outsourced for the first time
- Succession planning as pension managers and their teams are due to retire
- Increased governance requirements putting stress on under-resourced teams.

Rather than continue to operate with full in-house teams, an increasing number will look to outsource all or part of their function to third parties. This provides opportunities for Pegasus to grow substantially by taking on these large, outsourced mandates.

We believe that the market for our expanding range of pension governance services will continue to increase steadily over time. We continue to invest in the people and skills required to be a market leader in this growth business.

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Charles Luke and Iain Pyle, managers of Murray Income - 25 February

Catalysed by hawkish signals from the Fed given concerns around the inflation outlook, real bond yields have risen since the start of the calendar year. This has resulted in a sharp style rotation within the equity market favouring value at the expense of quality and growth companies which tend to have a longer duration of earnings while 'concept' stocks (mostly in the technology sector) with little or no cashflows have been particularly affected. Macro influences can have a salient impact on share prices in the short term but we are reminded of the saying attributed to the famous investor Benjamin Graham that 'in the short run the market is a voting machine, but in the long run it is a weighing machine' or in other words long term share price performance will reflect the fundamentals of the businesses that we invest in and that is certainly borne out empirically.

At the time of writing, the Russian invasion of Ukraine has just commenced for which the outcome and consequences are currently unknown. However, for now, our baseline forecasts are for global growth to remain above trend in 2022, helped by a rebound from the Omicron headwind. For the UK, in particular, the backdrop is generally supportive with pent-up demand and a fast booster rollout, albeit the prospect of higher utility bills weighing on consumer disposable income and other less benign inflationary pressures are increasingly areas of concern.

We take comfort that the valuations of UK-listed companies remain attractive on a relative basis and as such we think a fair proportion of the portfolio may be vulnerable to corporate activity. Moreover, the dividend yield of the UK market remains at an appealing premium to other regional equity markets let alone other asset classes. Furthermore, international investors remain underweight the UK providing a further underpin. Therefore, we feel very comfortable maintaining our long term focus on investments in high quality companies capable of sustainable earnings and dividend growth.

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Harry Nimmo and Abby Glennie, managers of abrdn UK Smaller Companies Growth - 24 February

The Reference Index advanced strongly through July and August, in a month of relatively quiet news flow. UK stocks performed well, helped by company earnings and further easing of Covid-related restrictions. However, Covid-19, the resulting 'pingdemic' and Brexit caused staff shortages and supply chain issues which hit markets in September , hindering many areas but most notably the UK hospitality and retail sectors.

There were widespread falls in share prices in September, as fears over slowing growth and rising inflation spilled into equity markets. In the UK, shares were down over the period, with larger companies outperforming mid-sized and smaller companies. The disruption caused by the fuel shortage dented sentiment, with investors concerned about the longer-term impact of a shortage of delivery drivers on companies' supply chains. The Bank of England became more hawkish about when interest rates would need to rise, which drove gilt yields higher and weighed on investor sentiment.

In December the spread of the Omicron variant of the coronavirus became the obsession. Markets oscillated between concern over the rapid rise in cases and the apparent relatively benign nature of this new variant. The Bank of England, in a surprise move, raised interest rates from 0.1% to 0.25% on 15 December. In the US, the Federal Reserve is also sounding increasingly hawkish on rates.

The big increase in inflation and fear of rising interest rates have already been reflected in commodity prices, not helped by logistics, supply chain and labour shortage issues, however companies are generally learning to cope with these challenges. On the commodity front, Brent Oil, Gold and Copper all tracked sideways during the period.

Semi-conductors in particular remain in short supply although this too may be reaching a peak. Shipping transport remains dislocated and may remain so well into 2022. Shortages of key workers such as lorry drivers remains an issue particularly in post Brexit UK.

Most stock markets around the world tended to show more modest appreciation in the second half of 2021 than the first. China, Japan and Brazil traded off over worries on growth and Covid, while South Africa and India were strong. Nasdaq was relatively robust while a number of European markets, such as Germany and Switzerland, performed strongly. Smaller company markets lagged large caps in the UK although quality and growth stocks performed well as the Omicron panic took over.

Sector performance was led by five sectors: media, software, real estate, personal goods and leisure goods. The weakest sectors were food producers, telecoms, retailers, travel & leisure and electronics & electricals. Being light in oil & gas was also unhelpful as gas prices increased sharply in the run up to Christmas. Profit warnings were widely in evidence in retailers and certain industrials and consumer goods sectors where logistics and shortages within the supply chain hit home on the real economy.

Bid activity still continues, with the Morrisons deal completing in October 2021. There have been recent bids for U&I Group (real estate) and Playtech in computer gaming software. Private Equity is still much in evidence with the occasional trade buyer.

The world is splitting into two camps when it comes to the approach to the Omicron variant of the coronavirus. The UK, Europe and the US are tending to relax the rules on travel and quarantine. They take the view that it is futile to try and stand in the way of such a contagious disease and in any case vaccine levels are high and symptoms are generally modest. Others in the Far East, such as China, Japan and South Korea, are imposing draconian restrictions. The former has led to optimism on growth but accompanied by rising inflation and indeed actual or potential rate rises. In the Far East, the heavy restrictions mainly mean that growth will be subdued.

At the time of writing we have seen a massive style shift from quality, growth and momentum to recovery, oil & gas and value in 2022. Under-performance of the portfolio at the very start of 2022 has been prodigious and, while the Reference Index fell by over 6% in January, the NAV total return of the Company was almost -14%. New years quite often lead to style rotations and indeed it is conceivable that the current value rally may last a number of weeks. Indeed we may have to wait until the March/April reporting season before normal service is resumed.

Most countries are trying to return to normal with significant relaxations in restrictions. This is certainly the case in most parts of the UK . However, when new flare ups occur in Far East countries strict measures are taken. This all has a negative impact on economic growth although much ground has been made up since the height of the Covid emergency.

Rising inflation is an issue for market levels and is likely to result in policy changes at central banks, making interest rate rises a racing certainty in the next few months. Economic growth has returned but it has been accompanied by major shortages and dislocations across many sectors. It is noticeable that most of the Company's retail holdings warned about the impact on earnings forecasts of disruption to supply chains. International logistics challenges and labour shortages across key sectors such as trucking are likely to remain for many months to come. The UK has the added disadvantage of the impact of Brexit.

We are now through the first stage of the economic recovery and are in a somewhat dangerous stage in the cycle, as the market waits for interest rates to rise as inflation goes up. The holdings in the portfolio, apart from small pockets impacted by supply chain disruptions, are in good shape judging by the most recent results season. Their QGM characteristics indicate to us that they should be able to ride out choppy market conditions as the strong get stronger in each new economic cycle however, in the short term, if markets continue to focus on recovery sectors, performance could continue to be hit hard. The new issues market is quieter but there are still a number of interesting companies that might look to list if our meeting schedules are anything to go by.

As we have said before, our process remains unchanged. Our emphasis on risk aversion, resilience, growth and momentum still feels right for the future over all time periods except the short term. Caution should be the watch-word however. Smaller company investing should be viewed as a long-term investment and we have no doubt that patient investors will be rewarded in the longer term. Our stable process has been seasoned by fully four economic cycles. We remain very optimistic about the future of the Company in the long term.

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Sir Laurie Magnus, chair of City of London - 18 February

The Omicron variant of Covid-19 appears to cause less severe illness than earlier variants, especially for those who are fully vaccinated. It is now increasingly unlikely that there will be a return to an economically damaging lockdown and the UK and other developed economies are expected fully to reopen during the next six months.

The monetary response to the pandemic currently remains largely in place, but is likely to be progressively withdrawn with rises in interest rates (albeit remaining low by historic standards) expected because inflation is proving to be more severe and persistent than had been hoped. Governments are moving to phase out the fiscal reliefs introduced in response to the pandemic and, as already proposed in the UK, to increase tax rates in order to restrain their borrowing requirements. The resulting reduction in liquidity may test equity valuations, especially at the more speculative end of the markets. International tensions are a further reason for caution, with the crisis in Eastern Europe causing particular concern.

At present, no more than a slowdown in economic growth is expected and therefore corporate profits and dividends during the rest of the current financial year should continue to increase. Households in aggregate still have a high level of enforced savings from the lockdowns to support consumption, although their discretionary real spending power may be reduced by inflation, tax increases and rising interest rates in the next financial year and beyond. The dividend yield from many high-quality UK equities remains attractive, with the continuing trend of takeovers demonstrating potential additional overall upside.

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Gervais Williams and Martin Turner, managers of Diverse Income - 17 February

Sometimes economic conditions can be unsettled and adverse geopolitical events can cause substantial volatility in asset prices. Mainstream stock markets do not always appreciate and sometimes can deliver disappointing returns over several years. During these kinds of periods, institutional investors seek out sectors that have the potential to buck the wider pattern, which includes areas such as smaller quoted companies.

During globalisation, asset market returns have been excellent. Aside from Japan, stock markets around the world have typically delivered strong returns over a number of decades. During this period of plenty, institutional allocations in UK quoted small companies have gradually been crowded out by larger weightings in some of the best performing areas, such as US technology stocks. This trend has been evident globally, with most exchanges dedicated to quoted small companies closed for lack of institutional interest.

