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Monthly summary | Investment companies

February 2018

Economic & Political Roundup

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

Exchange Rate	31/01/18	Chg. on month %
GBP / USD	1.4191	+5.0
USD / EUR	0.8056	-3.3
USD / JPY	109.19	-3.1
USD / CHF	0.9313	-4.4
USD / CNY	6.2888	-3.4

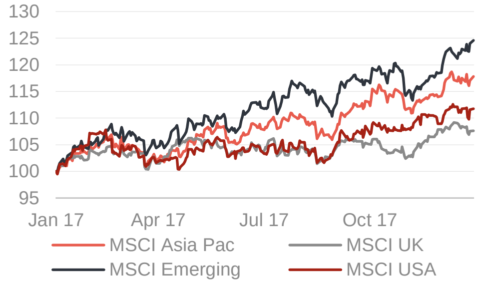
Source: Bloomberg, Marten & Co

Roundup

The major factors at play over January were a weak US dollar and a strengthening oil price. With the notable exception of the UK, stock markets continued to climb over the month. As we approached the end of January, concern began to build that strong global growth would lead to further interest rate increases and government bond yields rose. This has now manifested itself in a sharp pull-back in markets.

MSCI Indices rebased to 100

Time period 31/01/16 to 31/01/17



Source: Bloomberg, Marten & Co

	31/01/18	Chg. on month %
Oil (Brent)	69.05	+3.3
Gold	1345.1	+3.2
US Tsy 10 yr yield	2.7050	+12.5
UK Gilt 10 yr yield	1.51	+26.9
Bund 10 yr yield	0.695	+64.3

Source: Bloomberg, Marten & Co

Global

Warnings about expensive valuations, rising inflation and the potential policy responses to that but no long-term gloom.

Mike Brooks and Tony Foster, the managers of Aberdeen Diversified Income & Growth, said that many mainstream asset classes appeared to be expensive. In particular, they saw little value in 'safe' assets such as developed market government bonds or investment grade corporate bonds. Richard Killingbeck, chairman of Bankers Investment Trust, cited rising inflation and the reaction of central banks to that as one of the bigger macro issues affecting global markets in the year ahead. He cautioned on global stock markets and currencies. Alex Crooke, the manager of that fund, does not yet see the seeds of a global recession or prolonged market collapse, however. Richard Martin, chairman of F&C Managed Portfolio, cautioned that valuations in the US were stretched but thought that tightening monetary policy in the US had been well flagged.

United Kingdom

QE and low interest rates have pushed up valuations but UK (domestically-focused) small caps have been held back by politics. Stronger sterling could highlight the relative attractions of domestic companies. As yet, the bond market is not indicating that interest rates will return to 'normal' levels, at least not in a hurry.

The managers of Henderson Opportunities highlight that the excess money created by ten years of quantitative easing has to some extent encourage asset price bubbles. Andrew Chapman, chairman of River & Mercantile Micro Cap, says that companies are investing in improved productivity as a way of handling inflation. The managers of Artemis Alpha draw attention to the potential impacts of strengthening sterling, notably lower inflation in the UK and a flattering of domestic earners' results relative to overseas earner's. The managers of Aberforth Split Level Trust believe that the muted reaction of bond markets to stronger economic activity and the prospect of further rate rises might suggest that the "reflation trade" is another false dawn and that we might be condemned to low growth for years to come. Paul Trickett, chairman of Aberforth Smaller Companies, also highlights the tension between equity and bond valuations but draws attention to the valuation discount placed on UK smaller companies, possibly as a result of the UK political situation and Brexit. Neil Hermon, manager of Henderson Smaller Companies, thinks the 'normalisation' of monetary policy will be a slow and measured process and points out that companies' balance sheets are more robust than they were in 2008/2009.

Japan

The Japanese market is less expensively valued than its peers, there is cash that could be tempted back into equities and companies are increasing returns to shareholders.

Harry Wells, chairman of CC Japan Income & Growth, notes the recovery underway in the Japanese economy and the Japanese stock market's valuation discount compared with its developed market peers. He also draws attention to the vast amount of money sitting in liquid financial assets earning poor returns in Japan and speculates that some of this could be tempted into equities. The manager of that fund says that the strength of the Japanese stock market is underpinned by the improvements in corporate performance and the steady but meaningful increase in returns to shareholders.

Russia

A number of positive factors should work in Russia's favour but political risks remain.

