

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.

Roundup

In mid-February, stock markets fell on concerns that strong global growth and emerging evidence of rising inflation would lead to further hikes in interest rates. The UK market and to a lesser extent European markets also reacted to concerns about the progress in the Brexit negotiations. US Government bond yields crept up in contrast to German Bunds.

Global

Positive outlooks toned down by concerns about valuations, inflation, central bank policy and politics.

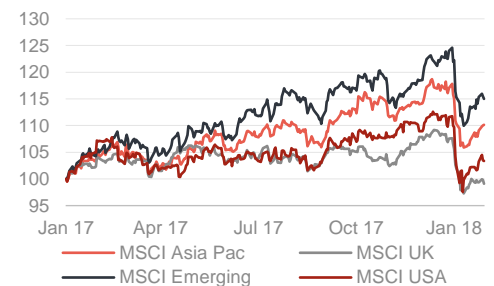
The Lord Rothschild, chairman of RIT Capital Partners, questions whether stock markets have experienced a resurgence in volatility and asks whether current valuations, which (in their opinion) remain excessive, adequately reflect the risks which lie ahead. The managers of Ruffer Investment Company say that change is happening, as inflationary pressures build, and the era of QE comes to an end. They also highlight that we are seeing societal and political upheaval, (e.g. the rise in populist movements). Peter Moon, the chairman, of Scottish American joins with many in this month's round up to consider the longer-term implications of rising inflation, Brexit and President Trump's presidency. He also points to the related fact that global economies, with the possible exception of the UK, are growing. Carolan Dobson, chairman of Brunner, agrees and highlighted, continental Europe, which is experiencing its strongest period of economic growth since the financial crisis. She goes on to say, however, that valuations are high, especially in the US.

Exchange Rate	28/02/18	Chg. on month %
GBP / USD	1.3760	-3.0
USD / EUR	0.8201	+1.8
USD / JPY	106.68	-2.3
USD / CHF	0.9446	+1.4
USD / CNY	6.331	+0.7

Source: Bloomberg, Marten & Co

MSCI Indices rebased to 100

Time period 28/02/16 to 28/02/17



Source: Bloomberg, Marten & Co

	28/02/17	Chg. on month %
Oil (Brent)	65.78	-4.7
Gold	1318.31	-2.0
US Tsy 10 yr yield	2.8606	+5.8
UK Gilt 10 yr yield	1.501	-0.6
Bund 10 yr yield	0.653	-6.0

Source: Bloomberg, Marten & Co

Cautious optimism is shared by most of the companies. There is consensus that the UK economy is growing but, post the Referendum, but less impressively than the rest of the world. UK Plc seems robust...for now. Valuations are on the high side. Most expressed concerns about politics, Brexit, inflation and the normalisation of interest rates

Asia continues to be (at the same time) a catalyst for, engine of and beneficiary of the global economic rebound.

Investors remain optimistic on the outlook for Europe, whilst pointing out the headwinds that the continent might face in 2018 from the end of QE and changes to the global trade environment

United Kingdom

John Reeve, chairman of Temple Bar, echoes the points raised by the global fund managers about systemic risks brought about by geopolitics and by low interest rates as a result of central bank policy. Whilst acknowledging these issues and recent stock market volatility, the managers of JPMorgan Mid Cap are positive on the economic growth and the outlook for UK mid cap. companies. The same is true for the managers of Aberdeen Smaller Companies and Standard Life UK Smaller Companies, although they add a note of caution that, whilst conditions are favourable in the short term, strong equity market returns should not be expected in the long run. Michael Wrobel, chairman of Diverse Income Trust agrees. He contends that equity markets that have run ahead of valuations suggesting a lack of productivity growth. He also agrees that wages have not risen ahead of inflation and that Brexit negotiations and politics, in general, give cause for concern. James Goldstone, portfolio manager of Invesco Perpetual Select Trust, concluded that the world feels an increasingly uncertain place but that any change would present attractive opportunities. Charles Luke, the manager of Murray Income Trust, summed up the domestic UK economy as not having suffered the sharp slowdown that many commentators expected following the Brexit vote, although growth has been somewhat anaemic.

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Asia

First State Investments, the investment managers of Scottish Oriental Smaller Companies Trust noted that the global economic recovery, at which Asia is at the heart, has broadened into more structural growth and can therefore be said to be relatively strong. As bottom up stock pickers, they fight shy of agreeing if this has peaked or not. The economy and weaker US dollar has allowed central banks to keep interest rates low.

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Europe

All European managers that reported results in February shared the same opinion about the end of support from central banks. The managers of Jupiter European Opportunities commented that the ECB has indicated that it will reduce its 'quantitative easing' to more normal levels. They also agree that valuations of European smaller companies are not stretched, following a period of positive equity markets. Ollie Beckett and Rory Stokes, fund managers of European smaller companies reported that they remain a relatively scarce source of value in an expensive world TR European Growth's Jack Perry CBE, chairman, of European Assets Trust said that global asset prices have obviously recovered strongly since the economic crisis and that action by central banks may have an impact on European smaller companies.

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As with Asia, Emerging markets are beneficiary of the global economic rebound. They are, however, susceptible to possible trading restrictions imposed by the US

Emerging markets

Austin Forey, the manager of JPMorgan Emerging Markets pointed out that, despite the strong performance of emerging markets equities since 2016, valuations are normal, coming, as markets have, from a low base. Emerging markets have benefited from the structural shifts in the global economy, as well as developments in technology. Mark Hadsley-Chaplin, chairman of Aberdeen Emerging Markets, and the fund management team at Aberdeen Standard both agree that the global economy has encouraged growth in earnings but also comment at length on the global political environment, particularly tensions between the US and China. This has become more apposite in March, as the Trump administration has proposed steel and aluminium import tariffs; a move that has been criticised by Beijing. The investment advisers to the Gulf Investment Fund make a case for investing in the Gulf Cooperation Council (GCC) area as a diversification away from the larger emerging markets such as China.

The outlook for commodity markets remains moderately positive as synchronised global economic growth continues.

Commodities and natural resources

Ian Cockerill, chairman of BlackRock World Mining believes that 2018 should be another year of synchronised global economic growth and an environment where commodities generally perform well. The sector is also still trading at a material valuation discount to broader equity markets. The managers echo his sentiments and go into greater detail about the economic and geo-political risks hanging over the asset classes in which they invest. Of note are the comments made by Evy Hambro and Olivia Markham, managers of BlackRock World Mining regarding battery materials, such as lithium, as the electric vehicle sector develops and grows. The managers of Riverstone Energy reported that oil prices spent most of the past two years oscillating in a range of \$40 to \$55 per barrel to push through \$60 per barrel in the second half of last year as the market rebalanced. They believe that this is due to five consecutive years of strong global oil demand growth, high OPEC compliance levels and various supply disruptions. The outlook for oil is in part driven by the US demand picture and their ability to “turn on and off the shale gas tap”.