Fortunately, the government has sustained support for a number of small companies exchanges in the UK via dedicated tax exemptions. Small, quoted companies have the political advantage that they generate additional skilled employment and increased productivity, and ultimately enhance the tax take for the Exchequer.

We worry that mainstream stock markets may not continue to deliver strong returns in future. If this is the case, then the UK has a major advantage over others in having retained its vibrant universe of quoted smaller companies – with all the advantages of genuine diversification they bring. If the returns on many mainstream stock markets do disappoint in future, then the ongoing advantages of UK quoted smaller companies could lead to renewed institutional interest.

Dan Whitestone, manager of BlackRock Throgmorton - 7 February

Global stock markets have made strong progress over the past 12 months as the announcement of effective vaccines at the end of 2020 fuelled optimism around an economic recovery. During the year countries around the world began lifting the restrictions that had impacted so many businesses across a raft of industries throughout 2020 and the world started to return to a new level of normality. In truth, the equity market rise over the full year masks the path the market has taken during 2021. The recovery has not been linear, and there have been bouts of extreme market volatility. Investor sentiment has jumped continuously between optimism about the recovery, to fears of new variants of COVID-19 and the potential impact on the global economy. This occurred first with the emergence of the Delta variant and more recently the highly contagious Omicron variant where transmission accelerated over the Christmas period, a time of year that is so crucial to many businesses including pubs, restaurants and retailers that rely on a seasonal boost from Christmas shoppers.

To add to the COVID-19 debate logistics issues, supply chain disruption, labour shortages, and rising inflation have all contributed to higher intra-month volatility during the year, with investors constantly grappling with the duration and impact of these factors on economic growth and corporate profitability. These factors are important inputs that determine therefore the likely path for monetary policy in the near future and this has led to some sharp factor/style rotations within equity markets. Fortunately, within the small and mid-cap space, which we believe is home to some excellent and differentiated companies, these rotations have presented us with some fantastic opportunities throughout the year.

2022 has got off to a difficult start for equity markets. There have been some large moves in share prices in the ‘growth’ and ‘value’ categories and this has disproportionately impacted many of our growth-oriented UK listed mid-cap companies, some of which have fallen between 15 and 30%. Moves such as this, whilst painful, are alas not uncommon, and the severity of moves can be significantly exacerbated at times of lower liquidity (such as during the holiday season) or when there is a backdrop of limited corporate news flow. Indeed, where there has been corporate news we have generally found it to be very reassuring and for the most part it has confirmed our investment views; the companies themselves are often trading well with ongoing positive momentum in forecasts.

The reason for these large moves is due to market concerns of rising inflation and interest rates, which in some cases have the potential to erode corporate profitability. We believe this risk is centred firmly on low margin businesses with limited pricing power and volume growth and where we have already seen evidence of pressure on profit forecasts. As discussed many times, these are businesses or industries we seek to avoid or short. Inflation can be accommodated more easily in businesses with high margins, volume growth and pricing power. These are exactly the companies we look to invest in, and while investors will inevitably worry about all companies for a while, we do expect our holdings to fare better in due course.

As to the impact of inflation on the interest rate curve, we acknowledge the relationship between interest rates and the discount rate, but this we believe is a much bigger problem for loss making, "jam-tomorrow" speculative companies. This has never been our area of focus but has indeed been the source of profitable shorts. The last few weeks have reaffirmed how indiscriminate the market can be at times, as there has been little distinction in the share price falls of 'jam-tomorrow' loss making speculative investments and the fast growing, highly cash generative companies priced at what we believe to be attractive valuations. Fortunately, this is the opportunity of equity markets.

Whilst we acknowledge the market's immediate focus on inflation and its potential impact on interest rates, we think January is nothing more than a painful but temporary mark-to-market exercise in response to a more hawkish Fed rather than a permanent loss of capital for our clients. We are firm believers in our holdings and, whilst we acknowledge that in any given year we will make mistakes in individual holdings, and that not all our investments will deliver as planned, we also believe the majority will prosper. The valuations of many of our investments have fallen back in the last few weeks to levels we believe offer significant value, at a time when in many cases their market position and outlook has improved. Corporate results continue to reassure us and we think this bodes well for the months to come.

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James Henderson and Laura Foll, managers of Henderson Opportunities - 3 February

We invest across the UK market in companies of all sizes. This allows us a greater set of opportunities. Large company investors have little exposure to dynamic technology stocks, while small cap investors will have little exposure to the banking sector, where substantial value can be found. We have the flexibility within this Company to invest in both areas. Some of the large companies we hold are reinventing themselves. They are adapting to a much-changed economy, while the smaller companies are utilising their ability to be nimble.

It is an exciting time to be investing in the UK. Rapid changes within the economy are creating real opportunities for those companies with the ability to grasp them. For instance, the alternative energy companies have extraordinary potential if they have the technology that will help the world move away from fossil fuel, while the step up in infrastructure spend within the UK is creating opportunities for more traditional construction based businesses. The portfolio is a blend of very different businesses. Diversity of businesses and end markets together give us the opportunity to invest in the next generation of successful companies. We remain positive about the opportunities for the portfolio and intend to maintain a reasonable level of gearing.

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Richard Davidson, chair of Aberforth Smaller Companies - 1 February

The enduring fascination of financial markets is that they never cease to surprise. Had I been told at the start of 2021 that ten year government bond yields would finish the year still below their pre-pandemic levels, I would have concluded that nascent inflationary pressures had given way to the disinflationary conditions with which we have become familiar since the global financial crisis. And yet the year ended with inflation running at its highest rates for decades. With the rhetoric from the central banks evolving, it does appear likely that the coming year will bring some form of resolution.

The nature of the resolution will have important implications for the direction of equities as a whole, for the Managers' value investment style and for ASCoT's returns. I would note that financial markets ended 2021 in a familiar manner – bond yields were low and growth stocks had resumed leadership within equity markets.

At the risk of being confounded again, I would venture to suggest that the burden of proof does not sit with the value investor. The second order effects of the pandemic, in the form of inflation and supply chain challenges, threaten to hamper the profit recovery in 2022, but a year of progress nevertheless seems likely. Political developments in many parts of the world remain unpredictable and affect equity valuations. At home, it is remarkable how rapidly political uncertainty has re-emerged after the decisive general election result at the end of 2019. This has no doubt contributed to the valuation of UK equities remaining below their global peers. It is notable, however, that these valuations are attracting the attention of other companies and private equity as M&A activity recovers to levels last seen before the EU referendum

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Managers of Aberforth Split Level Income - 1 February

Equity returns are determined by the progress of corporate profits and the rating ascribed to those profits by investors. Inflation and monetary policy are important influences on the latter since they affect the discount rates used to value financial assets. One of the curiosities of 2021 is that the highest rates of inflation for decades have not had a greater impact on the pricing of financial assets.

Government bond yields in both the UK and US are still below their pre-pandemic levels, while growth stocks returned to the fore after weaker relative performance amidst the vaccine rally. So far, therefore, the markets appear to be anticipating economic and financial conditions little changed from those that have pervaded since the global financial crisis: low real economic growth, low inflation, low interest rates and low bond yields.

It is not clear that today's inflationary pressures will be short-lived and easily controlled. The supply chain problems will be sorted in time, but there may be more intractable influences. Underinvestment in oil and gas development projects in recent years could keep energy prices high. Meanwhile, there is concern that the supply of labour has be n affected by issues stemming from the pandemic and, in the UK at least, by Brexit. Macro-economic data and anecdotes from companies indicate that wages are accelerating. Inflation raises the stakes. While its recent resurgence clearly does not prevent a return to the disinflationary conditions of the past dozen years, it is perplexing that the financial markets do not yet harbour more doubt. The chance that bond yields prove too low and that growth stocks are too highly valued is higher today than before the pandemic, but that is not reflected in current valuations. Were more doubt to creep into valuations, ASLIT's value investment style should benefit in terms of relative performance. However, we should be careful what we wish for – equities struggle when monetary policy belatedly plays catch-up and relative gains might be achieved against the backdrop of lower share prices.

Turning back to corporate profits, the outlook is encouraging as economic activity normalises and demand continues its rebound from the 2020 recession. Such recovery remains a common theme from the Managers' recent engagement with ASLIT's investee companies. There are, though, risks.

First, the pandemic is still with us and may elicit further measures by governments. However, the efficacy of the vaccines means that such measures should affect the pace of recovery rather than threaten the recovery itself. Second, there are the supply chain problems, which are another recurring feature of company trading updates and will take time to resolve. Indeed, energy and labour costs may put sustained pressure on corporate margins, with demand also threatened by the impact of energy costs on consumer spending. Third, there is the chance that central bankers tighten monetary policy to control inflation and thus bring about economic slowdown. At this stage, this risk is more speculative since monetary tightening, such as the Bank of England's 0.15% increase in interest rates in December, has so far been modest – in most western economies interest rates remain deeply negative in real terms.

So, from the strategic perspective, 2022 feels like a pivotal year as the inflation debate comes to a head. Equity valuations will be affected, including those of small UK quoted companies. In such uncertain circumstances, the records of these companies offer reassurance. They have coped with the global financial crisis, the Eurozone crisis, Brexit and the pandemic. Despite their cyclicality they have displayed great resilience through each episode. ASLIT itself benefits from a diversified portfolio of companies, with wide ranging activities and geographical exposures. These companies boast strong balance sheets and generate returns on equity that point to profitable and growing underlying businesses. Remarkably, these characteristics are available to the Managers without having to compromise on the value investment philosophy.