Gill Nott, chairman of JPMorgan Russian Securities, says that rising commodity prices, especially for oil, could have a positive economic impact on Russia in 2018. The economy is growing but sanctions and global politics are weighing on the stock market. The managers of that fund say Russia is a market where we could see interest rate cuts and lower inflation. They see scope for further economic reforms and believe that valuations are supportive if you can accept the current level of country risk.

Commodities and natural resources

The market is being too bearish on oil prices, technological change provides new opportunities and companies will not get carried away on the back of rising commodity prices.

Ed Warner, chairman of BlackRock Commodities Income, thinks commodity prices will stay strong in 2018. He points out that developments that are seen as threats to the sector, such as the growth of electric vehicles, provide new opportunities for the companies providing the raw materials needed to support this change. The managers of the fund think that companies will be more disciplined in the face of rising prices than they were in 2010 and that scepticism towards the sector is unjustified. They also note that, despite the growth of electric vehicles, oil demand is not expected to peak until 2030 – they think the market is being too bearish on oil prices.

Debt

Debt markets may become more volatile as economic policy become less accommodative.

The managers of Chenavari Toro Income are more relaxed about the European political situation than they have been in some time. They are expecting further US rate rises in 2018 and, towards the end of the year, an end to the ECB's asset purchase programme. They think high yield bond valuations are stretched. The managers of TwentyFour Select Monthly Income think markets may become more volatile.

Property

Ediston talks us through its views on the industrial, logistics and retail warehouse markets. Safestore gives us an update on the self-storage industry.

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Global

(compare Global funds **here**)

Mike Brooks and Tony Foster, managers, Aberdeen Diversified Income & Growth: Our view on the global economic outlook has not changed to any great extent: global GDP growth of 3.6% is expected in 2017 followed by 3.8% and 3.6% in 2018 and 2019. Our forecasts are closely in line with those recently published by the IMF. We expect global inflation to be around 3% p.a. over the next three years. Employment markets are tight but wage pressures remain low. Taking account of recent changes in guidance from central banks, we anticipate that UK interest rates will hit 1% in 2018 and our forecast is for US interest rates to rise to 2.25% in 2018 and to 3.0% in 2019.

Against this fairly benign background and, with market volatility at historically low levels, our view is that many mainstream asset classes appear expensive. Over the medium term, we see little value in supposedly safe assets such as developed market government bonds or investment grade corporate bonds.

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Richard Killingbeck, chairman, Bankers: Rising inflation and the reaction of central banks is likely to be one of the bigger macro issues affecting global markets in the year ahead. Increasing globalisation of the world economy has manifested itself in many ways with one key aspect being the downward pressure on labour costs across major economies. The recent increase in broader inflation measures has not yet resulted in a significant increase in labour costs but the time may be getting closer when labour cost pressures will be more evident. Central banks in the US and UK are beginning to withdraw the monetary support to their economies by raising interest rates. How aggressive this removal of monetary support will be, especially with most markets at all-time highs, will be one of the key determinants of market direction in 2018.

On a more positive note, global economic growth remains positive and corporate earnings growth in most major markets is accelerating. Whether this growth is already reflected in market valuations is another critical aspect in trying to forecast returns for next year. One thing about which I am certain, however, is to be cautious in extrapolating the returns of the past two years into next year. Global stock markets and currencies may not be as positively aligned in our favour as they have been during the past two years.

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Alex Crooke, manager, Bankers Investment Trust: There are plenty of future trends like Brexit, fading Chinese growth and shrinking liquidity that may make investors cautious. A negative outturn from any one could result in a sharp fall in stock markets. However, the seeds of a global recession or prolonged market collapse are not yet obvious and so share prices may continue to rise. Seeking out fundamental or intrinsic value has long been a sound investment strategy but, in recent years, they have been forgotten in favour of growth and momentum. It seems clear to us that inflationary pressures exist in labour markets and higher wage growth will favour a market shift towards more careful analysis of value and the price paid for growth.

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Richard Martin, chairman, F&C Managed Portfolio: The global outlook for equity markets remains constructive. That said it would be wrong to ignore that markets have had a remarkable run since the great financial crash nearly ten years ago and that geo-political risks abound. Valuations in certain markets, especially the US are elevated, stretched even. However neither age nor valuation are, when viewed in isolation, reasons why further positive returns cannot be achieved. The economic recovery has broadened out through Europe, Asia Pacific and many emerging markets. Globally corporate earnings growth is strong and looks likely to continue in robust fashion into 2018. Although monetary policy is tightening in the US this has been well flagged and is gradual, whilst elsewhere it remains stimulative and supportive of equity markets. There are risks, which warrant a cautious approach with regard to strategy and investment selections.

