QuotedData
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INVESTOR

Economic and political roundup

Investment companies | Monthly | March 2023

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.

"We have made little if any progress on inflation. There is little if any reason to expect a large slow down going forward." – Harvard economist Jason Furman following the release of US consumption data.

It may well be that we are witnessing a reversal of a decade's material outperformance of financial assets over the real economy. Investors will likely need to adjust their expectations to the very different environment.

Inflation remains the only game in town for developed markets. Headline numbers for the Eurozone came in hotter than expected for February, and core inflation (excluding energy and food) accelerated to a new peak. Considering that inflation on the continent in 2022 was primarily a function of higher energy and food prices resulting from the war in Ukraine, accelerating core prices are a concern as it suggests pricing pressure may be embedding in the economy. Data out of the US also showed inflation accelerating for the first time in 3 months, and similar sentiments were echoed by both central banks with ECB chief economist Philip Lane suggesting that rates could be elevated for "quite a long-lasting period'', while the Fed's Raphael Bostic noted that "the economy packs sufficient momentum to weather higher interest rates''.

The transmission mechanism for monetary policy works over years, not weeks or months.

Market pricing in the UK tracked higher in sympathy, with rates now expected to reach 4.75% by year end, up from a peak of 4.25% at the start of the month. However, the BoE pushed back with Andrew Bailey suggesting he had not seen any data to justify the change in outlook, so all eyes will now look to CPI data for February which is due on 22 March.

The UK smaller quoted companies market is the most challenged with particularly poor liquidity. This is an existential threat

The nominee governor for the Bank of Japan told lawmakers that he was wary of damaging economic growth and would make no change to monetary policy for the time being. The Japanese yen weakened relative to the dollar over the month.

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At a glance

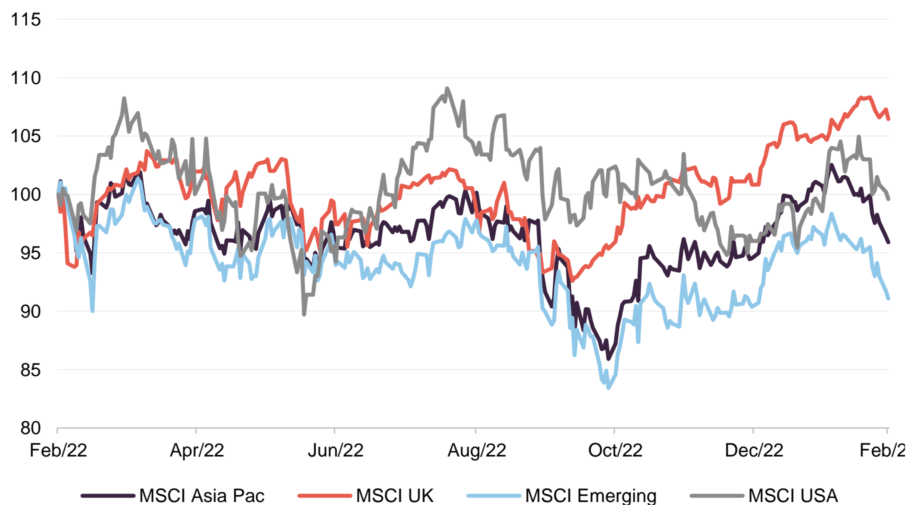
Exchange rate		28/02/23	Change on month %
Pound to US dollars	GBP / USD	1.2022	(2.4)
US dollars to Euros	USD / EUR	0.9456	2.7
US dollars to Japanese yen	USD / JPY	136.17	4.7
US dollars to Swiss francs	USD / CHF	0.9422	2.8
US dollars to Chinese renminbi	USD / CNY	6.9356	2.7

Source: Bloomberg, QuotedData

MSCI Indices (rebased to 100)

Global indices tracked down for the month while the USD strengthened as sentiment turned on stronger than expected inflation data. Still, markets remained well ahead of the cycle trough despite expectations for terminal pricing in the US and core inflation in the eurozone both hitting new highs. UK markets remained relatively resilient, finishing the month roughly where they began despite the growing global unease and a large rise in local market interest rate expectations.

Time period 28 February 2022 to 28 February 2023



Source: Morningstar, QuotedData. Converted to pounds to give returns for a UK-based investor.

Indicator	31/01/23	Change on month %
Oil (Brent – US$ per barrel)	83.89	(0.7)
Gold (US$ per Troy ounce)	1826.92	(5.3)
US Treasuries 10-year yield	3.92	11.8
UK Gilts 10-year yield	3.83	14.8
German government bonds (Bunds) 10-year yield	2.65	16.0

Source: Morningstar, QuotedData

Global

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

Sir James Leigh-Pemberton, chairman, RIT Capital Partners – 28 February 2023

2022 was the most difficult year for financial markets for more than a decade. The global economy was affected by significant supply shocks, with particularly sharp rises in energy and raw material prices. In financial markets almost all asset classes saw declines. The S&P 500 and the NASDAQ closed the year down -18% and -32% respectively, while Emerging Markets recorded a loss of -16%, Europe -10% and the FTSE 250 -17%. Furthermore, these year-on-year figures, stark though they are, do not tell the whole story of 2022, which saw significant shifts in investor sentiment and money flows at different points of the year, resulting in elevated levels of volatility.

Outlook

In early 2022, I highlighted some of the challenges we may see as a result of the removal of many of the extraordinary underpins for markets of recent years. It is not clear at all that we are through the fundamental transition entailed by the end of low interest rates. While the reintroduction of more rational pricing for risk and capital is welcome, the consequences of such a significant shift (and at such a fast pace) are unlikely to be short lived. The existence of 'free money' for so long, will no doubt have created widespread embedded distortions, which will take time to resolve. Low rates of economic growth, continuing pressure on both corporate earnings and consumer confidence, and limited scope for fiscal stimulus are likely to remain with us for some time, so that the conditions for a sustained recovery in markets appear at present to be remote.

In this environment we expect to continue with a relatively cautious exposure to quoted equities, while at the same time remaining positive about the opportunities for the long term which will emerge in stocks and alternatives such as the dislocated regional credit markets.

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Diana Dyer Bartlett, chairman, Smithson Investment Trust – 28 February 2023

Uncertainty around future interest rate rises, high levels of inflation and fears of a recession are likely to continue in the coming year. Whether the opening of the Chinese market post the lifting of COVID-19 restrictions will have a positive impact by generating economic growth or unleash further inflation or both is also uncertain. Political uncertainty has increased and there seems no end in sight to the Ukraine conflict. These are not easy conditions for a portfolio manager to navigate.

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Managers, RIT Capital Partners – 28 February 2023

It may well be that we are witnessing a reversal of a decade's material outperformance of financial assets over the real economy. Investors will likely need

to adjust their expectations to the very different environment of a higher cost of capital, labour and raw materials, and with no safety net provided by central banks. Participating in this market will be remarkably difficult, with central banks having unfinished business in their fight against inflation, companies facing margin pressures and uncertainty around economic growth, and consumers adjusting to the tighter financial conditions after a period of generous covid support schemes. This backdrop, in our view, warrants a cautious net quoted exposure combined with dry powder.

However, we also believe the macro uncertainty discussed above, combined with the risk of 'financial accidents', can create compelling bottom-up liquid opportunities in both equities and credit markets. We will follow our long-standing disciplined approach, focused on fundamentals-driven investing while looking for strategic openings which present themselves in such dislocated markets.

We would note that our patient approach also means we are unlikely to participate in short-term sentiment driven rallies. Nevertheless, we have demonstrated our resolve to act quickly and decisively when there is an opportunity, such as the value-oriented assets that benefitted from a more reflationary environment. We believe there will be additional opportunities in the upcoming year. For example, in 2022, the market disproportionately punished all long duration assets as a result of higher discount rates, without discriminating between the fundamental ability for companies to produce healthy cash flows and continued growth. We believe that many high-quality companies in our private investment book as well as our quoted biotech exposure could benefit from the market taking a more discriminating view of long duration assets.

Additionally, over the past year, driven by the sharp rise in the cost of capital, there has been a considerable expansion of the opportunity set for strategies that do not require rising equity markets. For example, merger arbitrage, structured credit, and equity market-neutral strategies can produce healthy returns with little resort to leverage in the current market environment.

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Tristan Hillgarth, chairman, JPMorgan Global Growth & Income – 27 February 2023

Six months ago, I noted that there were challenges facing the global economy and these continue. War, elevated global geopolitical tensions, increasing inflation, rising interest rates and slowing economic growth all point towards an uncertain outlook at least over the next couple of years. Much of the world may be facing recession in 2023, if not already there. Notwithstanding these risks, the positive start to 2023 continues with interest rate and inflation optimism as central banks stuck to their previous guidance and delivered the news investors were expecting. Global equity markets have continued their ascent on hopes that there is light at the end of the tunnel.

We note that current valuations of our portfolio stocks look reasonably attractive from a long-term perspective and should contribute to strong investment returns over time. We should not forget that recessions create investment opportunities.

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Helge Skibeli, Tim Woodhouse, James Cook, chairman, JPMorgan Global Growth & Income – 27 February 2023

Our only brief comment on the macroeconomic outlook this time around will be to say that the transmission mechanism for monetary policy works over years, not weeks or months. We should not expect a clear answer to the question of a recession for some time, and we would argue that even if one were to occur, it is more likely to be a mild one. Banks are better capitalised than in the past, the consumer has plenty of excess savings, the labour market is tight, and ultimately all of those factors contribute to one conclusion - there is just not that much leverage in the system. It is this leverage that in the past has caused recessions to become crises, and so whilst we continue to watch carefully, we don't believe there is any cause for markets to panic, even if economic data does weaken this year.

We have spent a significant amount of time parsing through data to ensure that we are taking advantage of the very best valuation opportunities. We have seen a rapidly evolving landscape in recent months. Where a year ago we saw a sizeable growth bubble in the US, we now see (some) more reasonable valuations. We have seen a rebound in cyclicals more recently, yet there is still a real opportunity in certain sectors to find good value in these companies more sensitive to the overall economic environment. You might ask why, if we see a risk of a recession, we would choose to invest in these more cyclical names? The answer, of course, is valuation. If we were to wait until there was no controversy around these companies, we would miss the opportunity. We are fortunate to have over 30 years of data that helps us contextualise when companies are cheap versus their peers. It is that insight that has driven the strong recent performance, and we will continue to search out those most attractively valued names.

One notable characteristic of the portfolio today is the sizeable overweight to companies based in the United States. Whilst we are finding many opportunities in names that might be considered more cyclical, we do of course think carefully about the range of outcomes for each company. Undeniably, the US has been a more resilient economy than much of the rest of the world for some time, as they are less susceptible to external shocks impacting economic growth. Europe was facing a difficult time after the Russian invasion of Ukraine, and even China now still faces an ageing population despite reopening looking to boost the economy in the short-term. Therefore, to ensure that balance exists in the portfolio, and that no economic outcome can overly drive the fortunes of our shareholders, we see it as prudent to have more of the portfolio in US companies than has been the case for some time. One other important driver of this is the more appealing valuations of some US technology companies, after significant pullbacks in their shares over the past year.

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Robert Hingley, chairman, The Law Debenture Corporation – 27 February 2023

The beginning of 2023 has brought some tentative optimism from investors that inflation and the cost-of-living crisis will perhaps subside sooner than first thought. While I welcome a more optimistic outlook on UK market valuations, particularly with the more stable environment that we are now seeing, there is still some way to go, and it is reasonable to expect much of this year to follow the current trends. The majority of the portfolio is invested in UK equities, although many of the earnings

are derived from outside the UK. James and Laura continue to believe that UK market valuations are too low and offer some attractive longer-term growth opportunities with a lot of bad news already priced in.

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James Henderson and Laura Foll, investment manager, The Law Debenture Corporation – 27 February 2023

The major event in the global economy during the period was the upward move in interest rates, as a result of inflation breaking out everywhere. The catalyst was the Russian attack on Ukraine, forcing up oil prices as well as agricultural products. Prices in other products and services responded by increasing at rates not seen for forty years. However, inflationary pressures had been building before the Russian attack. The effect of Covid-related restrictions led to supply issues in many product areas. The monetary expansion required to alleviate the worst effects the pandemic had in many areas was always likely to stimulate inflation.

The upward move in interest rates after a prolonged period of unnaturally low rates led to a number of foreseeable consequences. Property prices fell, as did other alternative asset classes, as investors demanded higher yields. However, the fall in the economy generally has not so far been as marked as some predicted, the reason being that, although interest rates were very low, this had not resulted in high levels of bank borrowing overall in the economy. The regulations brought in after the banking crisis had made accessing the low rates difficult for many. Therefore, the rapid rise in interest rates has slowed the economy, but not brought about deep recessionary conditions. This can be evidenced in the UK by the continued low level of unemployment. Inflation, as well as meaning interest rates rise, has put an upward pressure on wages, leading to public sector strikes. The debate rages about how entrenched inflation has become.

We remain mindful of this difficult economic backdrop, but the Portfolio is invested in individual companies not in "UK plc". The businesses we regularly see are dealing with the cost pressures and achieving price increases for their products, which is resulting in a preservation of operating margin.