Why should that be? Many aspects of ASLIT's investment policy and strategy – investment in small UK quoted companies with a value philosophy – have been out of favour for several years.

- Since the financial crisis, smallness has come with concerns about low liquidity. These have trumped the longer term associations of smaller size with faster growth and higher total returns.
- Since the EU referendum, UK assets have be n out of favour and remain lowly valued in the global context. This is despite the recent upsurge in M&A, which recognises the de p valuation discounts.
- Quoted companies are increasingly being se n as outmoded, with private equity meanwhile lauded for long termism and its ability to use more leverage. However, as mainstream funds increasingly look to take stakes in private businesses, it is notable that the private equity firms themselves are seeking stock exchange listings. Moreover, it is notable that illiquidity is not a concern when it comes to private equity.

- Finally, value investment has be n challenged by the environment of low inflation and low interest rates since the global financial crisis. But a continuation of these conditions is not a given, especially in view of current inflationary pressures.

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Global emerging markets

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

Maria Luisa Cicognani, chair of Mobius - 25 February

Covid-19 has brought a fundamental re-thinking in our societies and of the way we work. It has also spurred the emergence of new technologies and the wider adoption of digitalisation in many businesses. We do not know as yet how the wider adoption of these new technologies will affect the real economy. The pandemic has brought some working efficiencies but has also taken a toll on human interactions and we are seeing many set-backs in education and in the way younger generations are learning about how to live together in the non-virtual world. We believe that the years to come will be very interesting as resource allocations will shift to new economic sectors and productivity gains will be driven by a wider application of technological applications: we are very optimistic for any company involved in biotech and chemtech, or just ready to adopt more tech. A lot will be learned from the pandemic which will accelerate progress in some sectors while those who are late in adopting the changes will likely become laggards. Our strategy is to continue to identify those rising stars and rough diamonds amongst the early adopters of change.

As I am writing, we are watching events unfold in Ukraine and are waiting to see how the world will react. I expect 2022 to be a volatile year as societies adapt to live with Covid-19 with a mix of progress through vaccine take up and development and herd immunity through infection.

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Managers of Gulf Investment Fund - 25 February

The GCC remains well positioned for robust growth, led by easing restrictions, sustained economic recovery and wider vaccine coverage than most countries. The IMF expects high mid-single digit GDP growth, partly on the back of higher oil prices. Higher oil prices will boost GCC government balance sheets, complementing fiscal reforms. We foresee all GCC countries reporting fiscal surpluses in 2022.

In Saudi Arabia, the government is pressing ahead with an ambitious reform agenda to deliver economic growth, following a slow start in recent years. Higher oil prices have refilled the Kingdom's coffers and are likely to provide additional resources for PIF and state funds to press ahead with investment plans. Saudi remains our second largest portfolio holdings at 33.2%, with exposure mainly in the financial sector of 11.3% to ride on the nation's progressive economic reforms.

Qatar is the biggest beneficiary of rising energy prices, while the FIFA World Cup preparation works, and LNG production expansion are growth drivers. The North Field project should boost LNG capacity by 64% with Nakilat (7.9% of NAV) set to be a beneficiary of the expansion. Qatar's external and fiscal positions are in a sweet spot, one of the strongest positions in the GCC.

UAE is enjoying a cyclical recovery, in particular Dubai, which was impacted last year due to Covid restrictions. The easing of these is boosting economic activity in tourism and retail. As the economy reopens, EMAAR (8.5% of NAV) with a varied retail asset portfolio should benefit from footfall rise in malls and shopping markets. Elsewhere, the switch to a Monday-Friday work week is also expected to improve UAE's prospects in the medium term.

Overall, we see strong opportunities among the stocks benefiting from re-opening. Regional banks should benefit from higher short-term interest rates. We see opportunities arising from sustained high commodity prices and supply disruptions coinciding with re-opening pent-up demand.

While global investors generally are underweight Qatar, Kuwait, and Saudi, the GCC weighting in EM indexes should increase as IPOs join the market, as Public Investment Fund PIF/government stake sales are made, and foreign ownership limits (FOL) are raised.

Qatar's weighting should increase as FOL are eased and likely attracting US$1.1-1.4bn of inflows, making us highly positive on the country. Global investors interest in GCC should increase. Therefore, foreign inflows to the GCC will continue, attracted by credible fixed currency rates, generous dividend yields, high oil prices and market reforms.

Europe

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

Alexander Darwall, manager of European Opportunities - 25 February

Since the outbreak of Covid two years ago, markets have been carried by two forces: cheap money and money printing (QE); and optimism around political slogans such as 'Build Back Better'. These two factors, in our opinion, will continue to dominate the investment backdrop. However, they are likely to dampen prospects as on both counts there will be a reckoning, the catalyst for which is inflation.

There is strong evidence that inflation, currently around 5% in Europe, is not a transitory phenomenon (as the politicians and central bankers hope). Rather, with a transition to the 'green economy', inflation is likely to be persistent and damaging. Policies such as the European Union's 'European Green Deal' and 'Fit for 55' green transition have been greeted with tremendous enthusiasm by the leading financial institutions, notably the big investment banks, and some investors. Yet the reality is much more problematic. 'Green' energy is, and is likely to remain, much more costly than conventional energy sources. We recognise that much political capital has been invested in this project. Accordingly, even though it is highly unlikely to realise their ambitions in full, some part of this transition either has been, or will be adopted. We consider both the cost challenges and the investment opportunities of this transition. With the prospect of higher energy costs we continue to avoid businesses which are unduly dependent on energy. On the other hand, we see opportunities for businesses which can realistically benefit from the transition: Neste, the Finnish producer of sustainable aviation fuels is one. Their fuels are proven, high quality and, critically, can be adopted to a modest extent by their customers, the airlines, with only a minimal impact on the profitability of the airlines.

Although central bankers have signalled their intention to reduce money printing and raise interest rates to bring inflation down to their typical target of 2%, it is unlikely that they will succeed. Indeed, there will be political pressure to keep interest rates lower and allow inflation to remain higher partly because inflation performs a useful function for politicians by reducing the 'real' value of outstanding government debt. It should be conceded that, at low levels, inflation is good for equities. Nevertheless, there are other considerations which impair market prospects and are likely to lead to lower growth rates in Europe: the partial reversal of globalisation (for example, trade disputes with China); the change in working practices particularly in the West; and the increasing size of governments. These factors are all likely to increase costs and reduce efficiency.

Whilst the investment backdrop is likely to be more challenging, we are confident that our strategy will prevail. Our focus is on identifying business models which can flourish in different economic scenarios. Our companies, we hope, are structural winners, not just bull market plays. We select companies with common characteristics from a broad range of sectors, from pharmaceutical to fish farming, agriculture to algorithms, semiconductors to sustainable aviation fuels. The prized characteristics are high value-added activities, sustainable differentiation and pricing power, with relatively low fixed costs, enjoying secular demand despite weaker economic activity. Having companies that compete globally mitigates, to some extent, the risk of weaker European economic growth. Moreover, global success is a convincing validation of products and services. The favourable investment conditions of the last two years have lifted valuations markedly, including those with dubious business models.

We anticipate tougher conditions which will cause a sharper division of winners and losers. We believe that we are well placed for this eventuality.

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North America

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

Tony Despirito, David Zhao and Lisa Yang, managers of BlackRock Sustainable American Income - 8 February

U.S. large-cap stocks, as represented by the S&P 500® Index, advanced by 42.9% in US Dollar terms for the year ended 31 October 2021. In Sterling terms, the S&P 500 appreciated by 34.8% during the year.

U.S. large-cap stocks rallied in the fourth quarter of 2020 as election clarity and the emergence of viable COVID-19 vaccines boosted investor optimism. Cyclical value stocks, those most beaten down in the COVID-19 crisis, staged a particularly strong late-year rally as financial markets anticipated an end to global lockdowns and a positive inflection in economic growth. Policymakers also continued to provide accommodative measures to combat the effects of the pandemic. This included passing the US$900 billion COVID-19 Relief Bill, an aid package signed into law in late December 2020, that provided new direct payments to Americans, as well as additional paycheck protection programme loans and unemployment benefits.

Markets encountered bouts of volatility in the early stages of 2021 but ended the first quarter on an upbeat tone, reaching all-time highs. The U.S. economy was fuelled on multiple fronts. Firstly, monetary policy support continued to persist with the Federal Reserve (the Fed) signalling its intention to keep the federal funds rate (i.e. the target interest rate for commercial bank overnight lending) near zero through at least 2023. Secondly, fiscal policy remained stimulative with the signing into law in March 2021 of the American Rescue Plan, a US$1.9 trillion fiscal stimulus package. Thirdly, further progress on vaccine supply and distribution aided a rebound in economic activity levels. These elements stayed in place for the duration of the annual reporting period and functioned as a notable tailwind for financial markets.

U.S. stocks extended their rally in the second and third quarters despite bouts of volatility and investor concerns related to rising inflation, supply chain bottlenecks and the emergence of new COVID-19 variants. For example, broad market indices traded lower in September as investors focused on potential systemic risks in China related to Evergrande, a debt-challenged real estate developer, before posting their strongest month of the year in October. Stronger corporate earnings were the primary driver of rising stock prices, as companies beat consensus expectations on both earnings and revenues, albeit versus easy year-on-year comparisons. Revenue growth was particularly strong, as companies flexed their pricing power in passing through higher input costs to end customers via higher prices.