Valuations remain high but could go higher. The sector is reliant on the global economic rebound

Financials

Tetragon’s management team see valuations in financials as high and in some cases overly stretched. However, at the current point in the cycle, albeit in the later phase, financials still have the opportunity for further prices rises. Robert Kyprianou, chairman of Polar Capital Global Financials, notes that sentiment towards the sector has become more balanced and constructive. However, memories of the 2007-08 financial crisis are long and so he believes that the better outlook for financials is not fully reflected in valuations as the sector continues to carry a legacy risk premium. The managers, Nick Brind and John Yakas, say that while the sector's performance has picked up in recent months, it remains reliant on the outlook for economic growth and therefore interest rates. Looking forward, it can be seen that regulatory and technological changes are leading to profound changes to the sector. In the short-term, the impact of technology has been limited and the main drivers remain the outlook for economic growth and interest rates.

Underperformance of this defensive sector is “unsurprising” and has exposed investment opportunities

Infrastructure

Geoffrey Burns, chairman of Premier Global Infrastructure, noted that the sector underperformed wider equity markets in 2017. Global equity markets continued to set new highs, and he sees it as perhaps unsurprising that a defensive asset class such as infrastructure, and especially the utility segment, should lag. The investment managers of Premier Global Infrastructure are optimistic for prospects in 2018 and continue to see increased earnings, particularly in many of the emerging markets, which trade at modest valuation levels. The relatively weak performance of listed infrastructure companies has created an investment opportunity in the medium to long term. Premier believe that regulated utilities can benefit from anticipated higher global interest rates.

Growth in the UK and London has slowed but less than expected. Brexit is a concern for overseas asset management.

Property

According to Derwent London, economic growth in London and the UK has slowed since the EU referendum result but, overall, the outcome has been better than initially expected. Markets expect low levels of UK GDP growth, as Brexit and political uncertainty continue to weigh on business decisions and more interest rates rises are expected as the economy recovers. Vikram Lall, chairman of F&C UK Real Estate sounds a cautious note and adds the uncertainty over Brexit and international trading as concerns. However, AEW UK Investment Management LLP, managers of AEW Long Lease REIT are cautiously optimistic on the outlook for long lease property in the UK, particularly relative to the yields on UK government bonds. Rising interest rates may close this differential. Hammerson are seeing changes in the retail property market that are being affected by several structural trends. This is particularly in the way that their tenants are adjusting to the customer experience and the relationship between physically going shopping, buying on line and “click & collect”.

Installation costs are coming down all the time. The outlook for renewable energy prices is positive. Opportunities outside the UK are becoming increasingly attractive

Renewable infrastructure

Greencoat UK Wind notes that the regulatory outlook for operational wind farms in the UK remains stable owing to the UK Government's policy of "grandfathering" for operational projects. In general, independent forecasters expect UK wholesale power prices to rise in real terms from current levels, driven by higher gas and carbon prices. Alexander Ohlsson, chairman of the Foresight Solar Fund, reports that there is now a total of over 12GW of solar capacity in Great Britain, with over 8GW of ground mounted solar. The company sees the global solar market as delivering significant growth over the coming years as solar project costs continue to fall and grid parity is achieved in more geographies. Infrared, manager of The Renewables Infrastructure Group, has seen strong growth in the sector in 2017 and, for the second year running, more than 50% of newly installed electricity generating capacity globally and approximately 85% in the EU was in the form of renewable energy infrastructure. The direction of travel in Europe and beyond is towards a low carbon economy.

The outlook for Technology remains positive, as companies need to increase their spending

Technology

Katie Potts, manager of Herald Investment Trust, can see strong growth in technology companies in the UK and in particular in London. Despite headwinds from global equity markets, Robert Jeens, chairman of Allianz Technology reasserts that technology should continue to grow its influence over the global economy, driven by the need for companies to upgrade and invest in IT infrastructure. The case for strong relative performance from the technology sector remains robust.

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Other

We also have comment from CVC Credit Partners European Opportunities and Pantheon International

The management team of CVC Credit Partners European Opportunities are looking for improvements in productivity across Europe to support their asset class but are in broadly in agreement with the other managers in this report about the global macroeconomic environment.

Pantheon International note that as market valuations have become more disconnected from their appropriate risk premiums, the chances of a significant correction occurring have increased markedly. In early 2018, the indications are that such a market correction may have started to occur. However, private equity is a long term strategy and, as such, Pantheon are still finding opportunities.

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Contents

7	Global (thoughts from RIT Capital Partners, Ruffer Investment Company, Scottish American and Brunner)
9	United Kingdom (thoughts from Temple Bar, JPMorgan Mid Cap, Aberdeen Smaller Companies, Diverse Income Trust, Invesco Perpetual Select Trust, The Independent Investment Trust, Standard Life UK Smaller Companies, Mid Wynd, City of London, Murray Income Trust, Strategic Equity Capital and BlackRock Throgmorton)
14	Asia (thoughts from Scottish Oriental Smaller Companies Trust)
15	Europe (thoughts from TR European Growth, European Assets Trust and Jupiter European Opportunities)
16	Global emerging markets (thoughts from JPMorgan Emerging Markets, Aberdeen Emerging Markets, Aberdeen Frontier Markets and Gulf Investment Fund)
19	Commodities and natural resources (thoughts from BlackRock World Mining and Riverstone Energy)
23	Debt (thoughts from CVC Credit Partners European Opportunities)
23	Financials (thoughts from Tetragon and Polar Capital Global Financials)
27	Infrastructure (thoughts from Premier Global Infrastructure)
27	Private equity (thoughts from Pantheon International)
29	Property (thoughts from Derwent London, Hammerson, F&C UK Real Estate and AEW Long Lease REIT)
32	Renewable Infrastructure (thoughts from Greencoat UK Wind, Foresight Solar Fund and The Renewables Infrastructure Group)
35	Technology (thoughts from Herald Investment Trust and Allianz Technology)

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Global

(compare Global funds [here](#))

The Lord Rothschild, chairman, RIT Capital Partners: In the year under review global stock markets rose to extraordinarily high levels, stimulated by low interest rates and unprecedented monetary policy initiatives of central banks, at a time when major economies of the world have been enjoying significant growth. In addition, the USA has brought in tax cuts and reduced regulation, unemployment has been lower, inflation has remained subdued and geo-political concerns have been shrugged off by stock markets.

The world has undoubtedly recovered from the global economic crisis of a few years ago. The question is whether such benign conditions are sustainable. Quantitative easing is in the course of being phased out, and interest rates are rising. Debt levels are higher - indeed significantly higher than at the time of the financial crisis of 2008. The World Bank and other luminaries are highlighting the risks to the present growth in the global economy, in particular over the medium term.

In addition, the geo-political situation remains a cause of concern: the risk of war, terrorism and cyber-attacks, come at a time when American policies are highly unpredictable. Europe is enjoying a cyclical recovery but political conditions remain unsettled. Rising populist nationalism may well affect future elections. In the UK, we struggle with the problems and complexities of Brexit and a minority government.