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United Kingdom

(compare UK funds **here**)

James Henderson and Colin Hughes, managers, Henderson Opportunities: The big issue for markets internationally in 2018 is how quantitative easing ends and what are the consequences. In addition in the UK we face the added complication of trying to achieve a "good" Brexit deal.

The excess money created by nearly ten years of quantitative easing has to some extent encouraged asset price bubbles most notably in domestic house prices and bonds. Elsewhere, for instance in modern art, bloodstock and vintage cars, prices are often eye watering. It is still early days in the adjustment to a more normalised period of monetary policy from central banks but they are keenly aware that a false move, or two, could be negatively interpreted by the markets and cause unnecessary harm. In such a scenario equity markets would be impacted as well. But it would be wrong to be too dogmatic since the steady tightening of monetary policy in the US has been benign for financial markets. Real growth in profits, cash and dividends are being created by the best companies. We will need to live with higher valuations than in the recent past.

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Andrew Chapman, chairman, River & Mercantile UK Micro Cap: The favourable outlooks for many economies around the world contrasts with the subdued outlook for the UK economy as a result of Brexit. However, the UK Micro Cap universe provides a wide range of choice allowing the possibility to achieve 'close to zero' exposure to UK domestic cyclicals.

Looking ahead, the outlook for the UK consumer continues to look subdued, but British exporters benefit from the lower level of sterling. Aside from the slowing UK economy the majority of global economies are enjoying a synchronised improvement which is providing benign conditions that allow firms to thrive. Budding inflation is motivating corporates to invest in improved productivity. In general, these are proving attractive conditions for many UK listed Micro-Cap firms and investors are increasingly recognising this.

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John Dodds and Adrian Paterson, managers, Artemis Alpha: At the time of writing, the UK government has now reached agreement to move to phase two of the talks on Brexit. So the risk of a 'no deal' Brexit looks to have diminished substantially. That a number of concessions on previous 'red lines' were made during the negotiations increases our belief that an agreement on a new trade deal can be reached.

Sterling has rallied in response to the talks' progress, taking it to a six-month high versus the euro and a 12-month high versus the dollar. The pound's strength should start to feed through into lower inflation over the next few months, reducing the squeeze on real wages. We will be watching economic data from the UK closely for any signs of an improvement in corporate and consumer confidence. At a stock level, current foreign exchange rates should see the relative earnings momentum between the UK market's overseas and domestic earners reversing at the next reporting season.

In an environment where economic growth globally is strong - and where central banks are starting to withdraw liquidity - we believe that holdings in financials, and [*a*] bias towards value, will aid relative performance.

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Aberforth Partners LLP, manager, Aberforth Split Level Trust: Low interest rates, quantitative easing and sluggish economic progress have been headwinds for much of the period since the financial crisis in 2008. However, it is at one level surprising that the value style should have been buffeted over the past six months. One of the most notable developments of 2017 was the synchronisation of economic recovery around the globe, with all major economies enjoying GDP growth for the first time since the financial crisis. While the rate of progress of the US economy eased, tax reform offers the prospect of renewed impetus. Meanwhile, Chinese activity benefited from a bout of stimulus and, perhaps more significantly, the Eurozone returned to growth as the impact of quantitative easing was finally felt. The broad trend of improvement was seized upon promptly by the equity markets and has been termed the "reflation trade".

Its sustainability was, however, brought into question by the words and actions of the world's central banks, apparently keen to display their inflation-fighting credentials. Three interest rate rises in the US have been accompanied by commentary on how and when the Federal Reserve's balance sheet, bloated by quantitative easing, might be run down. To date, the Eurozone has seen no action but plenty of rhetoric from the European Central Bank, while the UK has witnessed its first interest rate rise for ten years. It is to be hoped that the central banks are not too focused on fighting yesterday's war and that they have judged the risks of runaway economic activity and inflation accurately. In this regard, a bit more nervousness on the part of government bond markets might have been encouraging: yields remain at extremely low levels in a historical context. The behaviour of bond investors suggests that the "reflation trade" is merely another of those false dawns to have punctuated the period since the financial crisis and that underlying economic issues of debt and demographics are so intractable as to condemn the world to very low rates of progress for years to come.

Such prospects are some of the factors contributing to the emergence of reactionary populism around the globe, though, again, bond investors appear little concerned by the inflationary effects of populist policies. To be fair, a useful test-case of populism, the UK's EU referendum, has hardly been a cause of concern for bond markets. There was no implosion in the immediate aftermath of the vote, but the second order effects of sterling's devaluation have been permeating the economy: inflation is picking up, real wages are coming back under pressure and to this extent the outlook for real growth is deteriorating.