'Unprecedented' fittingly describes the market environment over the past 18 months. The global pandemic, the intertwined monetary-fiscal policy collaboration and the post-lockdown economic restart are all unique relative to history. The performance of U.S. stocks has followed this tone as the S&P 500 has rallied at its fastest pace in the post-Second World War era. Notably, the index doubled in 354 trading days versus the average 1,000 required to achieve such a feat, according to an August 16 CNBC analysis. Amid noisy economic data that lacks relevant historical comparisons, we believe it is important to find useful anchors for our investment convictions.

A look at earnings, fundamentals and valuations offers some helpful clues. Firstly, the composition of recent quarterly earnings speaks to corporate resilience as companies have beaten analyst expectations on both earnings per share (EPS) and revenue growth. Secondly, fundamentals indicate corporate pricing power and pent-up demand. Why? Revenue growth has been particularly strong, suggesting companies have been able to raise prices and push higher costs on to the end consumer, a reflection of pent-up demand and the consumer's willingness to pay. Thirdly, while U.S. stock valuations are high on a price-to-earnings (P/E) basis versus history, the equity risk premium1 indicates stocks are undervalued relative to the risk versus reward they offer. All told, we remain constructive on U.S. equities, but cautious that starting points matter, and more muted return expectations are sensible at this stage of the recovery. We continue to believe that companies which run their businesses in a sustainable way, and which take into account all important stakeholders, can provide superior returns in the long run. Moreover, we believe our focus on both ESG leaders and ESG improvers provides a useful framework in which to capture this feature. After an extended market rally, we also believe markets are exiting a period of 'rising tides lifting all boats'. If true, selectivity could play a greater role in investment returns in the months ahead.

The biggest concern or risk to our market outlook is inflation, as inflation has proven to be more durable than first anticipated. Our concerns centre on inflation's potential to squeeze corporate profit margins, particularly if consumers grow less willing to pay up for goods and services. Additionally, persistently high inflation presents a more difficult challenge for Fed policymakers and it increases the risk of a potential policy mistake. We also continue to view COVID-19 as a market risk worth monitoring. Although we view the risks from current variants as manageable, we recognise that further COVID-19 upsets are possible and require a necessary measure of humility.

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Managers of Brown Advisory US Smaller Companies - 7 February

As we look back at the past six months (and year) of executing against our overall investment process, we are amazed by the multitude of macroeconomic cross-currents that blow across the investment landscape. We have witnessed vast changes in market leadership (i.e. low-quality to high-quality, growth to value and small to large) that have wreaked havoc on both absolute and relative returns no matter the type of strategy managed. These equity market gyrations have stemmed from a combination of economic recovery from COVID-19, fiscal and monetary stimulus, the rise of the Delta and Omicron variants, and a sizeable jump in inflation, which the Federal Reserve no longer describes as 'transitory'. The appropriate response to this development is both being contemplated and vocalised. If the Federal Reserve acts as it has suggested, we stand on the cusp of them attempting the most significant policy shift of the last decade (i.e. quantitative tightening and rate increases) and one that many investment professionals will not have experienced before. Unfortunately, as we look ahead to 2022, we will probably confront a volatile, uncertain, complex, and ambiguous ('VUCA') world. It is in times like these when remaining focused on the 'long term' is more important and valuable than ever.

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Japan

(compare Japan funds here and here)

Richard Aston, manager of CC Japan Income & Growth - 11 February

We believe that the steady progress of corporate governance reform and the associated benefits in terms of capital efficiency and shareholder returns provide the real catalyst for Japanese equities rather than short term macro or political considerations. The Corporate Governance Code, first introduced in 2014, is continuing to play a significant role in promoting the necessary improvements as its principles and guidelines are revised and enforced. Certain favourable trends can be measured directly such as the increasing presence of external independent directors, the reduction in cross-shareholdings, the elimination of parent subsidiary listings and general restructuring of non-core assets, although it is in the commentary and actions of corporate management where the change is most evident. The resilient dividend and share buyback profile of the last two years is in stark contrast to the UK and Europe and highlights the significant benefit this offers to Shareholders through greater and more stable returns. The run rate for the current fiscal year suggests that both dividend and share buybacks are on track to exceed their previous peaks in FY19.

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China

(compare China funds **here**)

Mark Hadsley-Chaplin, chairman of abrdn China - 24 February

Consensus is that China will become the largest economy in the world by the end of the decade and, while we would be naive to expect that there will not be bumps in the road, we believe that the prospects for a portfolio focused on this growth market are good. We believe that the regulatory changes that we saw the Chinese Government impose last year have now been priced into the market and we do not expect to see much further intervention by the Government on such a scale. When this is coupled with the early signs of easing of Covid restrictions in some Western markets and a more benign economic backdrop in China, the Board is optimistic that the long-term prospects of the Company are compelling.

Managers of abrdn China - 24 February

The China Opportunity and Why Now?

The enduring strength of China's vast consumer market allied to pro-growth domestic policies underscore our optimism about the prospects for A-shares in 2022 and beyond.

In contrast to developed markets such as the US and UK, where authorities are tightening policy to tame inflation, China has moved to ease financial conditions and access to funding. Although the Covid-19 pandemic has curtailed Chinese consumption for the past two years, the market's size means even sluggish retail sales growth generates a big increase in absolute terms. We predict China's consumer market will surpass the US in dollar terms by 2040.

Looking ahead, we suspect China's zero-Covid approach will allow life to go on largely as normal, but there will also be bouts of volatility as the authorities react to spikes in incidences of the virus. Still, we expect any pain to be short term. It won't change the government's commitment to bringing domestic consumption back to China. Investors will benefit by maintaining exposure to this structural trend.

We see the brightest future for firms able to adapt to changing regulatory frameworks and align with policy objectives in areas such as digital innovation, green technology, access to affordable healthcare and improved livelihoods. We are focused on five themes that we believe will drive returns in 2022.

Aspiration: We expect consumer names to fare well as China strives for a self-sufficient economic model. We buy into the "premiumisation" story - that urbanisation and rising middle-class wealth will drive demand for premium goods and services in the long run.

Digital: This theme aligns with the government's objectives of localisation, improving productivity, lowering costs, increasing innovation and helping to propel economic growth. Our holdings in this segment are primarily software-related names which have advantages given their knowledge of the domestic market and preference for localisation in areas such as cyber security and cloud services.

Green: This theme aligns with government policy on decarbonisation and net-zero emissions by 2060. Our holdings include solar wafer producers, component makers, battery and related component makers, automation-related firms and a company focused on upgrading electricity grids for a renewable future.

Health: The portfolio is overweight healthcare services, including firms providing innovative research and clinical trial services that bring high-quality therapies to market cheaply and quickly. Our holdings align with policy objectives to make healthcare cheaper and more accessible which is important given that China has a rapidly ageing society.

Wealth: This theme aligns with China's policy objectives of becoming a moderately prosperous society by 2035. The financial services sector plays a key role in creating and protecting wealth.

Flexible investment

(compare flexible investment funds **here**)

Managers of Ruffer - 28 February

It was the best of times

As you might expect, underneath all these signs of rampant capitalism, the underlying economy is doing well; pent-up demand, strong growth and household net worth at all-time highs have combined with continuing monetary and fiscal stimulus to produce this environment.

The Atlanta Federal Reserve 'NowCast' has US Q4 2021 real GDP at 7%; add 6% CPI inflation and you get a 13% nominal growth rate. The growth picture is similarly robust in Europe and the UK. One would have to go back around 50 years to find a similar surge.

With this backdrop, does the US really need the easiest financial conditions on record? Of course, this is helping us, and many others, make good returns for their investors, but policymakers are still running emergency levels of monetary and fiscal policy support when the economy is firing on all cylinders with a tight labour market.

The Goldman Sachs Financial Conditions Index is a composite including interest rates, equity valuations, borrowing costs and currency data to assess how 'easy' or 'tight' financial conditions are. This offers a broader gauge than the blunt tool of interest rates. The message is clear - we've never had it so easy.

The inflation conundrum

Looking at 2022, the fly in the ointment is inflation - from energy and housing to wages, raw materials, and food. In a nutshell, too much money is chasing too few goods. There is no denying the inflationary impulse has endured longer than many expected. Inflation is currently at its highest level in around 40 years and has made a clear break from the previous trend.

We are now experiencing the common knowledge of inflation; it is dinner party chatter. Everyone knows that everyone knows there is inflation, which makes raising prices or asking for a pay rise that much more palatable. This is how reflexive processes are born and many are risking their credibility by failing to acknowledge it. Former Treasury Secretary and Harvard Professor Larry Summers said, "I believe the gap between the Treasury & Fed statements and the everyday experience of businesses and consumers has perhaps never been wider."

The Federal Reserve and several administrations have spent a decade post-financial crisis trying to create inflation and now, like tomato ketchup from a glass bottle, they've got too much all at once.

The Biden Administration (and others around the world) will struggle to implement their high spending, deficit-fuelled big society, or climate change programs, if inflation stays elevated. Additional stimulus at this point would be like pouring gasoline on a fire. Even the Modern Monetary Theorists confess the only constraint on government spending is the emergence of inflation. Thus, putting this genie back in the bottle is imperative.