As I write this, stock markets have experienced a resurgence in volatility and we ask ourselves whether current valuations remain excessive, adequately reflecting the risks which lie ahead. Are we in the last chapter of a bull market, and one which is already the second longest in the post-World War II era?

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Ruffer AIFM Limited, the investment managers, Ruffer Investment Company: The cult of the central banker has driven markets for the last 35 years. Inflation-targeting mandates in a disinflationary world (think about the collapse of communism, globalisation, offshoring, the internet) have allowed the world's central banks to run monetary policy too loose and respond to any threat (the dotcom bubble, the Financial Crisis) with further stimulus. This is what has been known as the 'central bank put' and it is likely to be coming to an end. There are two reasons for this.

Firstly, central banks have exhausted most of the tools at their disposal, which will make it harder for them to respond in the future (they have admitted this themselves and called on governments to support economic growth via fiscal policy).

Secondly, the western world's have-nots are in the ascendancy (we see this through Corbyn's rise, Brexit, Trump) and in a world with too much debt, a wealth transfer needs to take place from the creditors (the have's) to the debtors (the have-not's). Central bankers recognise this (from an economic perspective at least) and continue to pursue a policy of financial repression, keeping interest rates below the rate of inflation in order to effect this transfer of wealth. This is not theoretical pontification.

UK inflation (as measured by RPI) is running at 3.9% and the Bank of England Base Rate is 0.5%; savers' nest eggs are being eroded in real terms. To date the impact has been mitigated as the principal form of inflation has been in asset prices which has benefitted the haves. This is unlikely to continue as valuations hit nose-bleed altitudes, while what little earnings growth there has been is fuelled by borrowing in one form or another. The combination of high levels of debt and high asset prices never ends well. If we are wrong then we hope to generate a positive return, which will look modest compared to the opportunities elsewhere and we will be an

inexpensive insurance policy which was not needed. If we are right then this is exactly the sort of scenario we need to protect our shareholders from. Nine years into the second longest bull market in modern times, history would suggest that caution will be rewarded.

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Peter Moon, chairman, Scottish American: Last year I suggested that the longer-term implications of both Brexit and President Trump's victory would take a while to emerge and that inflation was likely to pick up in the UK during 2017. Not particularly heroic predictions but as it happens correct thus far. Whether inflation persists at its current level is less clear, due to a combination of some weakness in the domestic economy and action by the Bank of England on the one hand and a strengthening oil price on the other. The likelihood of continued economic growth around the world seems strong, although the outlook for the UK economy is less positive. In addition, the concerns relating to valuations and rising interest rates mentioned earlier make share price progress less than certain, as has been demonstrated recently.

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Carolyn Dobson, chairman, Brunner: The economic backdrop is as positive as it has been for many years. The US economy continues to make steady progress with a mostly supportive if somewhat unpredictable political environment. Continental Europe is experiencing its strongest period of economic growth since the financial crisis. Less robust is the UK economy, where political uncertainty and sluggish growth suggests it may be a while before the UK regains its poise.

Looking forward, the main risks relate to financial markets themselves. Valuations are high, especially in the US, and there are signs that market breadth is deteriorating as investors bid up the prices of certain groups of growth stocks to ever higher prices.

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United Kingdom

(compare UK funds [here](#))

John Reeve, chairman, Temple Bar: It may be something of a statement of the obvious to recognise that we face a number of political and economic risks over the short to medium term, such as the ramifications of Brexit negotiations, the consequences of attempts by certain central bankers to reverse 'experimental' policies relating to ultra-low interest rates and the accumulation on balance sheet of vast quantities of fixed interest securities, and the possible impact of developments in US domestic and foreign policy under President Trump.

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Georgina Brittain and Katen Patel, investment managers, JPMorgan Mid Cap: 2017 marked the 25th anniversary of the formation of the FTSE 250 Index. In 1992, the combined market capitalisation was just under £100 billion, while today that figure stands at over £450 billion, despite a significant number of the success stories now being constituents of the FTSE 100. We remain confident of the continuation of this strong growth trajectory, despite the tortuous on-going Brexit negotiations, buoyed in no small part by the backdrop of very strong global growth.

Global stock markets have recently experienced a short period of notable volatility. In no way has this shaken our confidence in the outlook for our investments, and this is

evidenced by our choosing to increase gearing levels post December 2017 to over 5% today.

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Aberdeen Smaller Companies: 'In a world of ultra-low bond yields, equities' relative attractions are plain to see and this has ensured prices have continued to rise. Whilst these forces remain supportive, in the short term at least, we would not expect the level of share price growth we have seen in recent years to be sustainable.'

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Michael Wrobel, chairman, Diverse Income Trust: As company earnings have lagged the rise in equity markets in recent years, it has highlighted a growing concern regarding the absence of productivity improvements, both within the UK and overseas. In addition, despite ongoing employment growth, wages have not kept pace with inflation and this has led to changing preferences amongst many electorates. We believe that we have entered a period of flux regarding future global economic policies, of which Brexit is just one part.

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Patrick Gifford, chairman, Invesco Perpetual Select Trust: It is probable that there will be a gradual reduction in liquidity worldwide over the next year or so. Central Banks are keen to restore normality to their balance sheets, possibly in order to be able to fight the next downturn and rising global economic activity should also reduce surplus liquidity. This isn't usually a particularly supportive environment for securities markets, and especially not for fixed interest. Equities will be helped by rising profits and should perform rather better, though valuations relative to earnings may fall. This seems like a somewhat complacent view of the prospects and the scope for different outcomes, particularly less attractive ones, is considerable. The Trump Presidency is unpredictable and not necessarily benign. The UK continues to have its own parochial political problems with uncertain possible outcomes. Meantime, having experienced a major supportive monetary experiment in the last decade, we must watch nervously as Central Banks experiment with its removal. If they get it wrong, recession, possibly deflation, seems the more likely outcome than inflation. However, even if complacent, the central forecast is well supported by current trends, especially in rising corporate profits.

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James Goldstone, portfolio manager, Invesco Perpetual Select Trust: The UK equity market continues to push higher. This is despite a growing list of things worth worrying about. In no particular order and to name but four, these include geopolitics (North Korea), domestic politics (Corbyn), monetary policy (global QE tapering/reversal and rising base rate) and the uncertainties of Brexit. Whilst the headline valuation of the FTSE All-Share looks reasonable at around 14 times 12-month forward earnings, that average conceals some stark valuation differences between stocks, sectors and "styles" that by historical standards look extreme and have thrown up some compelling opportunities.

The most important of these is around inflation and the likely trajectory of interest rate policy. The sharp fall in sterling in the wake of the EU referendum flowed through quickly to the prices of food, energy and fuel and the tail-end of this move was still being felt in November with the consumer prices index (CPI) at 2.8%. However, the recent recovery in sterling against the dollar (and on a trade-weighted basis) means the rate of change in CPI is likely to be at or close to a short-term peak and is a factor in the market's view that interest rates will rise only very gradually. This potentially misses the significance of wage inflation. Private sector wage growth is already above 3% and the 1% cap on public sector pay has now been lifted. Wages at the bottom

end of the pay scale will continue to accelerate thanks not just to the pre-determined increases in the national living wage, but also to ample anecdotal evidence from management teams we meet of a very tight labour market. Since being given independence, the Bank of England has signalled consistently that inflation expectations, rather than current rates of inflation, drive policy and wage inflation is surely the biggest driver of those expectations.