The intention is to be a net buyer of equities. Investors' macro concerns have meant that valuation levels for companies are at historical lows. This is particularly the case with UK shares. There are opportunities to add positions for the Portfolio in companies that fulfil our investment criteria and we will continue to add to the Portfolio. The purchases will be in a diverse range of companies, as the testing economic conditions will mean some companies disappoint expectations. However, the dynamism and strengths to be found in some UK companies is not being recognised but, we are confident, it will become so, as some of the economic concerns are slowly resolved.

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Lord Macpherson of Earl's Court, chairman, Scottish American Investment Company – 10 February 2023

2022 has been another difficult year for the world, a period in which equity, bond and property markets have all been weak. As the challenges from Covid-19 receded those arising from the Russian invasion of Ukraine increased. The economic

recovery from the worst of the pandemic has been more tentative than expected, in large part due to resurgent inflation. With hindsight, central banks were too sanguine about inflationary pressures in 2021, and the energy price shock arising from the Russian invasion pushed inflation to levels not seen in 40 years. As a result, central banks have had to raise interest rates much higher than expected a year ago. The retreat from globalisation has continued, with trade barriers increasing as countries seek to protect their supply chains in the face of greater geopolitical risks. Closer to home, political missteps eroded confidence though as the year drew to a close there were signs of greater calm and stability.

On the positive side, industrialised economies have shown extraordinary adaptability in the face of the energy shock. Oil and gas prices have fallen recently, creating a more benign outlook for inflation. And the world economy is set to grow in 2023.

Equity and bond markets were weak last year, and other markets including property have also experienced difficulties. As 2023 gets underway, there are tentative signs of hope triggered by lower energy prices and reduced interest rate expectations. It is too soon to know whether the worst is behind us: government finances remain under pressure and many companies will struggle to grow their earnings and protect their balance sheets in the face of slow economic growth. However, with asset prices adjusting, there will be buying opportunities, and maintaining a focus on the strength and resilience of individual investments remains as important as ever.

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James Down, Toby Ross, managers, Scottish American Investment Company – 10 February 2023

Few predictions cast at the end of 2019 foresaw the advent of COVID in early 2020. Few of those who forecast continued economic despair during the ongoing lockdowns at the end of 2020 foresaw the enormous rally in equity markets in 2021. And few who prognosticated at the end of 2021 predicted the war in Ukraine at the start of 2022, with inflation reaching double-digits and interest rates spiking higher. As we begin 2023, we remain humble about our (or indeed anyone's) ability to foresee what is just around the corner.

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Carolan Dobson, chair, Brunner Investment Trust – 15 February 2023

2023 continues with some of the most troubling factors currently affecting the world: the ongoing war in Ukraine which confounds both logic and decency; and the inflation-fuelled cost of living crisis being felt tangibly by so many closer to home.

However, there are indications of inflation moderating. That may mean interest rate rises may be nearing their high but there is definitely central bank rhetoric in conflicting directions on the subject. The more soothing comments from China, as it reopens the economy, is a welcome development.

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Katie Potts, manager, Herald Investment Trust – 15 February 2023

Market induced valuation volatility is one dimension to performance. The more important one for the long term is investing in successful growth companies. Our belief is that good companies will grow whatever the economic backdrop, and that technology will continue to open up new markets. Early-stage capital is always scarce and by ensuring that we identify and research good companies ahead of others we can benefit from this.

Technology spend used to be mainly a capital expenditure decision, and demand was vulnerable to economic cycles. However, today businesses cannot run without information systems which are increasingly provided as a service on a rental basis, in effect outsourcing capital expenditure. This also means that more technology spend, across datacentres and communications infrastructure as well as software, has become non-discretionary. Importantly it means many technology companies are less exposed to cyclical demand and have defensive characteristics like utilities. Furthermore, businesses and governments alike are faced with other inflating costs, and the UK and North America in particular have very tight labour markets, so there is greater pressure than ever to find efficiencies, driving further demand for technology investment. The consumer, although wedded to the internet, is perhaps more fickle and may reduce expenditure on content and consumer electronics in uncertain times. Equally, inflationary pressures may squeeze advertising demand which is showing signs of weakness, but digital media continues to gain share. Business-facing subscription content should be more resilient.

Companies manufacturing technology products such as semiconductors are more exposed to softening demand than software companies. They have suffered from supply chain issues associated with Covid and capacity constraints, particularly in the semiconductor industry. This has left many companies with record order backlogs so short-term demand is assured, but for those higher up the supply chain the inventory cycle could produce adverse impacts.

Takeovers have continued to be a strong feature this year. In contrast, IPOs were few and far between, with stock markets virtually closed to new entrants.

Whilst we remain confident about the longer-term prospects for the majority of the investee companies, we have concerns about the state of financial markets particularly for smaller companies. The UK smaller quoted companies market is the most challenged with particularly poor liquidity. This is an existential threat. The Company's capital is much needed in the UK. The entrepreneurial early-stage part of the market, which the Company addresses, is on the frontline in the conflict between regulation and economic growth. Whilst we respect the need for regulation, it appears to us that the process of reducing risk from the markets seems also to be reducing the available risk capital. This is surely an unintended and undesirable outcome and a major factor in our gradually decreasing exposure to the UK market.

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Tom Black, chairman, Herald Investment Trust – 15 February 2023

We are privileged to meet many management teams throughout the world on a recurring basis and this gives us an interesting perspective from which to assess our market background. Everyone thinks their own economic problems are worst. The UK has a particularly negative view of its own position, perhaps driven by recent

political turmoil and media negativity on a wide range of problems. Thus far, profit expectations for companies in the UK portfolio have been particularly resilient, perhaps benefiting from sterling weakness relative to the dollar, and more conservative management of growth expectations. US businessmen are depressed by their country's social tensions and excessive fiscal and trade deficits, which dwarf the UK's. In contrast to the UK, in North America expectations for revenue growth are visibly weakening, and many companies have faced currency headwinds on their overseas revenues. The Chinese seem alarmed by their financial leverage, ageing population and a leadership unsympathetic to business. The manufacturing orientation of the sector in Asia means it is visibly more exposed to a cyclical slowdown in demand. Europe has the additional challenge of its proximity to Russia/Ukraine, energy supply issues, and most significantly the different countries in the Eurozone operating under one central bank, but no fiscal union. It is hard to find optimism in the current landscape.

Despite the myriad problems, the UK has the advantage of its own central bank, debt in its own currency, domestic gas production to meet half of its need and a significant capacity to generate electricity from wind with huge further potential. Perhaps due to the high cost of land and labour the UK has become a knowledge-based economy which is a significant positive and produces a large trading surplus in services, which are not energy-dependent. In addition, in a world of conflict and increased tensions, the UK does still have a defence industry which benefits a number of companies in the supply chain.

Beyond our home market, there continue to be opportunities for us in all of our markets. We have a strong focus on the United States which has scaled some software companies brilliantly, delivering high margins. As evidenced by the takeover volumes the Company has experienced, the scale of North American private equity activity has shrunk the size of the addressable listed market, albeit in recent years offset by a wave of speculative new issues. Whereas the AIM market in London has had numerous IPOs and secondary placings to raise development capital, US IPOs tend to have been exits for venture capitalists and private equity. Furthermore, there was a fashion for crossover funds or public company investors participating in late-stage venture rounds. This category of investor seems to have disappeared. As interest rates normalise, the extent to which these trends continue, and how they achieve exits, remains to be seen. Europe as a region is perhaps less easy to categorise and will remain a stock-specific market for the Company. Asia clearly the primary region for new listings, with its technology sector having emerged as a low-cost manufacturing location and now progressively moving up the value chain.

There are key areas of change which always open up opportunities for smaller companies. For many years there was a trend for manufacturing to migrate to China, with its lower labour costs. As salaries and skillsets in China rose and, more recently, as political concerns about China's direction of travel have grown, other emerging economies such as Vietnam and Mexico have become more important as manufacturing hubs. Whilst this shift has been underway for some years, 2022 has added a further dramatic twist. The Ukraine war and the related supply chain issues have magnified concerns about security of supply. 'Just in time' and lowest cost is no longer the buyer's prime motivation. 'Just in case' has become the new mantra. In addition, the increasing tensions between China and Taiwan are of great concern

and any conflict there would dwarf the Ukraine impact on the technology sector given the central role played by Taiwan in semiconductor manufacturing.

The major disruption of Covid has also led to a change in the employment market. There has been a rise in working from home as well as a significant reduction in the proportion of working age people available to work in developed countries. Despite the obvious attractions of avoiding the cost of offices and employing people more cheaply from far corners of the earth, we are unsure what long-run effect this will have. Many of the companies in our portfolio are based in knowledge clusters such as San Francisco, Seattle, Boston and London, where knowledge feeds on itself. Can this be sustained with working from home? Will centres of excellence become less relevant? These remain unanswered questions at this time. There is some evidence that the tightness of the labour market is receding, and employees are coming back to the office so perhaps the working from home trend may not be so acute as we once thought.

Outlook

There are many reasons to be anxious as we look forward. Excess government leverage globally in an environment where the cost of capital is normalising, geopolitical tensions across the globe and energy market turmoil all play their part. In this environment it is challenging to reduce risk in any portfolio. However, against this background smaller companies with genuine growth prospects and intellectual property seem appealing. This is where the Company operates, and the best returns have been made from investments in 2002-3 post the internet boom and 2008-9 in the financial crisis. We are optimistic there will be good buying opportunities ahead.

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Peter Burrows AO, chairman, UIL – 21 February 2023

A number of themes dominated global events last year: Covid-19, heightened geopolitical tensions, the outlook for inflation and interest rates, commodities and climate change.

On Covid-19 it was astonishing to watch China pivot from zero tolerance to living with Covid. The resultant surge in infections and herd immunity achieved will put the economy back on the front foot. Undoubtedly the impact on China will be brutal and scare people for many years to come. China is now focused on recovering the economy and we should expect that to translate into a surge in demand as the housing market and consumers recover. With China now open, the world's economies should be able to return to normal whilst living with infections from Covid.

Inflation remains elevated. This has been driven by the developed economies response to lockdowns which was to economically support the consumers. The consumer in turn saved much of this funding which led to a surge in demand as developed nations reopened. Supply chain disruptions created during the pandemic also added to the pricing pressure. This trend has been viciously reinforced by the Ukraine War which has led to energy supply challenges and highly inflated costs. Add to this tight labour markets with below trend unemployment rates. The response from central banks has been to raise interest rates to head off spiralling inflation. Our expectation is that the central banks have done enough and that 2023 will be characterised by falling inflation and interest rates. Our central case is for the global economy to post positive GDP for the year led by EM.

The ongoing friction between China and the USA is a clash of ideologies and is likely to continue between the two nations and their allies.

How is the world and in particular corporates responding to the challenges above? Simply put, they are diversifying their supply lines. Within EM, we are seeing a strong shift from China to nearshoring, and this is expected to continue for much of this decade. Countries such as Vietnam, Mexico and eastern Europe should therefore benefit.

Climate change is increasingly shifting to be a central focus and rightly so given the alarming evidence of a planet faced by the need to change its fossil fuel dependency. Over time we expect green policies will drive dramatic change. Short term security of energy supply is the key focus for most countries as they deal with the fallout from the Ukraine War and sanctions on Russia, but we expect renewable energy to accelerate in the coming years.

Flowing on from this there is likely to be an outsized demand for commodities: especially those in demand as China reopens and the need for a greener economy. Copper and lithium are certainly two examples and under investment in production is also likely to be a factor. Commodity led economies such as Australia, Canada, Chile and Brazil, should therefore benefit.

For 2023 we are optimistic for the global economy. If a recession emerges in the developed world, we expect it to be shallow. We anticipate inflation and interest rates to recede over the year. We believe demand for commodities, especially battery commodities to be elevated. Consequently, we believe that headwinds are turning into tailwinds, which should be positive for equities.

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UK

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

Sir Laurie Magnus CBE, chairman, City of London Investment Trust – 16 February 2023

During the six months under review, UK inflation reached a 40-year high, driven by spiralling energy prices. The UK base rate, which was 1.25% at the end of June, was increased four times by the Bank of England, ending at 3.5% in December and with a further rise to 4.0% in the New Year. The 10-year Gilt yield, which was 2.2% in June, rose to 4.5% in September, partly due to rising inflation but also the unfunded tax cuts which were announced by the Truss government. The situation was made worse by a steep depreciation in the value of sterling and by selling from some pension funds to pay margin calls on derivative products. By the end of December, the 10-year Gilt yield had fallen back to 3.7% and the fall in sterling had reversed, with the new Sunak administration pursuing a more conventional fiscal policy. The trend of increasing inflation and tightening monetary policy also prevailed overseas with, for example, the US 10-Year Treasury yield rising from 2.9% to 3.9%. In contrast, UK equities were resilient, producing a return of 5.1%, as measured by the FTSE All-Share Index, helped by a strong performance from the

mining sector (in anticipation of the reopening of the Chinese economy) and the oil and gas sector.

Inflation should fall over the next six months as the sharp upward movements in oil and gas prices at the start of the Ukraine war are timed out of the 12-month inflation calculation. The combination of a continuing tight labour market, higher wage settlements and strikes in various sectors of the economy is likely to keep inflation above the Bank of England's 2% target for some time. This will result in continuing elevated interest rates when compared with recent years since 2009, albeit remaining below the higher rates prevailing before the financial crisis in 2008. The reopening of the Chinese economy, after its Covid lockdown finally ended, is positive for global growth, while lower oil and gas prices are helpful for consumers in the UK and overseas. The dividend yield premium of UK equities over bank deposits and 10-year Gilts has narrowed, but equities offer the prospect of dividend growth and can therefore provide some element of hedge against inflation.