Perhaps because of these political pressures, the reaction function of the Federal Reserve is different this cycle. The Fed has moved from pre-emptive to reactive with a lag. They are deliberately behind the curve.

The devil and the deep blue sea

If, and it remains an if, inflation in advanced economies persists above 2%, central banks will have to decide between the devil and the deep blue sea. Do they stick with the current run-it-hot strategy, out of concern for financial stability and encouraging a broad and inclusive labour market recovery? Or do they revert to their more traditional policy approach, getting 'ahead of the curve', tightening those easy financial conditions but running the risk of a policy-induced recession, market tremors and the accompanying political fallout?

As former Federal Reserve Chair McChesney Martin once said - "the job of the Fed is to take away the punch bowl just as the party gets going". We believe they are coming under increasing pressure to poop the party. This is relevant because the economic boom and asset prices have floated higher on a sea of abundant liquidity and stimulus.

The Fed may have to choose between either financial market pain or inflation pain. To tackle the inflation pain they need to withdraw liquidity and raise rates - but that will almost certainly cause market pain. What the real economy needs today (higher interest rates), financial markets can't stomach. Stock markets are up 40% over two years, yet wealth inequality is at all-time highs in a boiling hot economy.

In reality, tapering amounts to less easing rather than meaningful tightening; interest rates will remain negative in real terms and near multi-century lows. But prices are set at the margin - markets respond as much to flows as they do to the stock - and financial conditions will tighten. Flows and liquidity have been crucial to this bull market, and they may be about to reverse.

Alternatively, if they don't tighten then the inflation pain will continue and will arguably get worse because the economy is strong, inflation is a reflexive phenomenon and policy remains extremely stimulative. The real risk-free rate is around -6%. As Jerome Powell famously said before the 2018 market wobble - we are a long way from neutral. The last time the Fed tried to raise interest rates meaningfully the S&P 500 promptly fell 18%, forcing Governor Powell to reverse course.

In a highly financialised world, the conundrum for policy makers is that in taming inflation and moderating growth they must reverse the very conditions that have been so beneficial for markets.

Investment consequences

The return of inflation has brought with it a new dilemma. Markets love certainty, but pricing uncertainty is hard. The long-standing complacency around low and stable inflation can be seen in term premium - the extra yield earned as compensation for the uncertainty that comes with lending for longer periods - which has progressively fallen and is now zero or negative. The end of this certainty points to asset prices falling and yield curves steepening.

Inflation insouciance

The wisdom of crowds ensures that usually the consensus opinion in markets is correct, but occasionally markets are poor at predicting the future - particularly at turning points.

We currently have the highest reported inflation since 1982.

What is really fascinating, however, is the forward looking inflation expectations priced into the inflation swaps market. Markets don't believe the world has changed. They are priced for a return to the low growth, low inflation, low rate post-GFC environment.

At the market bottom in April 2020 (the peak of lockdowns), the market was seeing deflation in the short term, but looking out a few years our magical, miracle-working policy makers would have inflation right back at their 2% long term target.

The market was completely wrong - it thought we would be experiencing deflation and very low inflation in 2021, instead we got 6% inflation. Today with inflation already high, the inflation swaps market is saying inflation will stay high for a while but looking out a few years will gravitate back to 2%.

This is the power of the paradigm of central banker omnipotence. This is the insouciance of markets undeterred despite a glaring forecast error in recent history.

We believe the macroeconomic environment has changed, but the investment environment has not yet caught up. This is the opportunity - because the market is complacent about these risks, they are not priced in. Long term inflation expectations rising would be hugely beneficial for inflation-linked bonds.

Hard choices

Longer term, our conviction is high that a new regime of more persistent and malign inflationary pressures has begun, but the journey before us is still unclear. This means we are as worried about inflation volatility as we are a higher average level of inflation.

One pathway involves a direct route to our inflationary destination; the other a path first through financial disruption and disinflationary dangers.

If we have not entered a new regime, we return to The Great Moderation of low and stable growth and inflation. Our portfolio will underperform equities in this benign scenario, but we still believe we have enough to generate a positive return. We believe this would be a fleeting scenario rather than an endpoint because of the changes to the political economy post-covid-19. There is now a populist desire and a political mandate for greater levels of stimulus to kickstart the economy, tackle climate change, increase wages and to redistribute wealth to those with a higher propensity to spend.

If we have moved into a new regime, our base case, there are two likely scenarios depending on whether policymakers try to tame inflationary pressures.

1 Tightening induced slump - inflation stays high and policymakers stem inflation with a sharp tightening of both monetary and fiscal policies. This could trigger declines in most asset classes, but especially in more highly valued, speculative sectors. In the portfolio we believe our unconventional protections in equity puts and credit protections would spring to life and help the portfolio as they did in Q1 2020.

2 Inflationary boom - inflation remains high but central bankers keep monetary and fiscal policy loose due to political pressure and to assist achieving soft goals like redistributive wage growth and climate change. Bonds and bond proxies look

vulnerable in this environment. In the portfolio inflation-linked bonds with the duration hedged via payer swaptions and gold exposure would be two pure expressions of rising inflation. Value stocks and those sensitive to real GDP growth would do very well.

Regardless of the path, inflation risk, an absent concern throughout the careers of most investors, will need to be priced once again. Therefore, we have built a portfolio robust to both 'left-tail' and 'right-tail' outcomes.

Renewable energy infrastructure

(compare renewable energy infrastructure funds here)

Managers of Greencoat Renewables - 28 February

The past two years have seen the Group successfully expand into Continental Europe, with operating assets owned in Ireland, France and Sweden, and forward-committed investments made in Spain and Finland.

The number of investment and portfolio optimisation opportunities that are being considered by the Investment Manager continue to grow, as the Company continues to execute on its strategy to build a pan-European renewable infrastructure portfolio.

Continental Europe

We continue to see the European market as attractive allowing the Group to continue to diversify geographically and technologically to capture the benefit of different weather systems, as well as advantageous power markets and regulatory frameworks, while not taking any currency risk. We continue to consider a range of portfolio offtake structures, including government support regimes and corporate PPAs.

We continue to see significant investment opportunities in Continental Europe. These opportunities are mostly from sellers well known to the Investment Manager, including European utilities and developers with whom we have transacted previously.

Irish Wind Market

The Company continues to execute its strategy to consolidate the Irish market, where it is already the largest owner of operating wind farms.

Progress in 2021 is evidenced by the strong growth dynamics in the Irish renewables market, with the continued buildout of new renewable assets under the RESS framework, as well as the emergence of a maturing corporate PPA market. We continue to see new investment opportunities of assets under both REFIT and RESS frameworks, with over 4GW of onshore wind capacity in operation or construction, representing a c.€8 billion market size.

Looking ahead further, we see other long term, national scale drivers for expansion and value enhancement in Ireland. The Irish government announced plans in 2021 to boost the country's offshore wind sector, build additional interconnection capacity, and provide incentives to develop an advanced green hydrogen industry. The Company is well positioned to benefit from this strong commitment to capitalise on the country's exceptional wind resource and drive towards a net zero economy.

John Rennocks, chair of Bluefield Solar Income - 22 February

UK day-ahead power prices rose to multi-year highs, rising from c.£78/MWh on average in June 2021 to c.£245/MWh in December 2021, as European gas hub prices rose to record highs amid tightness across global gas markets, below average gas storage levels and ongoing Russian gas supply limitations potentially exacerbated by developments on the Ukrainian border, with delays to the opening of the Nord Stream 2 gas pipeline further supporting rising gas hub prices.

Further price pressure was created by lower than usual renewable power generation and colder weather conditions increasing the call on carbon intensive thermal - gas and coal - generation, particularly in the second half of the period.

Looking beyond the near term and out over the next decade, whilst de-carbonisation is expected to drive a large increase in demand for electricity, medium to long term power price predictions have been lowered (from predictions in June 2020 and December 2020) as forecasters continue to believe that, despite rising demand for electricity, pricing will be suppressed by falling commodity prices and increased renewable generation post-2030. Volatility within the power markets has shown that power forecasters have underestimated near term future electricity prices and the Company has frequently achieved higher prices than expected.

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Helen Mahy, chair of The Renewables Infrastructure Group - 18 February

The climate change agenda will take another step forward in 2022 as countries attend COP27 in Egypt with promises of revised action plans to steepen the rate of decarbonisation. Our strategy is aligned with this and, increasingly, TRIG is delivering new capacity having built c. 200MW capacity across nine projects since IPO and with a further c. 450MW currently in construction across four investments comprising eight sites.

As the renewables infrastructure market continues to mature and attract more investors, an increasing proportion of relevant projects are trading to long-term hold investors earlier in their development cycle, including at or around the ready-to-build stage rather than in the early years of operations. Moreover, the Company itself is commencing developments on repowering, and further such opportunities can be expected as older sites mature.

The energy transition is being fuelled by renewable electricity generation, presenting further exciting investment opportunities for TRIG. As the investable universe expands, so too has the volume of capital seeking to invest in this sector.

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Biotechnology & healthcare

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

Paul Major and Brett Darke, managers of BB Healthcare - 28 February

To our minds, there were two main debates in healthcare during the year, both relating to the pandemic. The first revolved around the sustainable demand outlook for vaccines, COVID-19 treatments and diagnostics, and the second over the volume of elective procedures that could be sustained in the short-to-medium term given ongoing infection control precautions and enduring consumer willingness to defer elective treatment.