This leads to several conclusions: firstly that the risk to UK base-rates and market rates of interest is clearly to the upside (against a similar backdrop globally). Secondly, that in the near-term, the recent decline in real disposable income is set to reverse and boost UK consumption and in turn, the revenues and margins of companies exposed to the UK consumer. Thirdly that the pound, still well below purchasing power parity, could see substantial upside and in the process dent the earnings of export-led and internationally-based businesses at the same time as expanding disposable incomes further.

The impact of all this could be very significant indeed, not least given the current valuation disparity between the potential winners and losers. The momentum that has characterised the last several years in the equity market has left the share prices of companies exhibiting “value” characteristics, relative to those exhibiting “growth” characteristics, at levels rarely seen in the last 40 years; money has poured into so called “bond proxies” offering an income stream and into shares of companies perceived as capable of growing in a low growth environment. As an example, shares in UK Financials are still very close to their post-referendum twenty-year low relative to Consumer Staples. If the received wisdom that the low growth, low interest rate environment is permanent proves erroneous, sector rotation and the resultant correction in share prices could be dramatic.

The principal risk to all this is the outcome of the Brexit negotiations and, in the shorter-term, the perception of the likely outcome. Whilst the process will inevitably continue to generate headlines about the two sides’ positions and the economic impact of a good deal or of no deal, I believe that in time an agreement will be reached that avoids unnecessary mutual pain. An intervening period of brinksmanship will of course bring volatility to the UK stock market, but in time I expect this to be seen to have presented unusually attractive investment opportunities.

The second risk to a domestic resurgence is the rise of the Labour party under Jeremy Corbyn, who has successfully identified a number of serious societal and generational issues and capitalised upon them in the face of a Tory party weakened and distracted by Brexit and the surprise general election result. Whilst a Labour majority in the House of Commons would turn the scenario discussed above on its head, it is difficult to envisage a set of conditions under which the Conservative party would risk another General Election in the next 24 months. I am therefore watching the domestic political situation extremely closely but don’t view the threat as imminent.

To conclude, the world feels an increasingly uncertain place.

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Douglas McDougall, chairman, The Independent Investment Trust: Two factors were particularly helpful [*to us in 2017*]. First, it was a market environment in which investors were happy to re-rate companies with a good story and results to match. This was particularly true of UK domestic companies, such as the housebuilders, whose valuations were artificially depressed in the wake of the vote to leave the European Union. Secondly, an unusually high proportion of our companies produced operating results during the period that exceeded expectations. Either or both of these factors could reverse at any time.

Once again, there has been little change in the global economic background. Growth has been unexciting; inflation has been generally modest; and consumer spirits have been subdued by limited real wage gains (indeed, real wages have declined in the UK). Interest rates have started to rise in some parts of the world, but at a slower pace than some would have liked. The overwhelming impression is of policymakers trying to direct events that have a mind of their own. Markets have once again benefited from a combination of loose monetary policy and high levels of corporate profitability.

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Allister Langlands, chairman, Standard Life UK Smaller Companies: Perhaps inevitably, there remains a high degree of uncertainty around what the final deal for Brexit will look like and what the implications will be for the markets. We expect that this situation will persist throughout 2018 and into the first quarter of 2019. We have seen interest rates start to rise after almost 8 years and the market seems to have taken that in its stride. However, it is hard to see how the very low levels of volatility that we all experienced in 2017 can continue.

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Harry Nimmo, manager, Standard Life UK Smaller Companies: I think that the problem is that economies are actually too strong, which is pushing up inflation, causing central bankers to raise interest rates. This means there is a possibility of a return to normality after ten years of ultra-low rates. Returning to normality might be construed as a good thing, however it has the side effect of undermining market valuations and potentially puncturing what some see as an asset bubble in equities.

The success of leading Alternative Investment Market ("AIM") stocks continues. I feel that, tax benefits aside, this very much backs up our view that AIM is making the smaller companies market an even better place to invest, as these new developing growth businesses come through helping to create prosperity and employment in the UK.

We cannot, however, completely forget about Brexit and the uncertainties that may arise as negotiations reach their climax.

Caution should be the watch-word, however. The surprisingly good out-turn of smaller companies, generally, since the referendum on the EU may wilt if there is any sign of real weakness in the UK economy.

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Simon Edelsten, Alex Illingworth and Rosanna Burcheri, managers, Mid Wynd: US interest rates have started rising, though much more slowly than expected. The world seems set for a year of vigorous economic growth next year in almost every region. There is an argument that growth in a modern economy comes from investment in intangible assets - software, patents, data - more than tangible assets - plant and equipment. This could partly explain why the US economy which has been growing steadily since 2009 does not seem to be suffering from supply constraints. However, if this is the case and inflation returns, interest rates may have to rise more vigorously to contain it.

We find the best growth opportunities the further we travel from London. Commercial investment levels are rising and most listed companies have very strong balance sheets.

We note some areas of stretched valuations in the market - perhaps some are holding internet stocks for fear of missing out. However, we also continue to find good growth stocks on modest valuations in less fashionable areas.

Philip Remnant CBE, chairman, City of London: After a period of exceptionally low volatility, some turbulence in world equity markets is not unexpected. Moves towards a tighter monetary policy are testing markets but robust economic growth across the main regions of the world is leading to improving corporate profitability. For the many UK listed companies with operations in the US, the tax cuts should lead to further increased earnings, although this may be offset in translation back to sterling by the recent fall in the dollar.

The dividend yield from UK equities remains attractive relative to the main alternatives notwithstanding the small increase in the bank rate to 0.5% and possible further increases in 2018.

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NAH Rogan, chairman, Murray Income Trust: After many years in which it was better to ignore politics completely when assessing market outlook, 2018 is probably going to be again dominated by Brexit, the survival of the UK government and President Trump. Views on all three seem to be highly polarised but there is a lot of room in between for economies and companies to continue to grow their earnings and dividends. Some UK companies will struggle with Brexit but some have great opportunities and most will have plans to, and be able to, adapt. Quality companies with good management thrive on change.

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Charles Luke, manager, Murray Income Trust: Although the domestic economy has not suffered the sharp slowdown that many commentators expected following the Brexit vote, growth has been somewhat anaemic. The preliminary estimate of fourth quarter GDP suggested growth of 0.5% marginally ahead of the 0.4% reported for the third quarter. The Office for Budget Responsibility downgraded its forecasts for 2018 at the time of the otherwise generally uneventful Autumn Budget to 1.4%. Manufacturing activity has been robust, helped by the recent weakness of sterling and strong overseas demand. However, services and household consumption have been under greater pressure as inflation weighs down on real incomes. Furthermore, during November, for the first time in a decade the Monetary Policy Committee raised interest rates with the decision to increase rates by 25bps to 0.5% reached with a 7-2 majority. The committee explained that given the fall in unemployment there was a reduced level of slack in the economy and that the performance of the global economy had improved, although there remained considerable risks to the outlook, principally related to Brexit.