Though GDP growth forecasts should be taken with a pinch of salt, the trajectory that has taken the UK from the fastest growing G7 nation in 2014 to the slowest in 2017 is hardly encouraging. Meanwhile, the government is in a difficult position, undermined by the outcome of the general election, riven ideologically by differing views on the EU and inevitably focused on the terms of the exit negotiations.

In broad terms, today's universe of small UK quoted companies can be split into three groups, a framework that has been useful for the majority of time since the financial crisis.

The first comprises secular growth companies, whose valuations benefit from the low discount rates that encourage investors to extend their investment horizons well beyond historical norms. Decent memories are now required of the last time that capital became effectively costless for growth companies during the TMT boom in the run-up to the Millennium. This is not to deny the existence of some truly outstanding business franchises among the technology behemoths of the US and China or even, indeed, within the NSCI (XIC). However, experience suggests that capital does not remain costless indefinitely, that many growth businesses are being valued as if they are the next Amazon and that few businesses succeed in retaining high stockmarket ratings for extended periods.

The second group comprises companies whose growth is low but dependable and that tend to pay out a large proportion of their profits as dividends. Before the financial crisis these would have been described pejoratively as "dull" or "ersatz bonds" and, condemned to low valuations, might have fitted into a value portfolio. However, since the advent of quantitative easing with its suppressive effect on bond yields, the increasingly desperate search for income has seen them re-rated to high valuations.

The final group is everything else - the rump of companies that are lowly valued, typically cyclical, often reliant on the domestic economy, sometimes illiquid and thus uncomfortable for many investors to own. None of these characteristics means that these are all poor businesses that face an existential threat. Some will undoubtedly fall victim to the forces of disruption and these are to be avoided, unless prevailing valuations exaggerate the rate of decline and offer an opportunity for investment. However, many members of this group boast defendable market positions, volatile but good returns on capital through the cycle and the opportunity to grow though not necessarily year-in-year-out. These are the typical holdings of a small cap value fund just now.

An implication of this characterisation is that the big-picture issues of macroeconomics, government bond yields and politics are at present disproportionately influential on the valuations of the three groups that make up the universe of small UK quoted companies. The uncertainties stemming from the EU referendum play a part, but the more significant influence remains the extraordinary monetary policies that anchor bond yields in many parts of the world at very low levels. As long as this continues to be the case, issues specific to individual businesses are likely to play a secondary role in determining returns, though stock selection can make a difference with the help of some good fortune.

So what might move the world's major bond markets? A year ago, a reasonable response, though one that appeared unlikely to come to pass, might have mentioned a bout of synchronised global growth accompanied by higher inflation, tax cuts for the world's largest economy and monetary tightening. And yet government bond markets are unyielding. Perhaps in the face of a decades-long bull market in bonds, which has only intensified since the financial crisis, more convincing evidence is required and perhaps 2017's "reflation trade" will be condemned to the same fate as 2013's "great rotation". Financial markets certainly remain set up for more of the same: corporate bond spreads are extremely narrow, equity markets are led by a small number of beneficiaries of low rates and, to judge by the world of small UK quoted companies, funds tend to be heavily biased to those favourite stocks.

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Paul Trickett, chairman, Aberforth Smaller Companies: In economic terms, the environment has been more conducive as, despite a slowing UK economy, we have witnessed an acceleration and synchronisation of global growth - indeed, one might regard the biggest fear as being the extent of the consensus about the supportive conditions for further progress. Around the world, we have seen several central banks shift gears and raise interest rates. In financial markets, this has fuelled the debate between inflation and deflation. As a consequence, the tension between equity and bond valuations remains at the forefront of asset allocators' minds. As with political uncertainties, I would envisage such tensions to be resolved over several years but their significance should not be underestimated.

As an asset class, small UK quoted companies have perhaps missed out, owing to politics and Brexit, on the sort of re-rating witnessed in the broader financial markets. As represented by the NSCI (XIC), they look to be selling at around a 34% price/earnings discount to their larger brethren. Since 1990, only the period during and in the aftermath of the Long Term Credit Management crisis in 1998 has this discount been meaningfully wider.

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Neil Hermon, manager, Henderson Smaller Companies: Politically the environment in the UK remains uncertain. We have a hung parliament and a minority government, supported by a 'confidence and supply' arrangement with the DUP.