As several countries have gone as far as to offer booster #2 (i.e. a fourth dose of vaccine) and more and more countries jab ever younger children despite a lack of robust evidence that it has a positive risk/benefit, vaccine demand in the developed world is proving more resilient than we could have imagined. Even in light of this, valuations of COVID-19 vaccine suppliers seemed stretched to us because history shows that vaccine pricing always comes under sustained pressure within a few yearsand it is unsurprising to have seen them falling back in recent months.

With regard to COVID-19 treatments, the debate has largely moved on from antibodies to anti-virals. With the second-generation drugs such as Pfizer's Paxlovid (Gilead's Veklury being the first generation), it does appear we now have the weapons in our armamentarium to take the case fatality rate for COVID-19 down to levels below that for influenza and richer countries will stockpile these treatments. Diagnostic testing volumes have peaked and, with the approval of ever-more providers, prices have come down. We would judge that the market has done a good job at assessing the value proposition around testing.

This leaves the second point of elective procedure volumes as the ongoing conundrum. Broadly speaking, we feel that we judged this situation correctly; the market was too optimistic initially about a return to pre-pandemic procedure volumes and, especially for the lower acuity procedures such as orthopaedics, many companies have disappointed relative to their own early recovery expectations.

Overall, this weighed on sentiment. Nonetheless, the valuations of some of these companies at the low acuity end of the procedure spectrum continued to rise during the year: former holding Intuitive Surgical, for example, rose 35% in sterling terms to achieve further record valuation on forward-looking metrics despite 2022 and 2023 revenue estimates simply returning to pre-pandemic levels; we have struggled to rationalise these outliers.

If the last two years have taught us anything, it is that everything changes very quickly in such a febrile environment. Sadly, we are not so naive as to imagine this situation will normalise (whatever that means) in the short-term and so we will refrain from offering a sub-sector outlook as in previous years. We recommend that investors rely upon the detailed and discursive monthly factsheets for an up-to-date view on the outlook.

Growth capital

(compare growth capital funds **here**)

Managers of Seraphim Space - 23 February

The broader market environment in the Space domain continues to be very strong, attracting a record $12bn of private capital during 2021. The pandemic saw an acceleration towards companies in all sectors embracing digitisation, with many traditional terrestrial sectors from insurance and natural resources to logistics and utilities, seeking new digital innovation and adopting new ways to operate. This environment has enabled New Space companies to thrive, with customers increasingly open to innovation to improve productivity, differentiate competitively and drive down costs.

The overall trajectory of the Space domain is positive and is demonstrating strong evidence of maturing.

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Private equity

(compare private equity funds here)

Chair of Pantheon International - 24 February

The COVID-19 crisis appears to be receding in most developed economies as widespread vaccinations reduce the pressure on health systems, but its long-term impact, particularly in terms of mental health, working practices and consumer behaviour remains unclear. Inflation, which some central banks initially considered to be transitory, is showing signs of becoming more prevalent, and interest rates are now starting to rise as policymakers try to respond. This, together with escalating geopolitical tensions, has triggered a significant correction in global stock markets, particularly for technology-related stocks.

Private equity is seeing record levels of deal flow, particularly in the secondary markets. This trend is expected to continue as entrepreneurs and business leaders increasingly turn to private capital to support their growth ambitions and embrace the "hands-on" approach and operational expertise offered by private equity managers.

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Helen Steers, partner of Pantheon and manager of Pantheon International – 24 February

The impact of the pandemic continued to dominate 2021 and, while the rollout of vaccination programmes has offered hope in most parts of the world, the economic, social and financial fallout from the crisis has been colossal. Nevertheless, economic activity bounced back from the lows of 2020, and market commentators estimate that global growth in 2021 increased at its strongest rate for more than half a century. The listed markets rose significantly in 2021, but many of those gains have fallen away at the beginning of 2022 as investors respond to the impact of rising inflation, the threat of intensifying geopolitical tensions and fears that the emergence of new variants of the virus may lead to further social restrictions in the future.

Despite the challenges wrought by the COVID-19 pandemic, global private equity had a highly successful year in terms of fundraising, investment and exit activity, and demonstrated robust performance across all stages and geographies. According to Preqin, global private equity-backed deals totalled US$603bn in 2021 to October, far exceeding the US$470bn that was achieved in 2020 as a whole. This was primarily driven by the USA, which has the deepest and most developed private equity market and is where just over half of PIP's portfolio is invested. Strong appetite for private equity looks set to continue, with 41% of respondents to an institutional investor survey suggesting that they plan to invest more in private equity over the next year while 47% indicated that they would maintain their current level of allocation.

Before the pandemic, many of the private equity managers, or General Partners ("GP"), in PIP's portfolio had already been investing in more resilient sectors, such as information technology, healthcare and consumer staples and services, and many of the trends that were already under way in those sectors - e.g. the shift to remote working, digitalisation of businesses, the switch to e-commerce, the increasing need for online consumer services, shifting demographics and ageing populations - were accelerated by the crisis. This meant that there was very low negative impact from COVID-19 on PIP's portfolio, and indeed many portfolio companies experienced increased demand for their products and services. Healthcare products and services and businesses applying disruptive technology across multiple sectors form a significant part of PIP's portfolio and we expect them to continue to be attractive areas for investment.

There is now an estimated US$1.3tn of dry powder (capital raised and available to invest but not yet deployed) globally. As this capital is concentrated in larger global buyout funds, which often target secondary buyouts of smaller, but high-growth businesses, this points to a healthy exit environment for companies in PIP's portfolio, which is predominantly invested in the small/mid-market buyout and growth segments of the market.

In 2021, deal flow in the global secondaries market hit a record high and volumes reached approximately US$134bn, reflecting its growing importance as a method by which sellers are able to rebalance their portfolios and buyers can benefit from near-term cash generation. Market data suggests that sponsor- or "manager-led" sales, which are deals instigated by the private equity managers themselves with an aim to provide liquidity options for investors in their funds, accounted for around half of this activity. These types of deals comprise multi-asset GP liquidity solutions as well as single-asset GP GP liquidity solutions with the latter continuing to grow, forming 47%6 of the manager-led deals during the year, and we have seen individual deals of this type increase in both size and complexity. Single-asset secondary deals occur when the private equity manager carves one company out of an older fund that is coming to the end of its life and moves it into a continuation vehicle. Typically, these are highly prized companies which the private equity manager believes offer significant potential for further growth but require more time beyond the life of the fund or additional capital, which the existing fund does not have, to achieve it. These deals allow the existing investors in the fund to exit their position while offering an opportunity for the private equity manager's preferred investors to invest alongside knowledgeable owners and benefit from the continued success of the company.

This is a highly specialised area of the market, which requires significant investment and deal origination experience, as well as the resources to carry out the necessary detailed due diligence. As a result, there tends to be less competition than in other areas of the secondaries market. Market commentators are predicting that 2022 will be another positive year of growth for the secondaries market with single-asset secondaries in particular expected to retain significant market share.

Outlook

Notwithstanding inflationary concerns, the assets under management in the global private equity and venture market are forecasted to reach US$11.1tn by 2026. This compares to the private equity market being worth an estimated US$5.3tn at the end of 2021.

The signs are that the ongoing trend which has seen the number of public companies globally reducing, while the number of private equity-backed companies has increased, is set to continue. It is our belief that private equity is able to deliver to investors what public markets cannot:

· Access to exciting companies in high-growth sectors that are not available on the public markets: PIP's focus on small/mid-market buyout and growth allows it to invest in family-owned or founder-led firms where our private equity managers can help with formalising organisational structures in addition to helping them grow internationally or into new markets.

· Ability to tap into the growth phase of a company's development before it goes public, if indeed it does IPO at all: The majority of exits in PIP's portfolio are to trade buyers, executing on their M&A strategies, or to other private equity managers with the skills and networks to take the companies to their next stage of growth.

· Opportunities to gain exposure to companies benefiting from the long-term value creation strategies of private equity managers, which can be implemented out of the public spotlight and are achieved through their sector-specific and operational expertise. Over the long term, the hands-on approach of our private equity managers to managing their investee companies has consistently resulted in significantly stronger revenue and earnings growth in the underlying companies in PIP's portfolio when compared to those of the MSCI World index.

· Exposure to many private equity managers who increasingly see the opportunities that sustainable investment offers for value creation over the long term. The consideration of sound ESG principles is fully embedded in Pantheon's investment processes, which we apply to the investments that we make on behalf of PIP, and we actively engage with our managers to improve standards and accountability in ESG governance.

Looking ahead, we expect the current strong deal flow to continue but, at the same time, we are cognisant of the continued high valuation environment; and therefore, we will remain very selective about where we invest. We will stay alert to the potential impacts that rising inflation could have on PIP's underlying portfolio companies; however, the characteristics of private equity are such that high quality managers are able to manage their existing assets actively and take advantage of challenging market conditions to make exciting new investments.

Hedge funds

(compare hedge funds **here**)

Marc Gabelli, chair of Gabelli Merger Plus+ - 17 February

While the year experienced significant volatility, 2021 was a good year for stocks as the S&P 500 Index gained 28.7%, notching 70 all-time highs in the process. Robust earnings and record level corporate margins, paired with dovish Fed policy, provided a backdrop of optimism for markets for much of the year.