Overseas, macroeconomic data releases have continued to demonstrate a robust recovery in activity. Consensus forecasts suggest close to 4.0% global GDP growth in 2018 compared to a likely 3.6% in 2017. In the euro area, activity has continued to recover due to increased investment and household consumption with growth broad-based across countries. With significant slack in the euro area economies, inflation has yet to pick up. The European Commission's expectation of GDP growth of 2.1% for 2018 may well be too conservative. In the United States, the Fed raised rates in December for the third time in 2017 as the economy gained strength. Recent tax reforms are likely to provide a further boost to the economy during 2018 with the Fed forecasting 2.5% GDP growth for 2018. Emerging markets performed well during the second half of 2017 aided by the strength of the global economy, robust commodity prices and a benign US dollar. Consensus expectations suggest a further pick-up in growth to around 4.7% in 2018. Within this, China's GDP growth, having performed strongly in 2017, aided by credit growth and a loose fiscal policy, may slow down a little but is likely to remain at an impressive level above 6%.

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Richard Hills, chairman, Strategic Equity Capital: Over the past 18 months improving economic news and corporate earnings growth have led to an almost uninterrupted run in stock markets. However, strong economic growth is creating a tightening in labour markets with the possibility of increasing inflation and a more rapid rise in interest rates than previously anticipated. If this is indeed the outcome then stock markets could enter a more testing period.

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Jeff Harris and Adam Khanbhai, managers Strategic Equity Capital: The general re-rating across the market makes sourcing new ideas trickier as many companies have invariably become more expensive.

Although there are pockets of over-valuation, in aggregate the UK stock market isn't demonstrably expensive and equities remain generationally cheap compared to gilts. Despite the '30-year bull market', money continues to flow into bonds with a recent Investment Week article describing 2017 as 'the year of the bond fund.'

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Dan Whitestone and Mike Prentis, managers, BlackRock Throgmorton: Following the strong performance of the UK stock market in 2017, the potential for a market correction may be a concern for investors, meanwhile Brexit negotiations continue, creating prolonged political and economic uncertainty in the UK.

The UK domestic economy remains challenged and in the face of political uncertainty we see the possibility of weakness continuing for some time. Unemployment has continued to fall, but with negative real wages acting as a headwind for consumers, and uncertainty potentially causing companies to delay investment decisions, there are clear headwinds to UK growth. We are particularly cautious of those areas exposed to discretionary consumer spending, where we believe the risks are increasing with cost pressures from sterling and the national living wage impacting corporate margins while rising inflation and real wages turning negative is impacting demand for many consumer facing business models. This is a view that we have held for some time now and a number of consumer related profit warnings have reinforced our cautious view.

However, while we are cautious on the outlook for the UK economy, we are positive on the outlook for UK Plc. Economic growth globally remains positive, supported by the US, Europe, Japan, China and Emerging Markets.

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Asia

(compare Asian funds [here](#))

First State Investments, investment managers, Scottish Oriental Smaller Companies Trust: Global economic growth is now relatively strong with the cyclical rebound broadening out into more structural growth over the last year. There seems an increasing consensus that this has peaked but debate here is probably better left to economists. Interest rates remain low for this point in the cycle but a weakening US dollar has allowed Asia's central bankers to maintain accommodative policies which has helped markets rise further.

Europe

(compare European funds [here](#))

Ollie Beckett and Rory Stokes, fund managers, TR European Growth: European smaller companies remain a relatively scarce source of value in an expensive world. Furthermore, the European economic recovery provides a favourable backdrop for earnings growth. There are risks around issues such as the Brexit negotiations and the broader political environment. However, overall, we anticipate that politics will remain a noisy distraction.

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Jack Perry CBE, chairman, European Assets Trust: The fundamentals for European smaller companies look encouraging. The European economy is showing a broad based recovery and companies are reaping the benefits of this, delivering better than expected profit growth. For European smaller companies, with their greater exposure to both the domestic economy and more cyclically sensitive areas, this is potentially a particularly powerful point in the market cycle. Valuations in aggregate do not look unreasonable either.

It would however be sensible to note some areas of caution. Global asset prices have obviously recovered strongly since the economic crisis. While we do not know the extent of the benefit that these assets have had from coordinated central bank actions, it is inevitable that this has played a significant role. We are now at the start of the withdrawal of this liquidity, which must entail some risk. Together with fears of greater inflationary pressure, markets have recently experienced heightened levels of volatility. Additionally, there are areas of the market where valuations do not make sense to us and some assets appear to be driven by speculation rather than improvements in fundamental qualities.

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Sam Cosh, investment manager, F&C European Assets Trust: European equity markets started the New Year strongly reflecting optimism among investors that earnings growth is accelerating. Certainly, the economic outlook is supportive and we would expect European smaller companies to be able to harvest growth better than anyone else. Valuations also look reasonable to us. This optimism has however more recently given way to volatility which appeared to be catalysed by a strong US jobs report that has helped push bond yields higher. Whether this is indicative of a more challenging year for investors is yet to be seen, and, as stock pickers it is not in our DNA to make bold predictions. Some volatility should not really be a great surprise though. We are entering the tenth year since the financial crisis and asset classes across the globe have yielded handsome returns. Some of these returns have been supported by coordinated central bank actions. We are now at the point where this support will start diminishing, and this inevitably brings uncertainty.

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Jupiter European Opportunities: The ECB has indicated that it will reduce its 'quantitative easing' to more normal levels. This is likely to have an adverse effect on equity markets and expose European banks' debt problem. In addition, anti-business sentiment could lead to damaging measures. The European Commission, for example, is toughening its antitrust conditions in a way that is likely to restrict corporate activity.

Global emerging markets

(compare global emerging market funds [here](#))

Austin Forey, manager, JPMorgan Emerging Markets: Why have markets been so strong? The first point to make is that the gains seen in emerging markets since early 2016 came after several years in which corporate profits declined and share prices fell; so of course, there is an element of cyclical recovery at work and that recovery began from low valuation levels. In 2016, valuations rose while underlying profits did not move much; but throughout 2017, we began to see a significantly better outcome, with reported profits growing healthily. Some of this was down to big structural shifts taking place in the corporate world in emerging markets, where many of the same patterns that we see in our own country can be observed; the most obvious is the continuing impact of digital technology on all sorts of industries, including commerce and advertising, in which online models are rapidly displacing more traditional formats. But in the last six months, alongside such structural trends, we have seen a broader upturn in corporate profits which points to an improving underlying economic situation. Although it is hard to generalise about a very diverse group of countries, many emerging markets are experiencing rising economic growth rates, while inflationary pressures are still abating. That has been a good environment for equity prices.

Valuations in emerging markets today are normal rather than extreme. Second, we are really only in the second year of profit recovery; third, currencies do not look horribly over-priced to us. If there are big risks ahead, I suspect they will have more to do with the direction of US interest rates and investor complacency than with most other causes.