At the same time, the UK government is involved in Brexit negotiations with the EU. There is clearly a range of outcomes from these negotiations but what 'deal' the UK will end up with - if any - is, at this point, unclear. This uncertainty will probably cause some caution in the mind-set of UK consumers. At the same time they are facing the pressure of the rising cost of imported goods. This is squeezing consumers' net disposable income as wage inflation fails to match the cost of price inflation.

Outside the UK, economic conditions are strong, and if anything getting better, particularly in the US and Europe. With around half of the portfolios earnings from outside the UK we are well placed to benefit from this trend. The recent rises in US and UK interest rates have flagged to investors that loose global monetary conditions will at some stage reverse. However, the 'normalisation' of monetary policy should be a slow and measured process.

In the corporate sector, conditions are intrinsically stronger than they were during the financial crisis of 2008/2009. Balance sheets are more robust and dividends are growing.

In terms of valuations, the equity market is roughly in line with long-term averages. Merger and acquisition (M&A) activity remains a supportive feature for smaller companies. If corporate confidence improves, M&A is likely to increase.

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Japan

(compare Japanese funds **here**)

Harry Wells, chairman, CC Japan Income & Growth: A decade of unparalleled monetary creation has at last resulted in the world pulling out of a long period of economic stagnation, with firm evidence of a synchronised global economic recovery. For the moment, inflation remains benign, although important supply side reforms in China radically cutting back industrial capacity, together with low unemployment in Western economies, means that Central Banks and markets are watching price data carefully. The Federal Reserve is intent on trying to set higher interest rates and trim its balance sheet, which combined with the US tax reform agenda points to a stronger US dollar. However, the Bank of Japan looks like the last of the central banks to reduce its Quantitative Easing (QE) programmes, because of its firm commitment to policy action designed to create inflation with as yet only a modest impact. Perhaps their 2% inflation target will become a more realistic prospect, if we see persistent government initiatives encouraging the enormous surpluses in the corporate and household sector to moving back into the economy. Certainly, monetary accommodation has seen the Japanese economy picking up, with GDP forecast to grow 1.5% in 2017 compared to 1% in 2016; meanwhile unemployment has fallen to below 3%. The Tankan Index of Business conditions for the last Quarter of 2017 is standing at its highest level since 1991 with trade, exports and company earnings all improving. Indeed, the prospects for corporate earnings appear robust, with net profits rising by 35% in the first half of 2017, beating consensus by 10% and leading to stronger earnings guidance. Furthermore, the market valuation stands at a significant discount to other major stock markets, which gives plenty of scope for further advances.

Notwithstanding the continuing tensions on the Korean peninsula, our Investment Manager remains confident of the immediate prospects for Japan and should continue to find attractive investment opportunities as recovery spreads and new practices gain wider acceptance. Domestic funds are still shy of returning to the Japanese stock market, reflecting entrenched, risk averse convictions. A massive Y1,800 trillion (GBP11,800 billion) in savings is still sitting in liquid financial assets earning poor returns and have not yet been tempted back into equities. Hopefully, the cyclical earnings recovery should be accompanied by higher inflation expectations, which ultimately will engender more domestic investor interest in the underlying potential offered by their own stock market.

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Richard Aston, manager, CC Japan Income & Growth: We move forward into 2018 with a great deal of optimism. The domestic economy has remained robust despite the volatility of the currency during the past twelve months and is set to reap further benefits from the Prime Minister's economic and reform initiatives. The strength of the Japanese equity market has been underpinned by the improvements in corporate performance which have complemented the underlying efforts to improve productivity. Importantly, these improvements have been accompanied by a steady but meaningful increase in returns to shareholders. This aspect, in particular, is gaining wider recognition and attracting the attention of investors who have historically ignored Japan.

In the Japanese financial year to 31 March 2017, the aggregate dividends for the overall market rose 9.7% reaching a fourth consecutive annual record while the number of companies announcing share buybacks also rose to a new high of almost 700. This annual growth of dividends was again the fastest of the major global equity markets. Despite this, cash and deposits held by corporations continue to rise, such that now over 55% of listed companies have net cash on their balance sheets. For the market as a whole, the aggregate payout ratio still hovers around 30%, considerably lower than other major international markets and consequently offers considerable scope for improvement.

While the ability of many companies in Japan to enhance their potential shareholder returns in the future is clear, it is the willingness of management to do so that is often questioned. For example, although the number of companies announcing share buybacks has risen, the aggregate value of these programmes has fallen and this has been raised as evidence of a waning commitment to corporate governance reforms. However, many of these companies have cited new investment opportunities - capital expenditure and M&A - as alternative uses of these cash resources to sustain future growth and this confirms our opinion that companies are and should be considering share buybacks on a flexible basis.