The optimism in the equity markets was not lost on M&A markets, as the post-COVID deal frenzy continued in the second half of 2021. The fourth quarter of 2021 recorded $1.5 trillion in deals, the sixth consecutive quarter that M&A exceeded $1 trillion and the second largest quarter ever. The strong fourth quarter brought full year M&A activity to $5.9 trillion, the strongest year on record and an increase of 64% compared to 2020 levels. Excluding SPAC acquisitions of $600 billion, 2021 was still a record year for (traditional) M&A, creating a fertile backdrop for deal investing. Returns in the portfolio were driven mainly by several of our largest positions closing or making progress toward that end (details below).

There has been further volatility as we enter 2022. A headline inflation figure of 7%- the like of which has not been seen since 1982- has forced the Fed towards a more hawkish policy approach. Jerome Powell has retired the "transitory" label he had persistently used to describe inflation and indicated the Federal Reserve would begin to taper its bond buying program in 2022. Once completed, the plan is to start raising rates and, eventually, shrink the balance sheet. As we have noted in the past, the merger arbitrage strategy is a beneficiary of rising rates, as the risk free rate is one of the components of deal spreads. As rates rise, nominal spreads should widen, all things being equal.

As discussed in our last letter, the evolving U.S. antitrust landscape and aggressive policy reform rhetoric have increased volatility in deal spreads. While there is never a lack of risk, volatility provides us with an opportunity, as it is often indiscriminate. Mispriced risk allows us to add to our highest conviction positions at lower prices- the benefits of which will be apparent as these transactions progress towards closing.

Looking ahead, the drivers remain in place for another year of robust deal activity. We continue to find attractive investment opportunities in newly announced and pipeline deals. We remain focused on investing in highly strategic, well-financed deals with an added focus on near-term catalysts, and are upbeat about our prospect to generate absolute returns in 2022.

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Debt

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

Ian Francis, manager of CQS New City High Yield - 25 February

During the six month period under review economists and market commentators began to realise that the spectre of inflation was more permanent than they had previously realised. At the end of June 2021 the UK CPI reading was an annual increase of 2.4%; by the end of December 2021 this had reached 5.4% with economists predicting higher numbers once the effects of higher energy costs are eventually passed on to consumers. There was a similar pattern in other major economies such as the US and the EU where inflation is unlikely to prove transitory. Equity stock markets over the six months seemed to shrug off worries over inflation and were generally positive with major indices at near all-time highs in many markets. For the high yield bond markets, the second half of 2021 was fairly muted apart from in Asia where property firm Evergrande's continuing woes battered Chinese high-yield bonds with an average loss for the sector of 30%.

During the Summer and Autumn months of 2021 the UK economy suffered periods of supply chain disruption as there were shortages of key raw materials and cost pressures caused by rising inflation. As the year was coming to a close these issues were exacerbated by the appearance of the Covid Omicron variant which quickly established itself and caused further issues as many workers were forced to isolate. Fortunately, this particular variant, although very virulent, appears to be causing less severe illness than previous versions. In the US, the economy appears to be proving resilient to the effects of inflation and Covid; the same cannot be said of the EU at present with growth slowing sharply.

Government stimulus to protect economies and markets appears to be coming towards an end and it will be interesting to see how Omicron and higher inflation affects decisions on interest rates and subsidies. We saw increases of 0.25% each in UK interest rates in December 2021 and February 2022 and further modest rises are expected.

The outlook for 2022 is one of continuing recovery of the global economy, albeit slower than we saw in 2021. The major danger is inflation holding the higher levels that we are currently experiencing in Western economies for longer than Central bankers are forecasting. In the UK this will put even more upward pressure on wages when allied to the National Insurance increase hitting in April and not forgetting the massive hike everyone will be facing in the costs of domestic fuel. Although we believe the portfolio is in a good place we are cautious for the year because of the geopolitical situations in the Ukraine and Taiwan; those of us old enough to remember do not want a rerun of the Cold War, even more so with much of Europe relying on oil and gas from Russia. Markets may continue to be volatile but by the summer we should hopefully be in a far better position as regards the COVID epidemic worldwide which should improve supply chains as more countries get closer to economic normality.

Financials

(compare financials funds **here**)

Robert Kyprianou, chair of Polar Capital Global Financials - 17 February

The outlook for the year ahead at the time of writing would seem to be focused on two key drivers - inflation and COVID. The debate on inflation has - like that concerning the virus - centred on whether its upsurge can be characterised as elevated but transitory, or elongated and stubborn.

While the health battle is hopefully approaching its closing stages, the challenge facing central bankers to address rising inflation may only be beginning. As fiscal policy makers continue to focus on the cyclical and social fallout of the pandemic, there are early signs that central bankers are beginning to blink in their standoff with rising inflation. Among the 32 or so central banks that have already started to raise official rates, the Bank of England was the first of the major central banks to move rates higher.

The sharp pick up in non-wage inflation, unexpected supply disruptions in key markets and products, and the tightening of certain parts of the labour market do not seem to be a local story. The risk is that these pressures will be reflected in wage inflation, making the pick-up in general prices more severe and enduring. This is what many central bankers are now focusing on.

Importantly, the language from the Federal Reserve has clearly changed. Having been firmly in the 'transitory' camp on inflation, the Federal Reserve has removed this from its guidance and is now openly planning for a tapering in its asset purchases followed by a programme of official interest rate rises, and eventually moving to reduce the central bank's highly bloated balance sheet. The ECB, for the time being, is lagging but commentators expect its resistance to be tested by evidence of the effect of its policy stance on inflation, economic recovery and the Euro. In January 2022, Eurozone inflation rose to 5%, the highest level recorded over the more than 20-year life of the single currency, while the US reported 7%, representing a four-decade high.

Banks remain the largest component of the financials sector. Their strong performance in FY21 reflected their original conservatism in provisioning for pandemic related loan losses in relation to the resilience they demonstrated subsequently, and to their positive sensitivity to rising interest rate expectations. Since the global financial crisis in 2008, banks in general have been on a long path to rebuilding capital buffers, enhancing the quality of their balance sheets and improving their operational leverage.

In the near term COVID and the outlook for inflation and interest rates are likely to be more significant drivers of fortunes for banks and the sector as a whole. Uncertainties over the pandemic and responses remain, although it appears that many governments and ways of life are moving towards a virus cohabitation rather than elimination reality. This would leave the door open to continued economic recovery with the accompanying inflation concerns.

It seems that we may be at an important turning point in the interest rate cycle and in the extraordinarily accommodative stance of the central banks that matter. The level of global interest rates and bond yields has arguably been at a disequilibrium low level for some time, reflecting the presence of humungous asset buyers at any price, prepared to expand central bank balance sheets without any limit. This has resulted in oceans of liquidity which has provided rocket fuel for financial asset markets, to the point where arguably risk has been systemically mispriced. It has also had collateral consequences such as the rise of crypto currencies which have been in part a response to the debasing of fiat currencies by central banks and which have taken on a life of their own as a beneficiary of limitless liquidity and the disequilibrium in the pricing of risk.

Defining an equilibrium level for interest rates is not straightforward. However, it is unlikely to be at a level where a number of key short-term rates and major longer bond yields are trading at negative or paltry levels; more so when evidence of rising inflation and tightness in key labour and product markets dominates headlines.

Traditionally banks receive more support from a steepening of the yield curve than from the absolute level of yields. This time many banks may be beneficiaries of a rise in rates all along the maturity range, whatever the impact on the shape of the yield curve. For quite some time banks have seen their capital buffers and profits challenged by low or negative short-term rates. Faced with the liquidity piling up on their books following central bank asset purchase programmes, and the paltry rates available on longer term lending/ investing which does not adequately reward risk, banks have had little option but to take the pain of short-term placements at penal rates. A rise in short term rates will feed straight into the bottom line of banks from the large liquidity pools on their balance sheets, while a rise in longer term yields will reward better their lending and investment risk taking. The leverage banks experience in a rising interest rate environment may never have been so rewarding as it is in the current cycle.

Of course, the sector is more than banks, comprising insurance companies, diversified financials such as investment banks, asset managers and stock exchanges, as well as FinTech companies. Although not all are as sensitive to interest rates as the banking sector, they generally respond well to a recovering economic background.

A number of new players have also entered the market, typically in the FinTech sector, offering digitally-driven transaction services, brokerage platforms and custody services. Although carrying the risks inevitable in start-ups and young enterprises, they are helping to redefine banking products to the benefit of all participants. Rather than being disrupters that threaten the traditional banks, FinTech companies are likely to see not only significant consolidation, but also their futures within or in partnership with the mainstream banks. The combination of digital solutions that meet the new expectations of customers at the core of FinTech offerings, coupled with the capital, client base, risk taking capacity and experience of traditional banks, will help power performance of the sector as a whole.

Overall, the sector is set to be one of the major beneficiaries of a return to normal, not just in the way of life but also in asset markets and prices.

Despite the generally constructive sentiment towards the sector, reports that as many as 75% of FinTech start-up ventures fail; the experience of Danske Bank with its Estonian subsidiary; Credit Suisse's missteps with Greensill Capital and Archegos; and the issues arising in Chinese property companies show the importance of stock picking.