But overall, I still see a lot of opportunity; there are always new companies to look at, all the more so now that China's huge and liquid domestic stock market is accessible through the Hong Kong-Shanghai Connect scheme. Emerging markets continue to offer many things that investors of capital should be looking for: growing economies, better demographics in most if not all cases than the developed world and still great scope to improve productivity.

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Mark Hadsley-Chaplin, chairman, Aberdeen Emerging Markets: Strong corporate earnings growth and a marked improvement in sentiment towards the asset class have supported the significant gains seen in emerging markets over the past two years. The asset class has, and continues, to benefit from an improved global macro-economic environment, with recovering growth combined with moderate inflation, healthy trade flows and stable currencies. With emerging market equities trading at reasonable valuations we believe the prospects remain encouraging and the risks of less accommodative global monetary policies, ongoing trade negotiations and a busy political calendar do not undermine the fundamentally positive case for investing in emerging markets.

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The investment managers, Aberdeen Emerging Markets: Emerging economies are benefitting from an improved global macro environment, with recovering growth supported by moderate inflation and healthy trade flows allowing current account positions to improve. This is, in turn, supportive of emerging market currencies, which were, in aggregate, flat in USD terms over the period as measured by the JPM Emerging Market Currency Index.

We expect the on-going broad-based economic and earnings recovery being experienced across our investment universe to continue through 2018 and we take

comfort from the attractive relative valuation of emerging market equities despite their strong performance since 2016.

Major central banks are embarking on a path towards policy normalisation with interest rates expected to rise and central bank balance sheets to shrink over the coming years. While monetary tightening has historically been perceived as a negative for emerging markets, we believe the process will be very gradual and should not disrupt sentiment. Geo-politics will most likely continue to cause occasional market panics but in our experience these bouts of risk aversion are generally short lived and the worst case scenarios seldom materialise. Such was the case following North Korea's missile and nuclear tests in 2017 and the protectionist scare following President Trump's election victory in late 2016. Observers also point to risks emanating from China as a country and economy of ever increasing scale and importance. We believe that President Xi's consolidation of power at the recent party congress should facilitate a continuation of the reform process already embarked upon. We believe that debt levels in China, particularly at the corporate (in-particular state controlled corporate) level remains worrying but are manageable within the confines of a largely closed capital account. On balance, we believe that the risks discussed above should not be ignored but they do not undermine the fundamentally positive case for investing in emerging markets and we would not be surprised to see global allocators increase their allocations to the asset class further during 2018.

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Aberdeen Fund Managers Limited, managers, Aberdeen Frontier Markets: The outlook for frontier markets provides plenty of cause for optimism, in our view.

While corporate earnings rebounded throughout emerging markets in 2017, that is likely to moderate in 2018; meanwhile, earnings across several frontier markets have begun to accelerate, especially in Frontier Africa. In Frontier Asia, we expect another good year for Vietnam and Bangladesh, while Pakistan and Sri Lanka are due a recovery, given both markets now lie in value territory. We anticipate institutional investors will become increasingly interested in the asset class over the coming year, particularly as macroeconomic concerns recede in Africa and economies there return to growth. Furthermore, investors will likely be keen to participate directly in the rise of Asian frontier markets, most notably Vietnam.

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The investment adviser, Gulf Investment Fund: While we are positive about emerging markets, macro-economic risks in China and elsewhere deserve consideration, as do the now less-forgiving valuations. China's financial imbalances continue to loom menacingly. According to EM Advisors, outstanding credit to GDP is about 260% and the system credit/deposit ratio is about 120%. These numbers are high. Furthermore, bottom-up measures of growth in China are slowing and, we believe, are now below 5% on an annualised basis. Any renewed debt stimulus to boost this number would add to our concerns.

The Investment Adviser believes that GCC markets are an attractive long-term investment opportunity. Governments in the GCC are expanding their non-oil sectors with infrastructure development and investment in the social sectors.

The Investment Adviser has identified the following key themes for investment in GCC.

- **Banks:** The GCC banking sector tends to enjoy strong asset quality and capitalisation, along with government support and growth from infrastructure investments.

- **Real Estate & Housing Finance:** Rising population and an undersupplied residential market in most of the GCC countries is expected to create robust demand for residential construction and housing finance.
- **Healthcare & Education:** Shortage of medical services and education will continue to create a need for government spending on social development and these sectors have seen high allocations in recent government budgets.
- **Tourism:** Governments in the GCC are promoting their countries as tourist destinations. Tourism should drive demand for hospitality, travel and infrastructure sectors and create employment.
- **Retail:** Rising population, high spending power and increasing tourism should create opportunities for retail businesses.
- **Industrials:** The petrochemical sector contributed c.30 per cent to GDP in 2014 making it a key non-oil GCC export sector. The world petrochemical market is poised to grow at 8.8 per cent annually until 2022.
- **Localisation and Privatisation:** GCC countries are encouraging the transfer of knowledge and technology, and creating opportunities in manufacturing, maintenance, repair, research and development. Localization of business activity will be achieved through direct investments and strategic partnerships with leading sector companies. Privatization can improve productivity and the quality of services in education, healthcare, transportation and utilities.

Several GCC markets have been upgraded to emerging market from frontier market status in recent months. Across the region governments are seeking to encourage foreign investment. The privatisation of public assets, easing of foreign ownership restrictions and more transparency should accelerate the upgrade of further GCC markets over the next years.

GCC nations are diversifying away from oil and gas. The US\$100 billion Aramco IPO forms the centrepiece of the Saudi non-oil diversification reforms alongside the US\$500 billion plan to develop the NEOM business and industrial zone linking with Jordan and Egypt. The UAE plans to invest US\$163 billion on renewable energy projects. Qatar is expected to spend over US\$200 billion (from 2015 to 2021) on projects ahead of the FIFA World Cup 2022. As part of the Kuwait Development Plan (KDP), the nation plans to spend around US\$160 billion over 500 projects, including infrastructure, utilities and housing investments. Oman plans to invest about US\$35 billion on tourism related projects, which is expected to double visitor numbers by 2040.

GCC countries, historically used to large fiscal surpluses, have tightened their belts in recent years following oil price falls. As a result, non-oil growth has started to be impacted. Recent higher oil prices have provided more budget flexibility and as a result non-oil growth is expected to have increased to 2.6 per cent in 2017, from 1.8 per cent in 2016.

Most gulf economies continue to focus on education and healthcare. Saudi Arabia has allocated 40 per cent of its budget to these sectors, a trend seen across the GCC.

The International Monetary Fund (IMF) expects the GCC to have a current account surplus in 2017 as oil prices recover. Saudi Arabia's shortfall reached 9 per cent of GDP in 2015 but is expected to record a surplus of 0.6 per cent in 2017.