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Frank Ashton, non-executive chairman, Athelney Trust – 13 February 2023

The year of 2022 was, for many, including the investment community, one to forget. Shocks and surprises marked the year, which ended very poorly with market uncertainty and loss of confidence created by the short-lived Liz Truss premiership, made worse by the impact of double-digit UK inflation.

In an interview with the BBC in 2014, Charlie Munger, renowned partner in Berkshire Hathaway said: "Without a system of wise restraints, gross immorality and extreme craziness will happen in markets. They need to be dampened." He was talking about some of the causes of the Crash and Global Financial Crisis in 2007-08, but this is also true elsewhere. For example, a leader operating in a powerful political and governmental system with few restraints represents a risk: Ukraine's citizens, and to a lesser extent a large proportion of Europe's population are paying the price for Putin's 'grossly immoral' and unfettered ambition to control that country.

A new prime minister, seemingly believing the only opinions on the September mini-budget that mattered were her own and her Chancellor's, was swiftly brought low; however the damage had been done. The mini-budget resulted in 'craziness' for a few weeks with a dramatic loss of financial market confidence in the UK resulting in the Bank of England being forced to stabilise the bond market by temporarily buying long-dated UK gilts. Enter Hunt and Sunak as new Chancellor and PM to try to return the narrative to calmer and more acceptable content and tones. Now homeowners who have to start a new mortgage term face a dramatic rise in cost and many wish Truss and Kwarteng had used any 'system of wise restraints' before launching that particular mini-budget against the backdrop of a rising cost of living crisis.

All these events had a heavy impact on the UK Smaller Companies segment, the focus of this fund; smaller companies can be perceived to be a riskier investment because they tend to be less liquid and less resilient stocks in a challenging environment, compared even to FTSE-250 companies. Market sentiment has recently been strongly negative to this segment. By comparison the blue-chip FTSE-100 fared better than most markets because these large 'old-fashioned',

liquid, oil/gas- and commodity-based stocks were buoyed by the run from UK bonds, representing a safer haven than, for example the NASDAQ where Big Tech companies had a torrid 2022.

This time last year I commented on Apple being the first stock to reach $1 trillion market cap on 4 January 2022, after tripling the share price over the prior two years. Well, in 2022 Apple lost a third of that value, beset with problems on iPhone 14 shipments due to COVID restrictions at its main Chinese factory, resulting in declining earnings and disappointing fourth quarter guidance.

I mention such a large US stock in a UK small company fund report because this poor year, especially for Apple shareholders is a timely reminder; we should be investing in good stocks and management teams for the long term and resist perhaps emotionally driven reactions to news or poor performance over a relatively short period of time. Wars, times of political incompetence, market corrections and yes, apparent evidence of fraud at 'star companies' (such as Sam Bankman-Fried's crypto empire FTX) should really not surprise us much. Human nature and systemic failings are hardly news. Temperament is much more important than intelligence for investors (as Messrs Buffett and Munger have told us for a long time).

Outlook

Perhaps the main questions that will affect our performance for 2023 include:

- How long will UK inflation remain above that of other countries in Europe, and what interest rate medicine will be needed to bring it back in line (after reaching a peak of 11.7% in October, are we over the worst). This will affect our income
- What costs, including those to settle public sector pay negotiations, will be incurred by the government, over what period of time, and is a Labour government now inevitable in 2025; this affects general sentiment on the economy, tax burden and confidence for investors, including inward investors
- What global assistance or headwind for UK economic recovery might be expected? Potential global recession, no sight of an end to war in Ukraine, the rate and strength of recovery for China's economy, and the apparent weakening of America's economy, all play into the geo-political environment.

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Dr Manny Pohl AM, fund manager, Athelney Trust – 13 February 2023

While I was preparing to write this year's commentary, the following quote came to my attention:

"Time is the friend of the wonderful business, the enemy of the mediocre." Warren Buffett - Letter to Shareholders 1989

While supply chains are stretched and input products in short supply, it can be challenging to recognise the potential in companies, particularly those that are in the growth stage of their life cycle. It can also be difficult to evaluate the 'narratives' that some companies are telling about themselves. To invest in a company in the growth stage of their life cycle it is important to balance the company's narrative alongside its numbers and it is vital not to get caught up in the hype and noise of the internet and daily market movements.

A sound investment philosophy sets out a number of 'rules' or 'procedures' to fall back on when the market noise gets too loud. Companies that have a sustainable competitive advantage will always be well-placed to withstand short-term headwinds, regardless of market conditions, maintain market share and ultimately find new ways to grow. Their ability to be flexible, to move quickly, to take advantage of opportunities as they arise, and to capitalise on market trends and demand, will continue to support the ongoing success of such businesses, and provide significant long-term opportunities for their investors. The pandemic, devastating weather events, and the invasion of Ukraine are examples of macro-environmental shocks impacting companies worldwide and it is also of paramount importance to take a holistic approach when analysing the companies and their sustainability by considering the business competitiveness and ability to dynamically adapt and react to black swan events - to be resilient.

Over the past few years our industry, and society more broadly, has continued to evolve with higher expectations being made of businesses and their social licence to operate. Being a good corporate citizen is only part of it. Being a good corporate citizen that is compassionate, committed to its people, planet, and the community is mandatory. Any successful business owner makes decisions for the betterment of their long-term business. Having sustainable practices and a long-term mindset is vital for any operator in this modern, rapidly changing world.

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John Evans, chairman, JP Morgan Mid Capital Investment Trust – 10 February 2023

2022 was a poor year for equites on a global scale and in the UK the Mid Cap index recorded a disappointing return and one that was, unusually, significantly lower than the larger cap indices of UK equities. This is reflected in high levels of outflows from UK equity funds in 2022 and widening discounts for UK equity orientated investment trusts.

The reasons are not difficult to identify being a combination of rising energy and commodity prices, leading to sharply higher than expected rates of inflation which the Bank of England has responded to by beginning to raise short term interest rates. The follow through from the resurgence in inflation has been a rising number of labour disputes as employees seek wage rises in line with the increase in cost of living. Some of these negotiations have culminated in a series of strikes by workers in many key sectors.

The highly damaging political hiatus in September undermined international confidence in UK debt markets and came about at the precise time that the Bank of England was in the process of replacing quantitative easing with quantitative tightening. Debt is now priced more realistically than has been the case since 2008 and perhaps of greater import will now be less freely available and hopefully more appropriately employed.

All of the above combined to produce an awful background for the FTSE 250 and performance has reflected this. However, looking at long term valuations it is clear that much of the downside may now be priced in, indeed over the past 30 years there are only three other periods where forward valuations have been close to current levels.

The market has recession priced in and the ongoing risk is that the decline in earnings and profits is greater than currently anticipated.

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Georgina Brittain, Katen Patel, investment managers, JP Morgan Mid Capital Investment Trust – 10 February 2023

It is very easy to paint a dark and gloomy picture of the UK economy, and therefore of its perceived stockmarket proxy, the FTSE 250 Index. However, markets (and investors) are pre-emptive, and looking out to the next 12-18 months provides reasons to be more optimistic.

In line with most economists, we expect a mild recession in the UK in 2023. We believe inflation has peaked in the UK, and while we expect it to remain elevated, we do foresee a significant decline from the current 10.7% over the course of this year. In part this is due to gas prices, which are substantially lower than the peak in 2022, although still high versus historical metrics. After nine increases last year and one increase on 2nd February 2023, interest rates at 4.0% are much closer to peak. Consumer confidence remains very weak - headlines, strikes, utility bills and potential house price declines are all playing a part - but the unemployment rate remains very low at 3.7% and there are still over a million job vacancies. Freight rates have fallen significantly, and it appears that supply chains are beginning to function more normally, aided by the re-opening of China.

This leads us to valuations. The environment is going to remain extremely difficult for businesses and consumers to navigate this year - but a lot of this is already reflected in valuations. While it has rallied off its 9.8x low in October, the FTSE 250 Index price to earnings ratio is around 12x and on our favoured free cashflow yield metric the Index is undeniably attractive on 4.5%. As we have said before, acquirors of UK businesses recognise this. Merger & Acquisition ('M&A') activity continued in 2022 despite the economic backdrop, and we strongly believe it will continue this year while valuations remain so compelling on any sensible timeframe.

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Christopher Samuel, chairman, BlackRock Throgmorton Trust – 9 February 2023

In my report to shareholders this time last year, the UK had led the developed world with a successful vaccine roll-out and there was, to some extent, a degree of optimism as the spectre of COVID-19 dissipated and economic activity returned to more normal levels. However, although the uncertainty caused by COVID-19 related lockdowns had been removed, there were indications that there had been more longer-term structural damage to the UK economy. This damage became evident as companies reported supply chain bottle necks, labour shortages and rising operating costs, which were either absorbed, or in many cases, passed onto the consumer.

As the UK economy struggled with the challenge of transitioning from a COVID-19 driven demand for goods over services model, to a more balanced goods and services-based economy, this supply pressure inevitably led to rising prices and in turn rising inflation. These inflationary forces were then exacerbated by Russia's invasion of Ukraine in early 2022, triggering an energy supply shock, with Europe

being hit hardest given its reliance on Russian gas. The resultant spike in wholesale energy prices, coupled with price hikes for agricultural commodities, pushed up the cost of many food staples, driving up two of the key elements of inflation to levels not seen in over 40 years. The notion of 'transitionary inflation' was now firmly discredited and inflation not only persisted but continued to rise unabated throughout the financial year. At the time of writing UK inflation, as measured by the Consumer Price Index, is at 9.2%, having peaked at 11.1% in October 2022.

The Bank of England took decisive action to combat soaring inflation by reiterating its commitment to the 2% inflation target "at all costs" and implemented tighter monetary policy through several interest rate hikes during the year. Similar action was seen globally, as central banks sought to unwind decades of accommodating monetary policy resulting in excess market liquidity which has acted to stoke inflation. However, this action has negatively impacted UK growth forecasts and raised the likelihood of a more prolonged economic recession. The stock market responded by adjusting valuations downward to reflect this more challenging economic back drop and the compounding effect of a weakening pound, higher input costs and rising wages on corporate profit margins. This downward revaluation was particularly acute in the high-quality growth stocks within our portfolio, and many were materially re-rated, despite posting strong results and material trading updates.

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Dan Whitestone, manager, BlackRock Throgmorton Trust – 9 February 2023

Financial markets and macro data remain volatile and markets are likely to continue to be driven by inflation statistics and indications (or not) of slowing the pace of monetary tightening from central banks. This push and pull dynamic is likely to remain a recurring theme in the foreseeable future, but ultimately we continue to see evidence to support our thesis that inflation has peaked and is indeed falling and this will ultimately lead to the Federal Reserve (Fed) to adjust their course. Some of the largest contributors to headline inflation (energy and food) are now showing lower year-on-year increases and might even turn negative year-on- year as we move into the first quarter of 2023.

At the time of writing, four of the seven categories in core inflation (core inflation strips out food and energy from headline inflation) saw price declines in November data. Based on the data we track, we see leading indicators for shelter, the last remaining large positive contributor to core inflation, also reducing. We are not predicting either an imminent pivot by the Fed, nor a return to the ultra-lax monetary policy of the 2020/2021 period. We suspect the Fed will not pivot until there is a CPI data showing inflation close to 2% on a year-on-year basis. Our current best guess is quarter three of 2023, but we are not betting the house on it and will be led by the data. The change from hiking 75bps to hiking only 50bps at the last meeting demonstrates the direction of travel here too. That said, we do not expect this to be a smooth process and the market is likely to remain sensitive to both inflation data and any indications of changes to Fed policy.

Turning attention to the portfolio, we would urge investors not to conflate share price weakness with a deterioration in investment cases. Many of our investments have demonstrated incredible earnings resilience through 2022 despite the challenges

they have faced from rising input costs, supply chain pressures and weakening demand. They continue to generate cash and have strong balance sheets. Valuations have been reset and we feel that right now there is an asymmetric risk/reward profile developing within the portfolio. That is not to say that we think the market has definitively bottomed, but we do think very much that the worst is behind us, and share prices are already pricing in extremely bearish scenarios with little attention (and value) ascribed to their long-term prospects, increasing profits and growing cash flows. This will return in time.

Whilst we are always open to adding new short positions to the portfolio, we continue to believe the best value in the market today remains in well-financed companies with enduring long term organic growth prospects that will use this period to enhance their position to win more share.

We look to the year ahead with optimism.

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Ciaran Mallon & James Goldstone, portfolio managers, Invesco Select Trust UK Equity Share Portfolio – 8 February 2023

UK market sentiment was dominated by concerns around inflation as the consumer price index (CPI) continued to rise, driven higher by increases in the prices of imported goods and particularly the rising costs of energy, all of which had been exacerbated by the war in Ukraine. In order to try and keep control of the rapidly rising inflation figure the Bank of England raised interest rates four times during the six month period from 1% to 3%, with an additional with additional increases in December and February taking the Bank of England Base rate to 4% currently.

The additional issues of US-China relations regarding Taiwan, and UK domestic politics, which included two new Prime Ministers over the period, continued to play a part in the background. The ill-fated 'mini budget' announced by the Truss government caused turmoil in the gilt market. The Bank of England intervened to provide liquidity to some market participants and after the unfunded tax cuts were abandoned, yields gradually fell back to levels seen before the budget. Sterling also recovered from its lows versus the US dollar.