Importantly, we believe that the same company managements are increasingly focusing on the sustainability of the dividend payment as the primary objective of their shareholder return policy. The emphasis on growth, with this added security of an income return, represents the most significant change in recent years and has created the opportunity for investors to consider Japanese equities on at least an equal footing with other leading world markets.

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Russia

(compare European single country funds **here**)

Gill Nott, chairman, JPMorgan Russian Securities: The price of oil is a major determining factor for the Russian economy and if the price stability continues together with a rally in the prices of other raw materials, it seems likely to have a positive economic impact on the Russian economy and stock market in 2018. The Investment Manager continues to believe that the equity market in Russia provides a good long term investment opportunity if the right stocks are selected. However, economic sanctions against Russia remain and the political outlook is uncertain on many fronts, including the Middle-East, USA and Europe. These significant geopolitical and economic issues will continue to impact the Russian market.

There are continuing improvements in the domestic economy with a stable outlook for fiscal policy and expected growth in Russia's GDP. Thus, the outlook remains uncertain but with some potential for upside if the oil price continues to strengthen and economic and political stability are maintained.

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Oleg I. Biryulyov and Habib Saikaly, managers, JPMorgan Russian Securities: There have been few changes in the Russian equity market outlook since our last report to you. We believe that the stabilisation of Russia's economy is now well underway and will continue to have a positive impact on Russian equities. We expect the Russian economy to deliver 2% annualised GDP growth in the next three-to-five years, with potential upside coming from stronger investments and the recovery of domestic consumption.

Oil price volatility could be lower in the next 12-18 months due to structural changes in supply of oil, as lower capex for the last three years will start to cap growth in production globally. This kind of stabilisation will help to improve the outlook for the rouble and earnings growth, particularly in US dollar and sterling terms.

In our opinion, the reduction of interest rates is a very powerful monetary policy tool. We expect to see a continuation of interest rates cuts through the next 12-18-month period, together with lower inflation within the next five years in Russia. The Russian equity market is dominated by capital-intensive industries with long-term investment projects and long payback periods. Discounted cash flows for such projects have been depressed by very high cost of capital and, in most cases, projects with more than a 10-year life span were hit hard by these calculations. We think that if the cost of capital becomes normalised, we will see adjustments to the value of these long-term projects, which could have a beneficial impact on the valuation of such companies.

We continue to see scope for reforms and hope that - slowly but surely - further liberalisation and restructuring of the Russian economy will take place. The domestic political outlook currently looks very stable in Russia. Although we would expect to see some rotation of specialists in the government and presidential administration we think that the senior leadership in the country will remain unchanged for the foreseeable future. The global political outlook would appear to be improving, although it is still fairly uncertain, with Western sanctions continuing and the conflict in Syria heightening tensions in the region.

We believe that Russian equity valuations are supportive for investors who are willing to accept the current level of country risk.

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Commodities and natural resources

(compare commodities and natural resources funds **here**)

Ed Warner, chairman, BlackRock Commodities Income: The recent strength of mined commodity prices looks set to continue into 2018 as high levels of free cash flow in the mining industry translate into capital returns to shareholders rather than into increased capacity. In the energy sector, the equity market remains cautious on the longer term oil prices. However, absolute oil demand is not predicted to peak until at least 2030, and the Manager believes that equities with oil price exposure are undervalued and are due a re-rating.

Looking further forward, there are a wealth of likely changes that would represent a quantum shift in the demands placed on the energy sector, with the growth in the electric vehicle market and increasing output from the alternative energy sector being two. It is perhaps too easy to see only negative impacts on energy companies, but there will be opportunities as well. Some mining companies have exposure to growing demand for raw materials used in, for example, electric vehicles and further investment opportunities will almost certainly arise.

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Olivia Markham and Tom Holl, managers, BlackRock Commodities Income: The ongoing strength in mined commodity prices over the course of 2017 has seen almost unprecedented levels of free cash flow generated by the major mining companies. In the absence of both a material slowdown in the Chinese economy in 2018 and any poor capital allocation decisions from management teams, the sector should again deliver strong free cash flows and the table below setting out cashflow expectations for some of the key mining companies illustrates this. We would therefore anticipate a continuation of capital returns to shareholders and the wide valuation gap between mining shares and the rest of the equity market to narrow. The sector was in a similar position in 2010 and embarked upon a wave of M&A and project spending, which led to over supplied commodity markets and poor returns for the equities. Despite these similarities, we see the situation today as being sufficiently different to 2010 and expect to see little change in 2018 to the recent trend of returning cash to shareholders and more disciplined capital spending decisions. The market as a whole though, remains sceptical about the sector given the mistakes of the past and we see this as an opportunity for investors in 2018.