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Property

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

Richard Shepherd-Cross, investment manager of Custodian REIT – 22 February

Inflation is a clear and present risk in the market today and traditionally investors have looked to real estate as a hedge against the negative impact of inflation on investment returns. Over the longer-term history suggests property values and rents will increase broadly in line with inflation. Following a period of growth, the challenge for managers is to own properties with further rental growth potential whose valuation will most closely keep pace with rising prices.

The greater driver of inflation appears to be cost-push rather than demand-pull as the economy struggles with supply chain constraints, labour shortages and the aftermath of pandemic restrictions. These factors all mitigate against widespread, low cost, speculative development which would otherwise help resolve the demand/supply imbalance that is promoting rental growth. We believe Custodian REIT's portfolio is particularly well positioned to see rental growth as it is focused on smaller regional properties. In the industrial and logistics sector, which accounts for 50% of the portfolio by value, smaller properties are more expensive to develop, pro-rata, so require higher rents to justify development. Rents will continue to grow until they balance out inflation in build costs.

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Kerri Hunter, interim investment manager of UK Commercial Property REIT – 3 February

We expect the polarisation in the office market to deepen over the course of 2022. Demand for prime assets should remain robust but weaken for secondary accommodation. Those office assets not deemed to be 'future-fit' are likely to see limited occupational and investor demand as ESG requirements become ever more important. This will result in value erosion and a heightened risk of asset obsolescence. As a result, we expect the office sector to underperform in 2022, with a greater wedge between prime and secondary rents.

Overall retail performance is showing signs of improvement. However, we believe this to be primarily driven by market factors and a product of the market cycle, rather than sector-specific confidence. From an occupational perspective, there is still significant risk of further retailer defaults and the prospect for rental growth remains remote. The sector remains polarised with retail warehouse assets, particularly discount-led schemes, expected to drive performance.

While the industrial sector is unlikely to match the extremely strong performance achieved in 2021, total returns are expected to remain robust in 2022. There is little scope for further yield compression and sector performance is likely to be driven by the occupational market. Demand continues to outstrip supply, allowing for upward pressure on rental values. Prime industrial and distribution assets are best placed to capture this reversionary potential. Although the industrial sector has experienced a pick-up in supply, increasing land values and a shortage of suitable development sites will help to keep supply levels in check.

Despite the Bank of England's recent interest rate rise to 0.25% in December 2021, and anticipated further rises over the course of 2022, rates will remain low in a historical context. This ensures a healthy margin between bonds and real estate. Rising inflation may also attract further investment into the UK real estate market from investors seeking to hedge their inflation risks. Assets providing long-term, secure, index-linked cash flows are in line to benefit.

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Jason Baggaley, investment manager of Standard Life Investments Property Income Trust – 2 February

In 2021, UK real estate performance reached levels not seen since 2015, with the industrial sector outperforming the all property average by a significant margin. Indeed, the spread between the best and worst performing sectors reached the highest level on record in 2021. However, we anticipate that the spread in performance between sectors will begin to converge, predominantly as a result of where we are in the UK real estate cycle.

The office sector was the worst performing sector in 2020. We think that the structural headwinds facing the sector will result in offices underperforming the wider market in 2022. But there will be a clear polarisation in performance between Grade A and secondary office buildings. A divergence in performance by quality is beginning to emerge, particularly in markets where vacancy rates are not significantly above historical averages. Premiums are being paid for Grade A office stock that is truly 'future-fit' and possesses the necessary credentials: flexibility, amenity, connectivity, technology and sustainability. Assets that score strongly on these metrics will be best placed to capture and retain tenants during a period of significant structural change for the sector.

ESG considerations are crucial for all UK real estate sectors. This has become increasingly pertinent following the implementation of the government's Minimum Level of Energy Efficiency standard (MEES). By 2025, MEES will make it unlawful for commercial landlords to lease space with an EPC rating below E. By 2030, all commercial properties must have a rating of EPC B or higher. This requires landlords to place a greater emphasis on the ESG credentials of their commercial properties.

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Paul Williams, chief executive of Derwent London – 24 February

Our forward ERV guidance has improved through the last 12 months. We estimate our ERVs will grow in the range 0% to +3% in 2022 as an average across our portfolio. As the economic recovery gathers pace, we expect this will translate into sustained future growth. With continuing strong investment demand, we expect investment yields to remain firm.

London is firmly coming back to life. It continues to attract global talent as a leading city where people want to live and work. Our 'long-life, loose-fit, low carbon' approach, combined with the delivery of distinctive next generation developments, puts us in an excellent position to benefit from the emergence of rental growth for the best properties.

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David Sleath, chief executive of SEGRO – 21 February

We enter 2022 with considerable confidence in the outlook for the business and its ability to deliver continued growth. The effects of the pandemic are ongoing, and we remain mindful of macroeconomic and geopolitical risks, but the world is adapting quickly and learning how to function alongside COVID-19 with the lasting impacts on the way that we live and work strengthening occupier demand. It has highlighted the importance of global supply chains facilitated by high-quality logistics space and we have positioned our business to take advantage of these structural tailwinds.

Against a backdrop of strong demand from an increasingly diverse range of businesses, combined with historically low vacancy rates across Europe, we expect rental growth to continue across our markets. We believe that the growth rate will be highest where developable land is in short supply, for example in urban markets such as London and Paris. This acute supply-demand imbalance delivered record rental growth during 2021, resulting in significant accumulated rental reversion in the portfolio which we will be working hard to capture during 2022 and the coming years.

Inflationary pressures remain but we expect to be able to offset these in our existing portfolio by capturing the significant reversion in lease reviews and renewals, whilst benefiting from indexation provisions in our remaining leases which represent approximately 40% of our rent roll. Rental growth has also allowed us to maintain the profitability of our development programme despite the additional cost pressures arising from increased construction and material costs.

The unique supply-demand dynamics of the industrial sector have attracted increasing competition from both investors and developers, but we are confident in our ability to source profitable new opportunities to grow. As evidenced during 2021, the combination of our significant portfolio of modern assets in the most desirable locations across Europe together with our well-established operating platform provides us with a clear competitive advantage.

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Steven Owen, chairman of Primary Health Properties – 19 February

The ageing demographic of western populations means that health services will be called upon to address more ongoing, complex, chronic co-morbidities. PHP stands ready to play its part in delivering the real estate infrastructure required to meet this need in the community.

Despite the continued volatility in the economic and political environment and the prolonged era of low interest rates, there continues to be an unrelenting search for secure, long and reliable income. Primary healthcare, with its strong fundamental characteristics and government-backed income, has been a significant beneficiary of this trend. The UK and Irish markets for primary healthcare property investment continues to be highly competitive with strong yields and prices being paid by investors for assets in the sector throughout 2021.

In July 2021, the UK government published a draft Health and Social Care Bill setting out a number of reforms in order to implement the commitments of the NHS England Long Term Plan. This included the introduction of regional Integrated Care Boards and Partnerships tasked with co-ordinating NHS partners with local government services and budgets such as social care and mental health, in a geographic area, for the first time; the idea being that services are then pushed to the most efficient, cost-effective part of the system (whether primary care, hospital or care home) for the best patient outcomes. We welcome these reforms and are hopeful they will lead to better outcomes for patients and to further development opportunities in primary care in the medium to long-term.

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Richard Smith, chief executive of Unite Group – 23 February

The outlook for student accommodation remains positive, with structural factors continuing to drive a demand-supply imbalance for our product. Demographic growth will see the population of UK 18-year-olds increase by 22% by 2030. Participation rates in the UK also continue to grow and are now at their highest ever level, reflecting the value young adults place on a higher level of education and the life experience and opportunities it offers.

The government is targeting growth in international student numbers, aided by the two-year post-study visa (three years for postgraduates). This ambition is underpinned by the UK higher education sector's global standing and the strength of its universities. Given constraints on new supply of university-owned stock and private-rented housing, the vast majority of this new demand will need to be met by corporate PBSA (purpose built student accommodation) providers.

Brexit has had a negative impact on EU student numbers due to the loss of home fee status and access to a tuition fee loan, with student acceptances falling from 32,000 to 16,000 in 2021/22. EU customers represent 5% of occupancy in 2021/22, down from 10% in 2019/20. We anticipate a more marginal reduction in EU student numbers over the next two years, which we expect to be more than offset through increasing demand from UK and non-EU students.

The Skills for Jobs white paper, published in 2021, underlines the government's commitment to widening participation in post-18 education and strengthening the global standing of the UK higher education sector.

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Margaret Sweeney, chief executive of Irish Residential Properties REIT – 15 February

Housing in Ireland is a sensitive sector from public, government, political and regulatory perspectives, due to significant supply challenges in meeting growing demand for new homes. This has resulted in a number of changes to the regulatory environment over the last year, including changes in stamp duty and rent price regulation. The company continues to engage with and take account of this changing landscape in its investment and operating decision making.

The economic growth outlook for Ireland and the fundamentals of our business remain strong with a young growing population, reducing household sizes, and continuing strong international investment supporting continued requirements for good quality professionally managed private rental accommodation. As we enter 2022, headwinds in relation to inflation and interest rates, which have not been a significant factor over the last 10 years, will put necessary focus on operational costs and efficiencies from operational scalability and enabling technology. The company is fortunate to have significant head room in its debt facilities as well as extended maturities, to minimise the impact of future interest rate increases.

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