Commodity prices during the period generally remained elevated although some key commodities such as oil and gas and wheat have eased. Prices of these commodities are of particular interest as they form a significant part of input costs for businesses whether it be production, transportation, ingredients or animal feed. Should prices fall further this would likely bring inflation down as we move through 2023.

The end of the period was marked by an increase in industrial action by various trade unions as the increased costs of living weighed on consumers. This caused many key services to reduce productivity which will undoubtedly have an impact on the UK economy. Estimates are that the impact of the disruption since June 2022 currently stands at around £3.2 billion or 0.25% of GDP. At a time when economic growth will be difficult to come by, a swift conclusion to the industrial action would be welcome.

Despite the headwinds of high inflation and higher interest rates we are optimistic that inflation will moderate over the course of 2023. We also recognise that

uncertainties in the global economy and the geo-political landscape continue to make the range of possible outcomes particularly wide.

We spend a great deal of time speaking to the management teams of companies. Their knowledge and expertise give us a great deal of insight into the sectors and economies in which they operate, often these insights can be more informative than regional economic data. It is because of this global footprint of the companies in the FTSE All-Share Index that we often say that the UK equity market is not a proxy for the UK economy. More than 75% of corporate earnings in the FTSE All-Share Index are derived internationally. Our analysis shows UK equities to be cheap across a blend of valuation measures, relative to history, and in particular relative to the US market. This opportunity is evident in every major sector, not just at an index level.

The current environment remains difficult to predict and whilst we believe that inflation may begin to fall quite quickly later this year, the fact remains that this will be largely due to base effects coming through. Prices for many of the goods and services that have risen sharply over the last year, as a result of rising input costs, specifically energy prices and second order effects of this, will likely remain elevated. Those companies that are able to pass on or absorb these increases, will likely fair better in our view.

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Wendy Colquhoun, chairman, Henderson Opportunities Trust – 2 February 2023

During periods of growing investor caution, it is often smaller companies that fall quickest and most steeply. This year was no exception. While the FTSE All-Share Index fell a modest 2.8%, the FTSE 250 Index of medium sized companies fell 20.5%, the FTSE Small-Cap Index fell 18.6% and the AIM All-Share Index of the smallest listed UK businesses fell 33.2%. It is the Fund Managers' view (shared by the Board) that steep falls in UK smaller company share prices have left valuations at attractive levels. Therefore, despite the current uncertainty, it is these low valuation levels and the belief that the companies held can grow over the long term that lead us to think there is currently considerable opportunity for the patient investor.

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James Henderson and Laura Foll, fund managers, Henderson Opportunities Trust – 2 February 2023

There are about a thousand companies quoted on the main list and AIM that we could invest in. Some of them over the next few years will become substantially larger regardless of the economic backdrop. The successes will come from many different areas of activity. They will have two things in common - dynamic management and strong business propositions. They will seize the opportunities that come along as well as having long-term strategies. There will also be many corporate failures. The current low valuation of the average company suggests the balance of probabilities is very much in the investors' favour as the corporate successes have current share prices that do not price in the prize of success. This is because despondency is high among investors with general concerns about the economy colouring appraisal of individual companies.

Graeme Proudfoot, chairman, BlackRock Income and Growth Investment Trust – 1 February 2023

When I reported to shareholders at this time last year, the UK market had been buoyed by a successful vaccine roll-out and there was, to some extent, a degree of optimism as the shadow of COVID-19 faded away and economic activity started to return to more normal levels. However, although the risk of direct COVID-19 related disruption appeared to have dissipated, the longer-term damage to the UK economy that many had feared was evident in strained supply chains, labour shortages and the rising price of materials, freight and logistics.

As the UK economy struggled with the transition from a COVID-19 driven demand for goods over services, to a more balanced goods and services-based economy, the mismatch in demand over supply inevitably led to rising prices and in turn rising inflation. This supply chain pressure was compounded by China's zero COVID-19 policy, which created bottle necks and was at odds with the resumption of economic activity seen around the industrialised world.

As we moved through early 2022, Russia's invasion of Ukraine triggered an energy supply shock, resulting in soaring wholesale energy prices, as well as price spikes in agricultural commodities, pushing up the cost of many food staples and further exacerbating the supply constraint led inflationary forces seen at the start of the period. These powerful inflationary drivers ensured the rate of inflation continued to rise throughout the financial year and at the time of writing UK inflation, as measured by the Consumer Prices Index, is at 9.2%, having peaked at 11.1% in October 2022.

The Bank of England has taken action to combat rising inflation by reiterating its commitment to the 2% inflation target and through monetary policy it has implemented several interest rate hikes during the year. However, this action has not come without cost, negatively impacting growth forecasts and raising the likelihood of a more prolonged economic recession. The stock market responded by adjusting valuations downward to reflect this more challenging economic environment and the compounding effect on corporate profit margins of a weakening pound, higher input costs and rising wages. This rise in operating costs has, in many cases, been passed on to the consumer, whose spending power has been steadily eroded as the rising cost of living bites.

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Adam Avigdori and David Goldman, investment management, BlackRock Income and Growth Investment Trust – 1 February 2023

As we look ahead into 2023, the headwinds facing global equity markets are evident. Inflation has consistently surprised in its depth and breadth, driven by the resilient demand, COVID-19 supply chain constraints, and most importantly by rising wages in more recent data. Central banks across the developed world continue to unwind ten years of excess liquidity by tightening monetary policy desperate to prevent the entrenchment of higher inflation expectations. Meanwhile, the risk of policy error from central banks or politicians remains high as evidenced by the turmoil created by the "mini-budget" in the UK that sent gilts spiralling. The cost and availability of credit has changed and strengthens our belief in investing in companies with robust balance sheets capable of funding their own growth. The rise in the risk-free or discount rate also challenges valuation frameworks especially for

long duration, high growth or highly valued businesses. We are mindful of this and feel it is incredibly important to focus on companies with strong, competitive positions, at attractive valuations that can deliver in this environment.

The political and economic impact of the war in Ukraine has been significant in uniting Europe and its allies, whilst exacerbating the demand/supply imbalance in the oil and soft commodity markets. We are conscious of the impact this has on the cost of energy, and we continue to expect divergent regional monetary approaches with the US being somewhat more insulated from the impact of the conflict, than for example, Europe. Complicating this further is the impact COVID-19 has had on certain parts of the world, notably China, which has used lockdowns to control the spread of the virus impacting economic activity. More recently, China's reopening in January 2023 has been well received by markets, with the return of the world's second largest economy bolstering the global outlook. However, the rapid reversal of the lockdown policy has seen infections rates surge to levels not seen since the height of the pandemic. We also see the potential for longer-term inflationary pressure from decarbonisation and deglobalisation, the latter as geopolitical tensions rise more broadly across the world.

We would expect broader demand weakness as we enter 2023 although the 'scars' of supply chain disruption are likely to support parts of industrial capex demand as companies seek to enhance the resilience of their supply chains. A notable feature of our conversations with a wide range of corporates has been the ease with which they have been able to pass on cost increases and protect or even expand margins during 2022 as evidenced by US corporate margins reaching 70-year highs. We believe that as demand weakens and as the transitory inflationary pressures start to fade during 2023 (e.g. commodity prices, supply chain disruption) then pricing conversations will become more challenging, despite pressure from wage inflation which may prove more persistent. While this does not bode well for margins in aggregate, we believe that 2023 will see greater differentiation as corporates' pricing power will come under intense scrutiny.

The UK's policy has somewhat diverged from the other G7 countries in fiscal policy terms as the present government attempts to create stability after the severe reaction from the "mini-budget". The early signs of stability are welcome as financial market liquidity has increased and the outlook, whilst challenged, has improved. Although the UK stock market retains a majority of internationally weighted revenues, the domestic facing companies have continued to be impacted by this backdrop, notably financials, housebuilders and property companies. The valuation of the UK market remains highly supportive as currency weakness supports international earnings, whilst domestic earners are in many cases at COVID-19 or Brexit lows in share price or valuation terms. Although we anticipate further volatility ahead as earnings estimates moderate, we know that in the course of time, risk appetites will return, and opportunities are emerging.

We continue to focus the portfolio on cash generative businesses with durable, competitive advantages with strong leadership as we believe these companies are best-placed to drive returns over the long-term. We anticipate economic and market volatility will persist in 2023 and we are excited by the opportunities this will likely create by identifying those companies using this cycle to strengthen their long-term prospects as well as attractive turnaround situations.

Europe

(compare European funds here and here)

Alexander Darwall, investment manager, European Opportunities Trust – 24 February 2023

The challenges faced by Europe are well-known: the energy crisis, inflation, higher interest rates, weak demand in China for Europe's exports, and dysfunctional labour markets. European equities are out of fashion and international investors have been substantial sellers of European equities. Where there is optimism, it might be unfounded in that the energy crisis is likely to remain a blight on Europe for years, and interest rates are likely to remain high for years. Europe's energy transformation, exacerbated by the conflict in Ukraine, massively increases Europe's energy bill. By some estimates power and gas costs are increasing by around EUR500bn between 2022 and 2024, something like 3% of the EU's GDP. Consumer spending has remained remarkably robust, perhaps indicating an expectation that the authorities will, once again, come to the rescue with cheap or 'free' money. We think this is unlikely. Inflation has set in, and the authorities will have to keep interest rates high in an attempt to bring it down. Inflation impairs the prospects for almost all asset classes including equities. Moreover, the policy direction is Quantitative Tightening ("QT") not Quantitative Easing ("QE"), meaning that interest rates are likely to remain high.

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Stefan Gries, representing the manager, BlackRock Greater Europe Investment Trust – 15 February 2023

We expect equity markets to remain volatile in the near-term as macro uncertainty remains elevated. Going forward, it will be important to see whether inflation comes down to levels the market can deal with. With energy prices having come down, there is reason to be hopeful this can be achieved. Clarity on the terminal rate of this hiking cycle – and a potential peak - would likely be enough to bring attention back to company fundamentals – the ultimate driver of long-term equity returns.

The market is forward looking and at some point will start to consider what a recovery could look like. For now, European equities remain under-owned and valuations are low. Some areas of the market, particularly within the cyclical sectors, have suffered a significant derating and signs of economic optimism such as easing inflation or a potential China re-opening, could help close some of these valuation gaps.

Whilst there are a number of unknowns from a macroeconomic perspective, we see opportunities for attractive returns in select areas. Corporate balance sheets are in decent shape and in much better positions than in previous downturns. Many companies in Europe have spent the last decade deleveraging balance sheets and interest coverage is significantly higher than during the Global Financial Crisis or other prior periods associated with deep recessions or prolonged bear markets. Corporate spending intentions also remain healthy and this spend is often linked to transformational capex.

Lastly, long-term structural trends and large amounts of fiscal spending via the Recovery Fund, Green Deal and the REPowerEU plan in Europe can drive demand for years to come, for example in areas such as infrastructure, automation, innovation in medicines, the shift to electric vehicles, digitisation or decarbonisation.

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Global emerging markets

(compare global emerging markets funds here and country specialist funds here)

Maria Luisa Cicognani, chairman, Mobius Investment Trust – 28 February 2023

2022 turned out differently from what many economists had projected. The war in Ukraine and China's hard stance on Covid-19 pushed the recovery back, when it had been expected to pick up pace in the second half of 2022.

However, a number of indicators are now pointing towards an improved outlook for 2023, especially for Emerging Asia.

1. inflation in the US has slowly been coming down - while it is not yet at desired levels, the fact that it peaked is a signal that
2. monetary policy will start to ease;
3. China has moved away from zero-Covid with surprising swiftness and determination, and this will spur the recovery, especially in Asia;
4. accordingly, growth in emerging Asia is expected to pick up driven by local demand, while growth in Europe and the US is forecast to slow down this year;
5. the USD rally has come to a halt amid easing inflation and with the end of the aggressive tightening cycle looming on the horizon.

All of the above, I believe, will benefit emerging markets. In addition, unfavourable sentiment towards the asset class during 2022 has left EM companies trading at record-low valuations compared with developed market peers as well as their own history, offering an attractive entry point.

We are already seeing a reversal in sentiment. After net inflows into the asset class in October, November and December of last year, during January 2023, emerging markets saw the largest monthly inflows in two years.

Challenges remain, with the war in Ukraine not nearing an end, a potential recession looming in the US and Europe, US-China tensions continuing and China struggling with the resurgence of Covid-19 cases. However, given the above-mentioned tailwinds, I believe, emerging markets have the potential to outperform after a long stretch of underperformance.

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Carlos Hardenberg, Mark Mobius, investment managers, Mobius Investment Trust– 28 February 2023

Emerging market investors have witnessed troubled waters over the past few years: a global pandemic that had a negative impact on trade, consumption and supply

chains; increased geopolitical tensions between the US and China; a war in Europe with wide ramifications for global trade and fiscal policies resulting in rising inflation, tighter monetary policy and appreciation of the US dollar. Furthermore, volatile commodity prices that benefitted a few countries but hurt many, and very difficult capital market conditions made it particularly difficult for emerging markets. In summary, all of this has led to very low confidence, record capital outflows and a sell-off in emerging markets. Over the last 10 years, emerging markets have delivered close to negative annualised real returns.