The recent strength in oil prices has been encouraging and we believe that the underperformance of oil-exposed E&P companies and certain US onshore service companies has opened a tactical investment opportunity. In the medium term we retain the view that the market is too bearish regarding the level of long-run oil prices being used to value equities and so continue in our conviction in our oil exposed holdings. When re-affirming this positive medium term oil view we test it against the team's view on electric vehicles. We are optimistic on the outlook for electric vehicles and think adoption rates will be at the high end of market expectations in the next decade. However, even under these optimistic scenarios, absolute oil demand does not peak until at least 2030, offering the opportunity for several market and pricing cycles still to come. That said, we are excited by the breadth of investment opportunities that the decarbonisation of the energy supply chain offers and will look to selectively take advantage of such opportunities in the coming year.

Debt

(compare debt funds **here**)

Chenavari Credit Partners LLP, managers, Chenavari Toro Income: For the first time in many years, we are not expecting significant political risk in Europe to be a disruptive factor going into 2018. In 2017, populist and extreme parties which had become increasingly popular in recent years, failed to gain enough votes to win power. Whether it be, Geert Wilders in the Netherland, France's National Front, Norbert Hofer in Austria or Alternative in Germany, these parties have not altered the European political landscape as radically as some commentators had predicted.

With the exception of Catalonia and general uncertainty surrounding Brexit, the only major upcoming political event is the Italian general election expected in the spring of 2018. However, we are not preparing for a potential wholesale change of government, due to the recent change in the Italian electoral law favouring a broad coalition.

The Euro area should also continue to grow and hover above 2% next year (after GDP growth of +2.8% YoY in the third calendar quarter of 2017) buoyed by a global recovery, improving business and consumer confidence and an acceleration of self-sustaining domestic demand. Unemployment rate in the Eurozone was down 1% in 2017 (as of October 2017) and is anticipated to fall further under 8% in 2018 as the business cycle accelerates.

The situation is not as positive in the UK where growth is anticipated to decline to c. 1% in 2018 from 1.5% in 2017 (Morgan Stanley, 2018 Global Macro Outlook, 26

November 2017) due to a number of factors, including Brexit, consumer risks and increased inflation. Furthermore, with a minority government torn over Brexit negotiations, another early election in 2018 remains a plausible risk.

Global central banks led by the US Federal Reserve embarked towards policy normalisation in 2017. We are expecting, further interest rate increases from the US Federal Reserve in 2018, accelerating its balance sheet unwind while the ECB starts to taper its bonds purchases. As the European economy continues to show robust growth and inflation expectations pick up, the ECB is likely to stop its open-ended asset programme at the end of 2018 while signalling a first interest hike for early 2019.

Barring any unexpected events, defaults rates on leveraged loans should remain below the 2% historical average as the European economic outlook is in a strong phase of the cycle, while inflation remains contained.

The leveraged loan market should continue to see healthy issuance driven by increased M&A activity, funding and investment appetite from private equity firms and bond-to-loan migration. The continuous tightening of spreads during 2017 appears to have bottomed out, volatility has increased from historical lows thereby creating potential for outperformance through trading gains and credit pricing has begun to decompress more adequately reflecting risk. Barring geopolitical shocks, the risk/reward of the asset class, particularly in a CLO structure, should remain very attractive throughout 2018.

Although the Portfolio Manager anticipates a favourable default and downgrade environment for 2018, which will support CLO equity performance, we believe dispersion amongst corporate credits will rise and high yield bonds remain the most vulnerable form of European credit given how stretched both valuations and positioning are.

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TwentyFour Asset Management, managers, TwentyFour Select Monthly Income: With the central banks now generally undertaking a period of tightening, markets may endure a pick-up in volatility, although the Portfolio Manager still expects the key central banks to remain accommodative and on guard with terminal rates in the major markets expected to remain relatively low compared to historic cycle peaks. As always the markets face a number of uncertainties in the coming period, with key elections in the Eurozone (particularly Italy) and key positional changes at the Fed.

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Property

(compare UK property funds **here**)

Ediston Property: **Industrial/logistics:** The level of investment stock available to purchase has increased, but there is still a notable supply/demand imbalance which has kept pricing firm for the good assets. Yields for industrial and logistics assets have hardened considerably and are starting to look overpriced. Yields for good multi-let estates have never been stronger and the yields on longer distribution income is almost at supermarket or annuity levels of pricing. This yield compression has been driven by strong institutional demand. These buyers are encouraged by the lack of supply (as there has been virtually no development for seven years) and the limited development pipeline.