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Commodities and natural resources

(compare commodities and natural resources funds [here](#))

Ian Cockerill, chairman, BlackRock World Mining: This year looks set to be another year of synchronised global economic growth, an environment where commodities generally perform well. We believe the recovery in mined commodity prices, which started in early 2016, is set to continue with another strong year for cash generation and significant earnings upgrades. The sector is also still trading at a material valuation discount to broader equity markets. Key to this positive outlook is that mining companies continue their recent focus on capital discipline, as high levels of free cash flow will then translate into further balance sheet strengthening, returns on capital and shareholder distributions, rather than increased capacity.

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Evy Hambro and Olivia Markham, managers, BlackRock World Mining:

The year started with a range of unnerving risks that could easily have upset the supportive global growth environment. The outlook for elections in Europe was particularly worrying after the surprise Brexit vote in 2016. Increasing popularity of the anti-EU momentum across Europe presented risks that there would be another surprise result in the forthcoming elections in Germany, France and Holland. Thankfully, these all passed without such a result and growth across Europe has significantly surprised to the upside.

In Asia, North Korea fired numerous missiles during the year, but the situation seemed to cool down in the second half of 2017 on the back of additional sanctions put in place by the United Nations. Another risk was the 19th National Congress of the Communist Party of China during October. This event could have seen a change in direction for the country, but it actually cemented the power and agenda of President Xi which should be supportive for economic stability, further growth and an enlarged reform agenda. It is important that shareholders understand the impact that these reforms have had on the commodity market. Huge falls in fixed asset investment into new materials supply, as well as closures of existing capacity, have seen the role of China in commodity markets evolve over the last 18 months. As capacity has been closed, China has moved from being a net supplier to a net importer in some metals which has tightened up seaborne trade and in turn lifted prices. Other reforms have seen China adjust the quality of commodities that consumers can use so that they are able to meet new environmental limits on pollution. With these reforms set to stay in place and in all likelihood stricter ones to come, it bodes well for China to act not just as a leader for demand but also as a support on the supply side.

In the US, economic growth again beat expectations as President Trump managed to garner support for his tax reform programme. The changes bode well for inward investment into the US economy as companies take advantage of the ability to 'onshore' foreign cash at a lower tax rate.

With the global economic backdrop so supportive to commodity demand, the move higher in commodity prices has been assisted by both a weaker than expected US dollar and the five-year trend of underinvestment into new capacity by producers. During the year, base metal prices rose significantly with most up between 20% and 35%. On the other hand, precious metal prices have been pedestrian by comparison (apart from palladium which is up by 56%). Bulk commodity prices have continued to be range bound but at very profitable levels for the producers.

After the strong rally in 2016, our main fear had been that management teams would use the recovery to start allocating capital to new growth projects just when demand

and supply were moving back into equilibrium. Thankfully this has not happened, and it has been pleasing to see the continued discipline deployed by the companies. Most have continued to pay off debt and complete portfolio simplification, which has allowed them to increase dividends with some even buying back shares. Despite this, the sector has traded all year at a significant discount to historic multiples and it seems that there is a lack of investor confidence in the sustainability of the recovery due to fears that capital discipline will be temporary. With most investors still on the side-lines, this bodes well for the chance of a rotation back into the sector during 2018.

BASE METALS

It was another strong year for base metals, with improving fundamentals from both the demand and supply side of the equation. A key feature of commodity markets in 2017 has been China's influence on supply via its reform programme, as well as its edict to improve environmental standards across the country.

This supported a number of the base metals particularly during the second half of the year, which combined with the sector's lack of investment into new supply, sees well supported markets for the base metals, in particular copper, over the medium-term.

The flagship base metal, copper, continued its upward momentum in 2017 increasing by 30.5% year-on-year. Supply side disruptions dominated the market during the first half of the year, resulting in the first fall in mined copper output for many years. While we see production growth returning, which should result in a broadly stable copper market in 2018, this year sees the last of the copper megaprojects being commissioned that were committed to during the previous cycle. The supply-driven copper deficit which has been 'three years away' for much of the past five years, is now only 18-24 months away from impact.

Last year's darling of the base metals, zinc, continued its strong run in 2017 rising by 30.5%, with the average price increasing by 38.2% year-on-year.

Zinc's price gains over the past two years have been spectacular with the price rallying from US\$1,568/t at the beginning of 2016 to US\$3,319/t by the end of 2017. Falling mine supply, increased environmental standards across Chinese domestic capacity and Glencore's curtailment of capacity in 2015, has materially tightened the market, with inventories today at their lowest level since mid-2008 at just under seven days of global zinc consumption. The market continues to look tight into 2018, even after Glencore confirmed it will restart its Lady Loretta mine and bring back 160ktpa of zinc by 2019.

The Chinese Government's push to rationalise the aluminium industry via its supply-side reform programme saw it become the best performing base metal in 2017, up 32.4% year-on-year. While the demand outlook for aluminium has been very strong in recent years, rapid growth in Chinese supply has left the market in oversupply. China's supply-side reform programme, has seen 4.5mtpa of 'illegal' capacity closed this year, with strict requirements around the amount of new capacity that will be allowed to come online in 2018. This is likely to see lower aluminium exports from China, which over the medium-term, may require the restart of ex-China capacity.

Finally, nickel enjoyed a strong run during the second half of 2017 following the market's excitement around the potential for higher demand via electric vehicles (EV). While we see battery chemistry shifting over time to a higher nickel content, the EV story is unlikely to impact nickel for a number of years, with the near-term price to be driven by the cost of making nickel pig iron (NPI) in China.

GOLD & PRECIOUS METALS

Gold has been remarkably stable over the past couple of years with the average gold and silver price flat year-on-year. This range bound commodity environment saw a

muted performance by the equities over the course of the year, with the FTSE Gold Mines Index up by 0.6% (GBP terms). Although 2017 has been a positive one for gold finishing up 12.6% to US\$1,303/oz, it has underperformed the base metals and bulk commodities and the Company has run a relative underweight to precious metals during the year.

Two opposing forces have largely driven the gold price in 2017 - on the one hand, a normalisation of Quantitative Easing (QE) with the US Federal Reserve (the Fed) moving to Quantitative Tightening and raising rates, offset by weakness in the US dollar and building inflationary pressures with the improving industrial outlook. As we saw in 2016, geopolitics are having an increasing influence on the gold price, with the price rallying ahead of European elections at the beginning of the year, building tensions in the Middle East in the second half, and the ongoing threat of a nuclear missile launch from North Korea.

While the QE era which has supported gold prices since the Global Financial Crisis is now coming to a close and likely to act as a headwind to gold, we would argue this is largely factored into today's price. Key for gold in 2018 will be the pace at which the Fed raise rates and whether or not they choose to remain behind the curve.

Turning to the fundamentals, the outlook for mine supply continues to deteriorate with the World Gold Council forecasting a decline in supply from 2019. The industry's lack of investment in exploration in recent years has seen the average reserve life of the industry decline to 12 years, the lowest level in five years. The industry's need to replenish reserves remains ever present, supporting our preference for high quality, longer life producers with resource bases sufficient to replace reserves that are mined each year. From a demand perspective, demand from jewellery, central banks and bars/coins is running below its five-year average; however, demand from Exchange Traded Funds (ETFs) i.e. investment demand, is running above trend with net inflows of 6.5Moz into Gold ETFs in 2017, although below the 15Moz in 2016.