After this prolonged period of weak performance, we now see several indicators suggesting that the tide is turning. First of all, investors should never lose sight of valuations. We are currently witnessing record levels of under-valuations in EM: the present average price to book value at nearly 1.5x is in the 30-year bottom quartile.

Secondly, while the US and certainly Europe will be challenged by a moderate to deep recession in 2023, growth in emerging markets, particularly in Asia, is forecasted to recover to average 4.9% in 2023. This should encourage investors to focus on these growing regions. The radical shift by the Chinese government away from zero-Covid that we have been witnessing in the past two months will have a very positive impact on growth and supply chains. We believe that we are at the beginning of a multi-year earnings growth recovery, and this will be driven by the reopening in Asia.

Furthermore, inflation pressure in the US is moderating. The slowing pace in inflation is a clear indicator that the Fed's rate hiking cycle is nearing its peak and monetary policy is expected to ease. Many emerging markets are ahead of developed markets in the hiking cycle and inflationary pressure, especially in Asia, remains contained. The US dollar rally is losing steam on the back of favourable inflation data, easing the pressure on emerging market currencies, debt and monetary policy.

Finally, over the past 20 years, business models in emerging markets have significantly evolved. Investors can find highly innovative companies that are still relatively undiscovered by the market. The new driver in emerging markets is technological innovation in areas including, but not limited to, factory automation, renewable energy, AI or Internet of Things (IOT), as well as digitalisation and modern and efficient service offerings.

Conclusion

The next year no doubt will remain challenging, with recession looming in Europe and the US. However, all of the above will be priced in well in advance and we have already seen a shift in investor sentiment towards emerging markets. After net capital flows to EM during Q4 2022, January 2023 saw the highest portfolio inflows to EM in two years according to the Institute of International Finance, with $65.7 billion.

We have heard many differing opinions about what investors can expect from the coming year. We share the view of Neil Armstrong, the first man on the moon, who once wisely said, "We predict too much for the next year and yet far too little for the next ten."

Anderson Whamond, chairman, Gulf Investment Fund – 22 February 2023

Following the recent sell-off in the market, valuations are becoming more attractive and we believe the markets will recover as soon as global market volatility settles down. Going into 2023 the outlook for GCC remains robust, supported by socio-economic reforms, infrastructure projects, and favourable oil supply-demand dynamics that provides the majority of GCC states with twin surpluses as well as an economy that is mostly shielded from recession fears in Europe & US.

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Managers, Gulf Investment Fund – 22 February 2023

Valuations are turning attractive, and we believe markets will recover as global market volatility settles down. Going into 2023, we believe the outlook for GCC remains robust, supported by socio-economic reforms, infrastructure projects, favorable oil supply-demand dynamics that provides majority of GCC twin surpluses as well as an economy that is mostly shielded from recession fears in Europe & US.

While global investors generally are underweight Qatar, Kuwait, and Saudi, the weighting of the GCC in EM indexes is expected to increase as more IPOs are listed, governments sell stakes, and foreign ownership limits increase.

Oil continues to support the GCC's economic stability, as other economies are still facing elevated inflation and interest rate hikes. A combination of high oil prices, tax and expenditure reforms (like the introduction of VAT) and continued non-oil growth will lead to an improved GCC fiscal balance of 7.3 per cent of GDP by 2022, which is expected to remain positive for the foreseeable future. GCC countries have benefited from significantly higher oil prices, which have converted budget deficits into surpluses for 2022.

The increase in hydrocarbon prices provides an opportunity for GCC countries to shift to a green growth strategy and accelerate economic diversification by investing their windfall in sustainable sectors. GDP growth for GCC is expected to more than double vs 2021, reaching 6.5 per cent in 2022. Despite continued increase in inflation levels not seen in decades in many parts of the world, the inflation outlook for the GCC is relatively benign at 3.6% in 2022 and 2.6% in 2023, according to IMF's Regional Economic Outlook for October 2022.Global investors interest in GCC should increase. However, foreign inflows to the GCC will continue, attracted by credible fixed currency rates, generous dividend yields, high oil prices and market reforms.

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Dien Vu, portfolio manager, Vietnam Enterprise Investments – 08 February 2023

Last year's precipitous market decline largely tracked increased global risk aversion as the Federal Reserve aggressively raised rates. Domestic pressures on the economy that emerged due to a weaker currency, imported inflation, and local rate hikes pushed money from the market onto the sidelines. Vietnamese sentiment however soured more than the global trend and arguably reached peak fear in Q4 2022 due to unintended consequences from policy decisions aimed, ironically, at improving the robustness of the capital markets.

Despite this, the economy saw impressive GDP growth of 8.0%, the highest in ten years. We have reason to believe the worst is behind us and that a repeat of the events that plagued market sentiment in 2022 is unlikely. Local political events that caused the market to decouple from major global indices have been addressed, and new Government initiatives are currently helping to reverse both cause and effect of these homegrown themes, and at serious pace.

Amendments to Decree 65 are aimed at reopening the bond market to ease corporate restructurings. More recently, Decree 26, which addresses the loan-to-deposit ratio in the banking system, previously expected to remain unchanged, now seems to be showing signs of loosening. This is intended to support system liquidity and create a calmer environment within the banking sector. For now, we can see the Government's trepanning of the 2022 liquidity headaches is working, this will help the real estate and banking sectors avert crisis to slowly gain momentum, which together make up over half the Vietnam Index. The Vietnam Bond Market Association has stated US$9.0bn of corporate bonds were bought back before maturity in 2022, spiking in December at US$1.7bn. Major corporates redeeming bonds early, and at an accelerated rate, disabuses the wider consensus of an inherent systemic risk that companies are well positioned to service their debt. This can easily be interpreted as good news, however there are c.US$13bn of corporate bonds maturing in 2023, the majority in H2, meaning default risk is still a concern in a high-rate environment.

Whilst aggregate earnings may not necessarily excite at first glance, it is worth noting these figures are skewed towards sectors such as real estate, which have been heavily sold and are underperforming due to a high interest rate environment and sector-wide liquidity problems, yet still represent 15.5% of the market's earnings.

The top 80 stocks under the Investment Manager's coverage have a trailing P/E of 11.8x, which is one standard deviation below the three-year mean, a significant recovery from the low base of 9.4x in 2022, and with healthy balance sheets and a modest debt-to-equity ratio.

We believe the ability to see through the short-term fog of volatility is crucial for accumulating high-quality stocks for the medium-long term as the market moves from a beta to an alpha one. This means picking stocks with strong balance sheets, solid fundamentals, and excellent corporate governance. These select companies will generally have more of a margin of safety against internal and external factors, reducing downside risk and leading to favourable EPS growth in 2023."

Macroeconomic Commentary

- GDP growth in Q4 2022 was registered at 5.9% year-on-year and 8.0% for 2022. The services sector was the main driver, rising 8.1% in Q4 2022 and 10.0% for the full year.
- Q4 2022 exports were US$89.2bn with imports at US$85.2bn, down 6.8% and 3.6% year-on-year, respectively, which has been attributed to a high-base effect from Q4 2021 and the global slowdown. The trade balance for the quarter was US$3.96bn compared to US$6.5bn in Q4 2021.
- For the whole of 2022, Vietnam's exports and imports amounted to US$371.9bn and US$360.2bn, increases of 10.6% and 8.4% year-on-year, respectively. The annual trade surplus was recorded at US$11.2bn, the

second highest ever in Vietnam following the US$19.9bn that was posted in 2020.

- FDI disbursement finished 2022 at US$22.4bn, having recorded US$7.0bn of disbursements in Q4 2022, an increase of 13.5% and 7.9% year-on-year, respectively.
- Registered FDI was recorded at US$27.7bn, a fall of 11.0% year-on-year. The overall decline is thought to be due to disrupted feasibility studies for new projects. The manufacturing sector attracted the highest registered FDI of US$16.8bn, contributing 60.6% of the total.
- The Vietnamese dong appreciated 1.0% against the USD in Q4 2022, putting the total depreciation at 3.4% YTD as of 31 December. The Vietnamese dong depreciated 6.9% against the pound sterling in Q4 2022 and its total appreciation was 8.1% YTD as of 31 December.
- Vietnam's CPI stayed under control in 2022, averaging 3.2% for the year. This was below the Government's target of a 4% maximum rise and due in part due to their effective control over prices including petrol, healthcare and education.

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China

(compare Chinese funds **here**)

Helen Green, chairman, abrdn China Investment Company – 14 February 2023

The last 12 months have been particularly challenging for investors in Chinese equities. We saw the Hang Seng Index in Hong Kong bottom out below 15,000, touching levels not seen since the aftermath of the Global Financial Crisis in 2008. Markets reacted positively to the announcements of the easing of Covid restrictions in China. This is, admittedly, following the heavily negative numbers, but it does highlight how much interest there is in China, interest that we believe is well-founded. The Board remains confident that any short-term headwinds that we may encounter in future will be strongly outweighed by long-term positive fundamentals and the compelling opportunities to invest in quality Chinese companies.

We consider that the actions that the Chinese government has taken in the last three months should not be seen as temporary and that, even if the uptick in domestic travel over Chinese New Year does lead to an increase in the number of people falling ill, there is little appetite for further draconian lockdowns such as we witnessed in late 2022, culminating in the tragic fire in Xinjiang. The return to the long-term trends of rising levels of urbanisation and the increase in the disposable incomes that the ever-expanding middle classes are able to deploy provides a ready market for high-quality goods and services.

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Nicholas Yeo, Elizabeth Kwik, managers, abrdn China Investment Company– 14 February 2023

While it is still early for the Chinese economy to show strong signs of recovery, we are positive on the outlook in 2023 for several reasons. Firstly, stimulus measures have been working their way through the system since the start of the second half of 2022. Furthermore, we believe macro policy is likely to remain largely accommodative, with more legroom to support growth due to relatively low levels of inflation pressures that remain well contained. Secondly, recent measures to ease Covid restrictions have come at an accelerated pace that has taken everyone by surprise and this is a positive development for markets. It reflects the Government's concerns over the state of the economy as a result of its zero-Covid strategy. While the pivot may not seem gradual by international standards at the time of writing, there are still restrictions such as the need for a PCR test before entering China and, more importantly, the mandate requiring everyone to continue to wear masks. Like other Asian countries, we think the reopening will be bumpy with infections peaking in different phases, starting with cities before moving to rural areas.

Additionally, the troubled property sector now appears to be well-supported, including a raft of liquidity support measures announced in recent months. This indicates that the central Government is well aware of the economic headwinds facing China and is prepared to intervene and protect the growth trajectory. Chinese companies have thus far demonstrated strong fundamentals, with earnings growth of around 20%, despite an extremely challenging environment in the Chinese equities markets for most of the Financial Year. Valuations also remain undemanding due to investor sentiment. We believe a combination of favourable earnings and supportive policies in 2023 will help improve international investor sentiment towards China.

Given the rapid pace of reopening, inevitably, the number of deaths from Covid will rise, but it is a price the Government judges as not being high enough to offset the benefits of abandoning its zero-Covid strategy. However, the direction of travel for China is still one of reopening and economic recovery. To that end, we believe there is strong long-term potential in our five portfolio themes: aspiration, digital, green, health and wealth. That said, the long-term growth trajectory also faces some headwinds, including supply chain diversification away from China and restricted access to advanced US technologies. This is where we believe our bottom-up stock-picking approach, grounded in fundamental research and local expertise, provides an advantage in finding the best quality companies in which to invest.

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Commodities and natural resources

(compare commodities and natural resources funds here)

Tom Holland and Mark Hume, investment management, BlackRock Energy and Resources Income – 1 February 2023

The phrase “paradigm shift” is often over-used but it seems entirely appropriate when reflecting on the investment landscape in 2022. For much of the prior decade, markets have been characterised by low inflation, very low interest rates and

relatively abundant, cheap energy with the many benefits this enabled. The last year has seen a major shift in these three factors with profound impacts on major financial asset classes and individual securities, as well on society more broadly. We now look set to enter a phase of the market cycle where inflation will be more of a factor, energy availability will be a critical question facing countries/industries and also capital will come with a higher cost.

This is going to require investors to find lessons further back in history than just the last ten years and have portfolios that are able, and willing, to adapt to changing circumstances.

The geopolitical events of early 2022 accelerated and magnified trends already present in parts of the energy market where underinvestment had left little spare capacity and even less resilience to any external shock or supply disruption.

One of the consequences of the most recent energy crisis has been to raise the question of energy security in many countries. The short-term responses vary between countries, but one of the clear longer-term consequences is a hardened resolve to transition to a greater share of renewable energy and to accelerate the energy transition. Legislation such as the Inflation Reduction Act in the USA is a demonstration of how willing governments are to ensure the correct incentives are in place to incentivise private capital to be deployed on a large scale across multiple industries that need to transition to lower carbon footprints. Some of the growth stocks in the equity market, that are exposed to the energy transition, have come under short-term selling pressure with rising interest rates supressing the market's appetite for growth stocks. However, the regulatory backdrop and the economics of transition technologies likely underpins longer-term earnings growth here, so for the Company, it is likely a matter of when, rather than if, we increase the exposure to these energy transition companies.