Retail warehousing is the one sector of the market which is looking attractive, albeit approximately 70% of the market is over-rented, so care needs to be taken in selecting the right assets with rental growth potential. However, the vacancy rate for all retail warehousing is just 5.1%.

The retail warehouse sector is well placed to benefit from yield compression. Following the EU referendum, institutional investors pulled away from the retail warehouse sector. As a result, values fell. As discussed above investors turned their attentions to the industrials and logistics sector, but with this sector now looking expensive, buyers are turning to retail warehousing which offers an attractive yield, the prospect of yield compression, good unexpired lease terms and deliverable asset management and development angles.

Investment volumes and the supply of investment stock will be key to the market going forward. Demand looks set to remain steady, however, in a lower return environment transaction costs could be seen as an impediment by some investors in making the decision to trade assets. This could reduce the level of stock being offered to the market for sale. The hunt for yield could overtake the current focus on liquidity as investors seek more value-add assets in core locations, especially where the underlying land values are high and there is an opportunity for alternative uses on the site.

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Safestore Holdings: The self-storage market in the UK and France remains relatively immature compared to geographies such as the USA and Australia. The Self-Storage Association ("SSA") Annual Survey (May 2017) confirmed that self-storage capacity stands at 0.64 square feet per head of population in the UK and 0.15 square feet per capita in France. Whilst the Paris market density is greater than France, we estimate it to be significantly lower than the UK at around 0.36 square feet per inhabitant. This compared with 7.8 square feet per inhabitant in the USA and 1.8 square feet in Australia. In the UK, in order to reach the US density of supply would require the addition of around 12,000 stores as compared to the current circa 1,000 stores. In the Paris region, it would require around 1,800 new facilities versus circa 90 currently opened.

While capacity increased significantly between 2007 and 2010 with respondents to the survey opening an average of 32 stores per annum, new additions have been limited to an average of 19 stores per annum between 2011 and 2016 (including container storage openings).

New supply in London and Paris is likely to be limited in the short and medium term as a result of planning restrictions and the availability of suitable land.

Respondents to the survey indicated aspirations to develop an average of 49 stores per annum from 2017 to 2019. Typically, actual developments have averaged less than 50% of respondents' aspirations although the 25 new openings in 2016 were closer than usual to the previous year's aspirations. This recent history suggests that circa 25 to 40 new stores are likely to be added in the coming year.

The supply in the UK market, according to the SSA survey, remains relatively fragmented. In aggregate, the top ten leading operators account for 27% of the UK store portfolio. The remaining circa 1,000 self-storage outlets (including 317 container based operations) are independently owned in small chains or single units. In total there are 693 storage businesses operating in the UK.

Consumer awareness of self-storage remains low, providing an opportunity for future industry growth. The SSA survey indicated that 58% (58% in 2016) of consumers either knew nothing about the service offered by self-storage operators or had not heard of self-storage at all. The opportunity to grow awareness, combined with limited new industry supply makes for an attractive industry backdrop.

Self-storage is a brand-blind product. 70% of respondents were unable to name a self-storage brand in the SSA survey, 88%(15) of respondents would not consider brand in their decision and 97% would not even use brand as a search criteria. The lack of relevance of brand in the process of purchasing a self-storage product emphasises the need for operators to have a strong online presence. This requirement for a strong online presence was also reiterated by the SSA survey where 71% of those surveyed (68% in 2016) confirmed that an internet search would be their chosen means of finding a self-storage unit to contact, whilst knowledge of a physical location of a store as reason for enquiry was circa 23% of respondents (circa 28% in 2016).

There are numerous drivers of self-storage growth. Most private and business customers need storage either temporarily or permanently for different reasons at any point in the economic cycle, resulting in a market depth that is in our view the reason for its exceptional resilience. The growth of the market is driven both by the fluctuation of economic conditions, which has an impact on the mix of demand, and by growing awareness of the product.

Our domestic customers' need for storage is often driven by lifestyle events such as births, marriages, bereavements, divorces or by the housing market including house moves and developments and moves between rental properties. Safestore has estimated that UK owner-occupied housing transactions drive around 8-13% of the Group's storage revenue. The SSA survey confirmed that only 28% of domestic self-storage customers stored for reasons related to a property move and this would include people renting accommodation.

Our business customer base includes a range of businesses from start-up online retailers through to multi-national corporates utilising our national coverage to store in multiple locations while maintaining flexibility in their cost base.

QuotedData

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