The year 2022 was marked by a flurry of unexpected events from the invasion of Ukraine to the replumbing of global energy markets, or the Federal Reserve's pivot from quantitative easing to quantitative tightening. We continue to believe that inflation will be persistently higher than recent years as the world looks to replumb supply chains across multiple industries. All of this is set against a backdrop of continued geopolitical fragmentation. Yet, rapidly rising interest rates and the subsequent hit to equity values are gradually opening up some attractive opportunities across our investment universe, even as economic recession looms large across the globe.

Traditional commodities are in an unusual spot in the cycle. China is finally exiting COVID-19 induced lock downs. We doubt it will be a smooth restart across the Chinese economy but the underlying pull on demand for traditional commodities will cast a strong positive tailwind for oil prices as shown in Figure 14 contained in the Annual Report for the year ended 30 November 2022, with incremental oil demand in the coming months in the order of 0.5-1.0 million barrels per day. This should be contrasted against recent downgrades to US shale oil production of almost 1.0 million barrels per day. Industrial mined commodities are also likely to be well supported as the Chinese economy regains its pre-COVID-19 levels and renewables demand for copper, nickel, lithium and aluminium continues apace. This comes at a time when investment in supply across the traditional commodities space remains at historic lows. Recent commentary from the US Administration

stated an ambition to replenish the US Strategic Petroleum Reserve at oil prices between US$67-71 per barrel.

Policy will continue to be a strong driver of equity performance next year. Yet, the need to balance energy security with decarbonisation is set to drive diverging policy agendas in different regions. Indeed, we believe that in many instances policy ambitions around decarbonisation continue to run ahead of demand-side behaviour. This consumer inertia is causing severe bottlenecks across supply chains and a repricing of both traditional energy and electricity base load prices.

In Europe, for instance, energy security concerns have galvanised policy makers to strive for ever more ambitious renewables targets. Spurred by the invasion of the Ukraine, the 27 countries within the European Union will play a key role in driving an increase in global renewables capacity of almost 2,400GW through 2027 according to the IEA's latest renewables report. This represents an 85% acceleration from the previous five years, and almost 30% higher than what was forecast in last year's report. Whilst this ambitious growth outlook bodes well for many of our companies, we are acutely aware that permitting remains a key impediment to expediting this growth.

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Adrian Brown, chairman, BlackRock Energy and Resources Income – 1 February 2023

As the Company's financial year began on 1 December 2021, markets were buoyant with many major indices achieving either all-time highs or pre-COVID-19 levels. However, supply constraints coupled with increasing demand as post-COVID-19 economic activity restarted, caused inflation to rise sharply. An already challenging market environment was exacerbated by Russia's invasion of Ukraine and the resulting humanitarian crisis. The energy supply shock that resulted drove energy prices ever higher, pushing inflation to a 40 year high of 10.7% in the UK in November 2022. In response, the Bank of England raised interest rates to 3.50% by December 2022 with further increases on the horizon which are likely to impact consumer confidence in the UK.

Against this backdrop, the Traditional Energy sector had the strongest start to the year in both relative and absolute terms (the MSCI World Energy Index was up by 68.7% over the year compared to an increase in the MSCI ACWI Metals and Mining Index of 14.8% - both in Sterling terms with dividends reinvested). In contrast the Energy Transition portion of the portfolio performed less well as margins were impacted by cost inflation, and a "growth" to "value" rotation drove a sell-off in share prices in high growth sectors.

With the impact of the COVID-19 pandemic receding, the longer-term implications for the global economy are beginning to play out, compounded by increased geopolitical tensions. Commodity prices remain elevated, partly due to the war in Ukraine and the continued sanctions on Russia, while labour markets remain tight, underpinning higher inflation trends in the US and Europe. This has put increasing pressure on central banks to raise interest rates, increasing the risks to economic growth. However, either way, it is likely that inflation remains entrenched above central bank targets for some time to come. Against a weakening economic outlook, the company's portfolio remains weighted towards well-capitalised companies in the

mining and traditional energy sector with scope to reinvest in growth opportunities in the energy transition sector which has derated over the last year.

Despite the current uncertainty, the longer-term drive by governments across the globe to decarbonise the energy supply chain and create a greener energy infrastructure is here to stay, and has been given increased focus by the events in Ukraine. Over the long term, capital investment in the relevant infrastructure and technological advances will create compelling investment opportunities both in the Energy Transition sector and for the companies that service the associated supply chains.

Financials

(compare financials funds here)

Robert Kyprianou, chairman, Polar Capital Global Financials – 20 February 2023

As we look forward in early 2023, the global economy and investors have a lot to deal with. The long list of headwinds is well known - war and geopolitics, decades high inflation, painful monetary tightening, structural labour market challenges, energy supply shortages, China and its Covid policy, to name a few. The predicament for policy makers and investors determining how far, how fast and for how long, will characterise the outcomes. It is not surprising that the most common description of the near-term outlook is 'uncertain'.

Initially not taking the inflation threats seriously, major central banks ended 2022 trying to restore some severely damaged credibility. In public statements that echoed the 'whatever it takes' mantra that underlay their previous 'too-easy-for-too-long' monetary stance, central bankers insisted they were serious about dealing with inflation. Even the Bank of Japan threw in the towel on its particularly long standing easy monetary policy stance. Despite this noise, concerns remain that inflation in developed countries will remain above central bank targets for a while, given stubbornly strong labour markets, and that fiscal and monetary policy may be at odds with each other. This concern can be seen in that, for the first time since 2014, the 2023 new year started with no sovereign bonds available at negative yields. Only 2 years ago more than 4000 such bonds, worth $18.4 trillion, were in negative yield territory.

Perceived as a cyclical sector with value characteristics, the prospects of the financials sector are balanced in this environment, as seen by its performance in 2022. The largest sub-sector, banks, are typically seen as vulnerable cyclicals in an economic slowdown. However, this traditional view requires qualification. In part driven by regulatory and accounting changes, banks in developed markets have better quality balance sheets and are better provisioned with greater capital and liquidity buffers than at any time since the global financial crisis (GFC). Banks delivered these improvements despite the huge hurdle of prolonged easy money and zero interest rates. This hurdle is now firmly in the past, and, although there are likely to be adjustment headaches for the broad economy, banks are one of the clear winners from this return to monetary policy normality.

The underlying recovery in the banking sector post the GFC has yet to be reflected in valuations, especially in Europe. Despite bumper profits, higher dividends and share buybacks, investors have not re-rated banks. For now, they choose to focus on the risk of greater non-performing loans despite evidence that the system is generally well-provisioned and has capacity to grow profits and provide further provisions given buoyant net interest income. The emergence of the "shadow banking" sector since the GFC which has pursued new lending aggressively, and the somewhat anaemic loan growth which many established banks have experienced in recent years are likely to now prove helpful in mitigating the need for large provisions. On the balance of risks, investors may be surprised by how well banks perform through the expected economic slowdown.

Beyond banks, in other sub-sectors there are different drivers for risk and performance, offering good performance diversification and opportunity. Asset managers and investment banks are vulnerable to further market corrections and depressed capital market activity, while general insurers have more stable earnings. Although troubled at the moment, we anticipate that FinTech will respond positively to any sign that interest rates have reached a peak and growth is back on the agenda. Overall, the breadth, depth and diversity of the sector offer both risk management potential and attractive return opportunities as the uncertain headwinds overhanging the global economy are played out.

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Nick Brind, John Yakas & George Barrow, investment managers, Polar Capital Global Financials– 20 February 2023

Looking forward, we remain very constructive on the outlook for financials, despite the shorter-term uncertainties which would argue for caution in a sector that is cyclical. Today, banks are more robust with significantly greater levels of capital and liquidity than before the global financial crisis. Importantly, their risk appetite coming into this downturn is at a level which would suggest much lower loan losses. In plain English, banks have made far fewer bad loans than they have in previous cycles.

Furthermore, banks have been benefiting from the rise in interest rates which has led to their net interest margins widening, that is to say the interest income they earn on loans has increased faster than the increase in what they have to pay out on savings accounts. Despite inflationary pressures, costs have been contained at a manageable level. Consequently bank earnings have risen over the year as analysts have had to factor in the changing interest rate environment. For some banks this has been significant, albeit not enough in many cases to offset weaker sentiment resulting in bank stocks derating.

The unknowns looking forward for bank investors will be the degree and duration of the downturn and therefore the cost to bank profitability. There are good reasons to believe loan losses will be modest, but this is complicated by the fact that the amount of loan loss provisions banks will have to set aside is likely to be larger than the actual losses due to accounting rules. As we saw during the pandemic, this led to banks taking significantly more loan loss provisions than they needed as the majority were written back when bad debts did not increase to the extent expected.

A cautious investor may look at the rise in interest rates and inflation, anecdotal stories of individuals and small businesses struggling with bills, the inversion of the yield curve, swill the tea leaves and quite reasonably assume that the downturn will

be severe. Conversely, the evidence so far shows that savings built up during the pandemic and more robust corporate balance sheets, plus help from governments to offset increased energy costs, has allowed consumers and corporates to withstand the slowdown which explains why delinquencies have not yet risen meaningfully. The increase in loan loss provisions seen in recent results announcements does not undermine this view as it is driven by accounting rules.

The uncertainty is whether the banking sector will see further weakness along with wider equity markets, in anticipation that the downturn will be more severe than that priced in by financial markets, before recovering as investors realise this is not a repeat of the global financial crisis or the early 1990s downturn. Or do investors start to see through the shorter-term weakness and see the value in buying banking shares and bid up share prices to reflect their longer-term value and earnings potential?

Unlike the banking sector, where investors have understandably stepped back as they see risks of a recession impacting short-term earnings and have for the most part ignored the longer-term improvement in their earnings from higher interest rates, for non-life insurance companies, investors are willing to look through the shorter-term impact to their earnings. We have been very constructive on the non-life insurance sector and continue to be, though we are conscious that its performance as described above was in part due to its defensive characteristics.

However, with non-life insurance companies there has also been a material improvement in underlying earnings, from better underwriting returns, due to higher insurance premiums relative to claims costs as well as higher investment income. Understandably, investors have willingly paid a higher multiple for that stream of earnings. Reinsurance companies that write property-catastrophe insurance and other risks have equally performed well despite 2022 being a poor year for returns, as reinsurance premium rates have risen sharply.

We continue to remain cautious on asset managers and investment banks, the former as, notwithstanding the recent rally in financial markets, we believe flows will likely continue to remain weak, and in the latter as they rely on activity in capital markets which we believe will be slow to recover. We own shares in MSCI and S&P Global as beneficiaries of the continued demand for ETFs and demand for data and services across their product areas, in the latter instance as a credit rating agency.

The portfolio remains overweight banking stocks, albeit by not as much as this time last year, where we see material upside in share prices. Otherwise, broadly the portfolio remains positioned in more defensive areas of the sector, notably non-life insurance, payments, fixed income securities and information services companies. Nevertheless, we have increased our exposure to Asia to benefit from the recovery of China's self-imposed zero-Covid policies as well as Europe, at the expense of the US.

The rally in financial markets over the last few months on the back of lower energy prices, in particular, in Europe, and softer inflation data has increased the probability of a shallower downturn and led to hopes of a "soft landing". Financials outperformed wider equity markets in both 2021 and 2022 and if this proves to be correct we would expect them to extend this outperformance for a third consecutive year. However, much will depend on how central banks react to the more positive data on inflation. Furthermore, will inflation come down quickly, as implied by

financial markets, or will it prove to be more stubborn as history would suggest, albeit history is largely from the 1970s and 1980s when unions had greater power? Either way, we believe the next 10 years will be far better for the financials sector now the era of cheap money has ended.

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Debt

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

Ian Francis, chair, CQS New City High Yield Fund – 27 February 2023

The six month period under review from 30 June 2022 to 31 December 2022 was one which most people would want to forget. A seemingly unending litany of woe - weak markets, higher inflation, unstable governments, crippling energy prices and rising interest rates were but a few of the horror stories we saw during the late Summer and Autumn of 2022. Despite all the bad news, we saw some signs of stabilisation towards the end of the year and the forward-looking stock markets managed to eke out a positive return for the six months to 31 December 2022.

During the six month period under review, inflation became much more embedded into the economy. At the end of June 2022, the UK CPI reading was an annual increase of 9.10%; by the end of December 2022, this had reached 10.50% although there are signs that it may have peaked. There was a similar pattern in other major economies such as the US and the EU. In response to the higher rates of inflation, most central banks have increased interest rates. In the UK, there was a series of consecutive interest rate rises with the base rate rising to 3.50% at the end of December 2022.

The bond markets had a very volatile period over the second half of 2022. UK 10-year gilts yields reached a 15 year high at 4.50% at the end of September on the back of former Prime Minister Liz Truss's growth plan which proposed billions of pounds in unfunded tax cuts, shooting up the country's risk premium. 10-year gilt yields have fallen back since then to reach 3.70% at the end of December 2022 but remain elevated as inflation persists.

In the US, the economy appears to be proving more resilient to the effects of inflation; the same cannot be said of the EU at present with growth slowing sharply.

The outlook for the next six months should be a little more positive as inflation starts to fall with fuel prices dropping back and supply chains in manufacturing returning to near normal. The main danger here is wage inflation and worker unrest. As regards interest rates, they are expected to continue to rise in the short term and it is key that central banks stop tightening before they push economies into recession as money supply is already falling at a rapid rate, a leading indicator which usually signals recession is on the way. As regards high yield bond markets, they are now offering a better balanced risk reward opportunity with many well managed companies offering bond yields in excess of 7.00%.

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Managers, M&G Credit Income Investment Trust – 03 February 2023

The UK is predicted to see the lowest rate of economic growth of all G7 nations in 2023. Higher interest rates, mortgage costs and taxes, alongside a shrinking labour force following the Covid-19 pandemic and Brexit, all look set to constrain growth. In the US, markets and the Federal Reserve remain in disagreement over the path of interest rates in 2023. The central bank is forecasting the base interest rate to be above 5% by the end of 2023 whilst futures pricing indicates a terminal rate of 4.9% by the middle of the year before a series of rate cuts to 4.5% by 2023 year-end. GDP for 2022 Q4 showed that the US economy is continuing to perform more robustly than many had forecast as higher wages from a red hot labour market and excess pandemic savings provided a tailwind to consumer spending habits. This has seen the probability of a recession recede. Similarly, stronger than expected Eurozone GDP for 2022 Q4 has seen economic forecasts for the region improve, although prospects for growth and indeed the wider global outlook look set to be shaped by the severity of winter, and the associated impacts to energy markets. Whether or not countries are pushed into recession, the economic backdrop will undoubtedly remain challenging for companies and consumers alike as central banks prioritise stamping out inflation over stimulating growth. Even a prolonged period of low growth or stagflation will present acute challenges for businesses already grappling with the effects of higher borrowing, labour and energy costs.

Although the road ahead remains uncertain, rising investor optimism that a recession may now be avoided in Europe and the US has fuelled a rally in both corporate and government bonds since the start of 2023. Despite this, given the "higher for longer" message from central banks there is a risk that investors are underestimating both the persistent nature of price pressures and the ultimate peak of terminal rates. There is certainly scope for interest rates to deliver a shock should inflation fail to subside as anticipated, presenting a stress-test for debt markets now carrying record levels of leverage. A sustained period of monetary tightening has the ability to reveal pockets of vulnerability in government bond markets, whilst only recently in the Chinese real estate and European REITS sectors have we have seen how the pressure of refinancing large piles of corporate debt can create ripples in credit markets.

The technical backdrop in fixed income markets is very strong right now, with all-in bond yields comparing favourably versus other asset classes thus attracting capital back into the market. Whilst it is important to acknowledge the potential headwinds, we believe there is now attractive value to be found in credit, with investors being well paid to take risk. Whilst we may see further volatility in the near term, from a long-term perspective we think credit provides compelling risk/return dynamics. Unlike the start of 2022 where risks were not priced in and the compensation investors were receiving was extremely low, today investment grade credit investors are in a much stronger position. The elevated yield provides a good cushion with which to navigate volatile markets, although selectivity and fundamental credit analysis remain key to shaping the portfolio in the year ahead.

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Private equity

(compare private equity funds here)

John Singer CBE, chair, Pantheon International – 22 February 2023

Times of economic stress present many challenges for investment managers but they can also create compelling opportunities, particularly for private equity managers who have the scale and capital to take advantage of dislocation and disruption.

Single-asset secondaries are a fast-growing part of the secondaries market. It is one which in particular should offer some exciting opportunities in the current slow exit environment as private equity managers turn to the secondaries market in order to hold on to their most prized assets. While it is common to talk in general terms about the relationship between economic cycles and investment opportunity, this is clearly a moment when having the skills and experience to make assessments on individual specific businesses, potential value creation and pricing are critical.

Outlook

We are living through an extraordinary set of circumstances caused by rising interest rates, high inflation, geopolitical tensions and a challenging outlook for global growth. It is difficult to predict how and when a more positive outlook will be on the horizon.

Uncertainty and dislocation create opportunities for private equity managers and we believe that now is the time to "lean in" and invest with the very best who are capable of outperforming public markets and even more so in a downturn.

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Helen Steers, partner and lead manager , Pantheon International – 22 February 2023

The world has changed substantially over the past 12 months and it is difficult to predict what is yet to come. But what we can say is that, while the last 10 years have been good for all asset classes, private equity has outperformed the public markets and the evidence suggests that private equity outperformance tends to be even greater during lower public market return periods. This is a testament to the "super active" private equity model and we expect the hands-on approach of our managers to become more important than ever through 2023 and beyond. There are clearly challenges which will impact private equity, as is the case for many other industries, but, perhaps thanks to its unique attributes, the assets under management ("AUM") in the global private equity market is still forecasted to grow by 10.2% CAGR from 2021 to reach US$7.6tn in 2027[1].

We believe that private equity investment can add real value to companies. The advantages of being backed by a private equity manager who has sector expertise and can implement active professional management, as well as being a capital partner who can support their portfolio companies when the going gets tough, should not be underestimated.

Renewable energy infrastructure

(compare renewable energy infrastructure funds here)

John Scott, chair, Bluefield Solar Income Fund, – 28 February 2023

One of the many lessons which we derive from the continuing and tragic war in Ukraine is the need for greater energy security. Domestically generated solar electricity has an enormous role to play in achieving the shift away from imported hydrocarbons, while simultaneously decarbonising the economy. Although the achievements of the renewable energy sector are remarkable, for example in providing (by some measures) over 40% of the UK's domestically generated electricity in the period January-September 2022, there remains a considerable amount still to do if we are to wean ourselves off our thirst for fossil fuels and play our part in the global efforts to reach net zero.

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Managers, Bluefield Solar Income Fund, – 28 February 2023

Power markets reached record highs in August 2022, as Russia's continuing war against Ukraine exacerbated concerns surrounding gas supplies to Europe ahead of Winter 2023.

As a result, power prices within the UK remained extremely volatile throughout the period, predominantly following the same patterns as the gas market, with day-ahead baseload power prices reaching extreme highs on 25 August and 9 December, at £565/MWh and £654.65/MWh, respectively.

However, high gas prices during the 2022 summer attracted strong LNG deliveries to Europe amid periods of reduced consumption which allowed EU countries to enter the winter season with gas stocks at 89% of capacity, above the EU target for 1 November 2022. This in turn eased concerns about shortages for winter, putting downward pressure on both European gas prices.

Whilst season ahead pricing has fallen from the highs of H1 22/23, in the absence of hydrocarbons from Russia both gas and coal markets remain tight, and expectations remain that energy prices will be considerably higher than historic long term averages.

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Managers, Greencoat UK Wind – 23 February 2023

There are currently over 28GW of operating UK wind farms (14GW onshore plus 14GW offshore). In monetary terms, the secondary market for operating UK wind farms amounts to approximately £100 billion.

Driven by recent security of supply and cost concerns, as well as by net zero climate objectives, the UK is now targeting 50GW of offshore wind by 2030, supported by the CFD regime. New build onshore wind and solar are also expected to contribute, both on a subsidy free basis and supported by the CFD regime. Over 10GW of total capacity was awarded in CFD Allocation Round 4, announced on 7 July 2022.

Power prices during the year were well above budget, primarily reflecting high gas prices. The average N2EX Day Ahead auction price was £203.79/MWh (2021: £117.43/MWh). Forward power prices over the period 2023-2026 remain high.

High power prices have inevitably been considered by the Government in the context of balancing the country's fiscal position. We now have clarity in relation to the Electricity Generator Levy at a rate of 45 per cent of annual average power revenue above an index linked £75/MWh. The levy applies from 1 January 2023 until 31 March 2028. We believe that the new clarity should lead to a material reduction in the "uncertainty discount" that has affected the sector during the second half of last year.

The Government's Review of Electricity Market Arrangements ("REMA") continues, with a second round of consultation expected shortly. The aim of REMA is to accommodate a higher proportion of renewable generation and storage on the electricity network in line with the UK's target to decarbonise the electricity sector by 2035.

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Property

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

UK Commercial Property REIT

Will Fulton, manager:

The positive performance that UK real estate recorded at the start of the year was unwound with a notable acceleration in the final quarter, as capital value declines weighed on performance. UK real estate recorded a total return of -10.1% in 2022, according to the MSCI monthly index data, having returned 9.6% in the first half of 2022 and -17.9% in the second half of the year. Regardless of the continued strength of many operational markets, there was a broad repricing of UK real estate, driven by a weaker macroeconomic environment and, primarily, rising debt costs. Value declines for All Property were 13.3% over the year and -15.6% in the fourth quarter alone.

Yields moved out across all real estate sectors, with lower yielding areas of the market, such as the industrial sector and long income which have experienced the biggest value gains in recent years, experiencing greater outward yield movements than the wider market. Indeed, given the magnitude and speed of correction we have seen in the supermarket, industrial and logistics, and areas of the long-income market, we think that market pricing for these areas of UK real estate will find a floor much quicker than we have seen in previous cycles. As such, our outlook and forecasts for these areas of the market have improved materially, given the level of correction these sectors experienced in the latter part of the year.

The UK economy has faced a period of significant volatility over the second half of 2022, as the macroeconomic environment weakened and political turmoil rocked financial markets. While greater political stability has returned to the UK, the economy is facing headwinds as we enter 2023. Although UK GDP edged up in November the ONS attributed this to a World Cup-related services boost and it

seems likely to be an upwards blip rather than evidence of a stronger underlying rate. We currently forecast UK GDP to decline by 1.3% in 2023, before recovering in 2024 with modest growth of 0.6%.

Headline inflation looks to have peaked with the Consumer Price Index falling in December from 10.7% to 10.5%. Powerful base effects combining with global goods disinflation are expected to pull inflation down in 2023. However costs remain high and underlying inflation pressures are still apparent, leading us to expect headline inflation to only moderate through 2023, not fall to pre-2022 levels. We expect 6.2% by the end of the year, before falling to 2.4% in 2024.

The real estate investment market reacted quickly to expanding interest rates and, as expected, the Bank of England continued its monetary policy tightening cycle in December 2022, with a further 50bps rise in response to the rate of UK inflation, taking the base rate to 3.5%. Further hikes are expected in early 2023, with the base rate expected to peak between 4.25% and 4.5% before a sharp rate-cutting cycle begins towards the end of 2023 as the Bank of England attempts to stimulate the UK economy out of recession.

Due to the recessionary pressures, we expect our view is more bullish than some for an earlier rate-cutting, which we expect being towards the end of 2023. While there is considerable uncertainty around the speed and trajectory of monetary policy easing, we expect the base rate to be cut to 2.5% by the end of 2023, before stabilising between 1-2% during 2024. The risk of the base rate returning to even lower bounds is skewed to the upside.

This has significant, and potentially very positive, implications for real estate. During the second half of 2022 the combination of an uncertain economic environment and rising cost of debt financing hit markets hard with significant negative repricing. The prospect of an earlier than anticipated rate cutting cycle, combined with a repriced market, offers the prospect of a far more positive real estate yield margin over a 10-year Gilt risk free rate, providing the potential for renewed interest and appetite for the real estate sector.

Higher costs in this inflationary environment are naturally having a significant impact on UK consumers who are experiencing a deepening cost-of-living crisis and are expected to face further pressure from a weakening employment market in the face of recession. The most obvious implication for real estate is likely to be further depressed retail sales as household discretionary spend drops but this weaker economic environment is likely to weigh on occupational sentiment across the entire real estate sector as we move through 2023. The relative strength of income and occupier covenant therefore will grow in importance as will asset quality and location, in addition to simple sector selection.

On a brighter note, and unlike previous market cycles, we enter this period of market turbulence with supply levels remaining tight across many sectors. This is particularly the case for those sectors benefitting from longer-term structural growth drivers, such as residential asset classes and industrial and logistics. In the latter sectors, tenant demand has remained robust and the UK vacancy rate remains near an all-time low of 3.4%, on top of which supply is expected to remain limited by the fact that development pipelines have been constrained by higher construction costs. We expect this to contain availability rates, albeit partly offset by rising occupational costs including an expected 2023 rise in business rates. It is hard to imagine that

business sentiment will not be weakened which will temper occupational demand but rental growth in the industrial sector is still anticipated to remain positive, at more normalised levels rather than the high-growth levels experienced over the last few years. As with the wider real estate market, asset location and specification will be important to secure this.

The question around the future occupation of offices and how this sector reacts is perhaps the hardest to decipher. There is a historic correlation between office take-up and GDP growth, with poorer business sentiment and a weakening economic environment expected to add further pressure to a sector already facing structural headwinds as businesses and employees re-evaluate working practices. And so, as we enter a recessionary environment in 2023, we anticipate demand for good-quality accommodation will prove more resilient but secondary accommodation will progressively face tougher conditions. ESG adds another layer of complexity to the office equation as owners face mounting costs to repurpose offices to a 'B' energy rating, the expected legal occupational and trading requirement by 2030 and that increasingly demanded by many tenants. It is fair to assume not all will succeed and a reduced national office demand, a response to agile working practices, is likely to lead to a concentration of that demand, and so rental growth, in only the very best offices.

Retail will continue to feel the impact of the cost-of-living crisis and the subsequent squeeze on household disposable incomes. Retail sales volumes have continued to decline and occupier sentiment, particularly in the discretionary end of the market, has weakened. The sector remains structurally oversupplied and further retailer failures are likely in this environment, adding further space to an already saturated market. Discount-led retailers and budget supermarkets have enjoyed more robust trading conditions, particularly in the run up to Christmas, but the prospect of rental value growth in the sector is more limited in the near term.

Turning to residential, fundamentals in the private rented sector (PRS) remain supportive reflected in very strong levels of rental value growth. We expect the limited availability of good-quality rental accommodation across much of the UK, and increasing demand, to offset consumer cost pressures and allow rents to moderate to more normalised levels of growth for PRS and the Build to Rent sector.

All in all a weaker economic environment is expected to weigh on occupational sentiment across real estate as a whole, as we move through 2023, with the relative strength of income, occupier covenant, location and asset quality growing in importance to tenants and so investors.

Quality will prevail across all sectors, with prime assets remaining far more resilient. The 2022 repricing of real estate and the likelihood of a positive recalibration of its historic attractive margin over a risk-free investment yield later in 2023 and into 2024 as interest rates fall is likely to enhance general investment appetite.

Investors continue to narrow their focus on prime and best-in-class assets, and particularly within those sectors that benefit from structural and demographic growth drivers. Secondary assets, and those that do not meet current environmental and occupier criteria, are expected to see much weaker demand from investors. Pricing is likely to recalibrate, as a result. While prime and secondary pricing moved out in tandem during 2022, prime pricing is expected to stabilise in 2023 while secondary pricing sees greater capital value declines. While this trend has occurred in previous

market cycles, we expect the divergence in pricing in some sectors to be more pronounced during this cycle as occupier and investor demand narrows.

The pace of repricing for UK real estate will mean opportunities will arise over the course of 2023, particularly as the path of monetary policy turns more accommodative. Those sectors that benefit from longer-term growth drivers, such as the industrial and living sectors, will see greater demand return and at more attractive pricing levels. The repricing of long-income real estate investments will also provide an attractive opportunity to investors, particularly as yields for gilts and inflation linked bonds are expected to move lower in line with the expected policy rate cuts from the Bank of England. Despite seeing significant capital value declines during 2022, the industrial sector will grow in favour once again. Investors are attracted by re-based yields and rental value growth prospects, driven by a very positive supply/ demand dynamic in the sector. Investors will focus on assets with good fundamental attributes, location and specification.

Derwent London

Paul Williams, chief executive:

2022 was characterised by a spike in global inflation, a rapid increase in borrowing costs and a cost-of-living crisis in the UK. Towards the end of the year, inflationary pressures began to ease, partly driven by a reduction in both energy and food costs, which has led to expectations of a lower peak in interest rates than was expected at the height of the political and economic instability.

Following a strong post-pandemic bounce in 2021, UK GDP was 4.0% in 2022 albeit weighted to Q1. The latest forecasts from Oxford Economics and others are for both the UK and London to experience a short-lived and mild recession in 2023 as households and businesses respond to the increase in input costs from higher costs of materials and utilities, and interest rates. The economy is then expected to return to growth from 2024, with London to maintain its outperformance.

Job creation is an important indicator for London offices. Forecasts from Oxford Economics show a small contraction in the number of office-based jobs in 2023, before a return to growth from 2024. These forecasts should be viewed, however, in the context of the last two years during which a combined c.280,000 net new office-based jobs were created.

The opening of the Elizabeth line, which has added c.10% capacity to London's rail transport network, has driven a surge in footfall around the central stations along the route. According to TfL data, more than 100m journeys have already been made since opening and daily usage is above the expected level of c.600,000. Tottenham Court Road is now in the top five most-used stations in the TfL network, with its usage increasing by more than 80% since launch. Approximately 41% of our portfolio is located in nearby Fitzrovia (including Soho Place).

Office occupancy rose through 2022 according to data from Remit Consulting, following an initial period of adjustment when work from home guidance was lifted in mid-January. West End office occupation has increased from c.10% to in excess of 45%. By contrast, occupation levels in the City continue to lag, reaching c.30% through Q4.

London remains an attractive location for domestic and international investors and CBRE estimates there is c.£33bn of potential investment demand targeting London

offices. The story of 'the best versus the rest' continues and investor appetite is polarised. Well-located and high-quality buildings with strong ESG credentials, let on long leases to strong covenants remain in demand as do those with potential for regeneration into prime. Investor appetite for secondary assets, however, is very limited and these are likely to underperform.

Investment activity for 2022 was £11.2bn, 12% above 2021 and in line with the long-term average of £11.4bn. Unsurprisingly, given the uncertain economic backdrop, investment volumes were low in the last quarter of the year, totalling just £0.7bn. Overseas capital dominated investment activity, accounting for 80% of all transactions, with investors from Asia the most active at 43%.

Underlying rates and credit spreads both increased significantly in the year with prospective investors appraising return requirements against the higher borrowing costs. Consequently, investment yields came under upward pressure through the second half of the year. The West End was more resilient than the City, with prime yields rising c.50bp to 3.75% compared to City yields up c.75bp to 4.5%.

The rise in yields combined with heightened risk awareness from credit providers is expected to present potential acquisition opportunities. Owners who are currently actively marketing assets for sale are primarily driven by a combination of upcoming refinancing events, future vacancy risk and EPC/upgrade capex requirements.

Vendor pricing expectations are being reset as transactional evidence starts to emerge and financial markets show signs of stabilising. In contrast to previous market corrections, both the development pipeline and the volume of debt maturing in the short term are relatively low, which is expected to limit the magnitude of any market correction.

SEGRO

David Sleath, chief executive:

Our long-standing disciplined approach to portfolio management means that SEGRO has one of the best and most modern pan-European industrial warehouse portfolios, through which we can serve our customers' entire regional and local distribution needs. Two-thirds of this portfolio is located in Europe's most attractive urban markets, often in substantial clusters in key sub-markets, where the lack of available land means that supply-demand dynamics are tightest and where long-term growth and returns are therefore likely to be the highest. This is complemented by the remaining one-third of our portfolio, comprising clusters of high-quality logistics warehouses situated at key hubs along major transportation corridors.

Occupier demand for warehouse space across Europe continues to be positive and is derived from a wide variety of customer types. Our space is flexible and can be adapted to suit businesses from many different industries which, when coupled with our relentless focus on customer service through our market-leading operating platform, is reflected in high customer satisfaction and retention rates, as well as our asset management and leasing performance. Our business is therefore both resilient and positioned to support growth sectors and adapt to trends, including e-commerce, the digital sector (data centres), urbanisation and the consequential need for industrial and distribution space close to the end customer from a very broad range of businesses.

Supply and availability of modern, sustainable warehouse space in the locations most desired by occupiers remains extremely limited across Europe. Vacancy levels are at historic lows and supply is likely to remain constrained given recent increases in financing and construction costs. We expect this contrast between positive demand and limited supply to drive further growth in rental levels. We already have £130 million of reversionary potential embedded in the portfolio (most of which will be captured through the five-yearly rent review process), as well as indexation provisions in almost half of our leases, both of which underpin future like-for-like rental income growth even before any further growth in market rental levels.

Our sizeable, mostly pre-let current development programme and well-located land bank, provide us with further potential to grow our rent roll profitably and allows us significant optionality due to the short construction periods of our assets. We will continue to be led by customer demand and our Disciplined approach to capital allocation as we make decisions regarding the execution of future projects.

With modest leverage, a long-average debt maturity of 8.6 years, no near-term refinancing requirements and virtually all of our debt at fixed or capped rates, we have significant financial flexibility to continue to invest capital in the development and acquisition opportunities that offer the most attractive risk-adjusted returns.

Macroeconomic factors caused a sharp correction in interest rates in the second half of 2022, with a consequential impact on real estate volumes, property yields and asset values. As we enter 2023, there are early signs of liquidity returning to the investment markets as investors see value at current levels of pricing. As the path of future interest rates becomes more evident, we believe there is a significant volume of capital ready to be deployed into the industrial and logistics sector due to its attractive fundamentals. We will continue to respond tactically to changes in market conditions, but our long-term strategic focus is to ensure that our properties are of the highest quality and the most sought after, able to generate superior long-term growth, and therefore command a valuation premium.

Unite Group

Richard Smith, chief executive:

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 140,000 (19%) by 2030. Application rates to university have also grown steadily over recent years, reflecting the value young adults place on a higher level of education and the life experience and opportunities it offers.

This backdrop creates significant opportunities to grow the business in the UK student accommodation sector through development and targeted acquisitions in our strongest markets and partnerships with universities.

The HMO sector, which provides homes to over one million students, is increasingly expensive due to rising mortgage costs for landlords and utility costs for tenants. We expect these cost pressures to only grow for private landlords given increasing regulation around the quality of homes and environmental performance standards through EPC certification. We expect this to further reduce the availability of private rented homes over time, increasing demand for the purpose-built, sustainable accommodation we provide.

Primary Health Properties

Steven Owen, chairman:

The modernisation of the primary care estate been is becoming increasingly important as the NHS seeks to work through the backlog of treatments created by the COVID-19 pandemic, address staff shortages and recruitment issues and deal with the inadequate provision of both primary and social care in the UK, which is directing patients, who could be treated in the community, to hospitals where many then remain longer than clinically necessary because appropriate provision does not exist in the community or care sector where it is needed.

In the longer term, the ageing and growing demographic of western populations means that health services will be called upon to address more long-term, complex and chronic co-morbidities. Consequently, the Government needs to respond and invest in new structures to deliver more healthcare in primary care and community settings and away from over-burdened hospitals. PHP stands ready to play its part in delivering and modernising the real estate infrastructure required to meet this need in the community.

In July 2021, the UK Government published a draft Health and Social Care Bill setting out several 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-ordination between NHS partners and local government services and their budgets such as those for 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.

Mark Huntley, chairman, Macau Property Opportunities Fund – 23 February 2023

The period ended with an unexpected and broadly welcome development: the removal of all travel restrictions to Macau and within the region following a decision by Chinese authorities to end their dynamic-zero approach to COVID control. This rapid change of circumstances had not been foreseen. Indeed, Macau was still slowly recovering from the effects of a major COVID outbreak in July that prompted citywide lockdowns and multiple rounds of mass-testing. Although the lifting of COVID control measures resulted in an “exit wave” of COVID infections across the territory, which affected the Company’s operations, it has ultimately led to several very positive developments. The border with mainland China – Macau’s primary source of tourists – has fully reopened, daily ferry services to Hong Kong have recommenced, travel on the Hong Kong-Zhuhai-Macau Bridge has resumed and quarantine-free entry to the territory has been restored for visitors from foreign countries.

Macau’s gaming revenues have reflected this surge in visitors, notably Hong Kong residents, who had been prevented from travelling freely to the territory. In contrast to the difficult situation that persisted for much of the period, this dramatic and much-hoped-for change will enable us to make renewed progress on our divestment

strategy. However, these changes occurred so recently that a solid timeframe for divestment is difficult to anticipate. Conditions in Macau were challenging in the lead-up to these changes, with low visitor numbers and a poor economic performance in gaming and other tourism-related revenues that saw the economy depressed further by travel restrictions and a lockdown in the third quarter. This had a huge impact on confidence, and the ongoing difficulties involved in visiting the territory hampered efforts to achieve divestment of our property portfolio. In the high-end property segment, to which we are exposed, transaction volumes remained low.

It will be interesting to see whether recent events spark a rekindling of investor interest and an end to the "wait and see" approach that has become established in the market. The recent marked rebound in visitor numbers, gross gaming revenue and the hospitality trade, which has included a significant increase in hotel occupancy, are all encouraging. However, any sense of optimism must be tempered by an awareness that the route out of any prolonged lockdown has been shown in other jurisdictions to be painful both socially and economically.

. . . .

The managers, Macau Property Opportunities Fund – 23 February 2023

Macau's economic performance in 2022 reflects the disruptive impact of zero-COVID measures on its twin drivers of growth, and also lends credence to the government's policy of reducing the territory's reliance on gaming. Gross domestic product plummeted 33% YoY in Q3 2022 amid a drop of 28% for the first nine months of the year. For full-year 2022, the territory is expected to register a YoY GDP decline of 17%. Unemployment among local residents rose as high as 4.7% in the second half of 2022, compared to an average of 2% pre-pandemic. Inflation was relatively benign at 1% during the same period. Macau's credit score has not been revised since early 2022, when Fitch Ratings affirmed the territory's long-term rating at "AA" with a stable outlook. Fitch has since said that Macau's GDP may rebound 46% YoY in 2023, although that observation preceded recent reopening measures.

Macau's economy came under severe pressure in the second half of 2022 as the territory waged a dynamic zero-COVID war against the highly transmissible Omicron variant of the virus. A large-scale summer outbreak — the first since the start of the pandemic — brought the city to a standstill as almost all non-essential activity, including gaming, was shut down. Macau's twin economic engines — gaming and tourism — bore the brunt of these measures as potential visitors were deterred by travel restrictions and the fear of being unexpectedly locked down. The already weak property sector suffered further headwinds as the territory recorded one of the worst periods of economic turbulence in its history. However, in tandem with mainland China, Macau dramatically and swiftly announced a complete reversal of its almost three-year-long zero-COVID strategy in December. The rapid and complete reopening led to an immediate increase in enquiries into real estate in the territory.

Looking Ahead Investor sentiment towards Macau has become significantly more buoyant in the last month, but we remain cautious in the near term, since the economy is likely to grapple with labour shortages and public health issues as it begins to recover from its sharpest declines in almost two decades. Analysts'

estimates for GGR growth suggest that 2023 will be a transitionary year, and that in 2024, GGR will rebound to US$27 billion, with net revenue at 77% of 2019 levels. The recovery of Macau's gaming and tourism sectors, with the attendant improvement in GGR and tourist spending, is expected to set the economy on a long-awaited road to revival.

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