Gold equities as measured by the FTSE Gold Mines Index returned 0.6% (GBP terms) for the year, underperforming the industrial miners.

BULK COMMODITIES

The biggest beneficiary of China's supply-side reform programme in 2017 has been the global steel industry. Significant cuts to blast furnace and induction furnace capacity has seen both prices and margins improve, with steel producers chasing productivity to maximise output. This has played into the hands of companies producing high-grade iron ore and metallurgical coking coal.

One of the most interesting features of the iron ore market this year has been the widening of the discount between lower quality (58% Fe grade) and higher quality (65% Fe grade) iron ore. This spread has widened significantly over the last 12 months, driven by steel producers' desire to maximise productivity. The debate in the market has centred on whether this widening is cyclical or structural. While the high level of steel mill profitability suggests part of the discount is cyclical, we see a greater proportion of it as structural, with China continuing to limit steel capacity, as well as improve environmental standards (benefiting higher grade material).

Despite record cash generation, we have been particularly encouraged by the discipline shown by the major iron ore producers during the year who remain focused on maximising value over volume. With average iron ore prices increasing by 20% year-on-year, we have seen substantial earnings upgrades for the producers underpinning material dividend increases for companies such as BHP and Rio Tinto.

Improved profitability across the steel industry has also benefited metallurgical (met) coal with average prices up by 32% year-on-year. In recent years there has been significant volatility in the met coal price largely due to weather events in Australia.

The spot met coal price has traded significantly above the cost curve during 2017 in order to incentivise every available tonne to the market. China's crackdown on pollution has seen Chinese coke production reduced, with steel producers being forced to import greater amounts of metallurgical coal hence bidding up prices. This has resulted in very strong margins for the producers such as Teck Resources. Disappointingly, the market's uncertainty over the medium-term price for the commodity, has seen the shares fail to reflect the current high levels of cash generation in the business. As the company continues to generate strong levels of cash, allowing them to deleverage and increase returns to shareholders, we remain optimistic on the outlook for the company in 2018.

Finally, on thermal coal, the market continues to remain tight with the average spot price increasing by 34% year-on-year. Strong industrial production with power generation up across all key Asian economies has underpinned high demand, with the supply side tightening following China's domestic supply cuts in 2016 which have effectively put a floor under prices. While we are cognisant of the long-term challenges to demand, near-term the market looks well supported with consensus thermal coal prices significantly below current levels.

BATTERY MATERIALS

Few industries have the potential to change as much as the automotive in the next ten years. Evidence for the rise of the electrified vehicle appears to have reached critical mass in terms of consumer preference, government incentive and technological capability. Targets for EV penetration were raised throughout 2017 by companies, industry experts and financial market participants. Adoption rates of EVs are far from certain, but the winds of change are being felt and market participants now believe around 10% penetration, or 10mil EVs, is now achievable by 2025. The first Tesla Model 3, the poster child for an affordable, desirable EV, rolled off the production line in July.

The lithium-ion battery and the metals it uses including lithium, cobalt and nickel, are at the centre of this trend. Increases in demand for these metals is widely anticipated and this means new mines must be incentivised through higher prices

The LME spot price for cobalt is up 130%. In addition, in 2017 the lithium price rose 5% to RMB171,000/t for lithium carbonate.

The outlook for 2018 is once again promising. The consensus forecast for global economic growth is 3.7% and, with a lack of investment into new capacity combining with the supply side reform agenda in China, it looks as though commodity prices should remain at levels that allow producers to generate strong margins. We are, however, aware that nothing is constant and that costs are likely to rise as inflation in some areas of the operating base looks set to increase. Our expectation is that the impact on margins can be minimised by further productivity gains, or prices remaining around current levels allowing the companies to generate significant amounts of free cash.

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Riverstone Energy: Oil prices have spent most of the past two years oscillating in a range of \$40 to \$55 per barrel. However, prices finally broke above \$60 per barrel in the second half of 2017 as the market rebalanced. This is due to five consecutive years of strong global oil demand growth, high OPEC compliance levels and various supply disruptions.

The oil market spent much of early 2017 seeking equilibrium. However, steadily improving fundamentals became clearer through the second half as oversupplied inventories began to decline and revert towards their five year average. Drilling activity in U.S. basins, as measured by oil rigs, slightly declined over the same period.

Meanwhile, geopolitical risk remains ever-present, with potential disruptions to supply from Venezuela and Iran, as well as ongoing tensions in Saudi Arabia, Northern Iraq and elsewhere in the Middle East. Prices have shifted to reflect these bullish developments, with prompt prices rallying and pushing the forward curve into backwardation. While this has helped improve market sentiment, energy equities have not experienced the same level of uplift as many fund managers have remained underweight on the sector.

While there is little doubt that higher prices will incentivise additional drilling and producer hedging, one of the key questions hanging over the market in 2018 is whether E&P companies will prove disciplined by focusing on returns, or ramp-up production. This ability for North American producers to "turn on the shale tap" has continually weighed on the market as prices have increased. However, there are some signs that U.S. oil production may be more restrained than the market expects. One potential obstacle is the exhaustion of "core" drilling locations in North America's more mature shale plays, such as the Eagle Ford and Bakken. This is a result of both the extensive drilling that has occurred in these basins and the "high-grading" of prospects towards the most economic acreage as oil prices collapsed. In addition, there have been no new substantial resource plays to augment the loss of core drilling locations and the inherent declines from existing wells. As a result, the trajectory for North American oil production may depend on whether improvements in drilling and completion technology can offset geological constraints.

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Debt

(compare debt funds [here](#))

CVC Credit Partners European Opportunities

Looking towards 2018, the market anticipates that the global recovery will be on-going for an extended period. There also appears to be scope for the strengthening to broaden further across Europe and emerging markets. Macroeconomic risks across these regions have receded and there is upside potential if productivity picks up alongside trade and investment.

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Financials

(compare specialist financials funds [here](#))

Tetragon: Active investing requires considering fundamentals relative to asset prices. At times, asset prices are so disconnected from fundamentals – often when asset prices are distressed – that investors are offered a highly attractive risk/reward opportunity and capital deployment decisions become easier. Notwithstanding rising asset prices, this does not seem to be one of those times. Applying a range of valuation metrics, we seem to be in the upper ranges of historic asset prices – Robert Shiller's analysis of U.S. equity prices, for example, submits that the S&P is trading at about a 100% premium to the long-run median. However, there are several reasons to believe that global fundamentals will continue to improve, and as a result, that asset prices (while perhaps stretched) may continue to rise. On the other hand, valuations may be so high that prospective returns in global markets may be modest or negative even if corporate earnings continue to grow.

In the current environment, there are a number of aspects to CLO equity which we find attractive. First, with reasonable near-term expectations of higher interest rates, CLO equity provides investors with relatively short duration, and therefore less sensitivity to potentially rising interest rates. Additionally, CLO equity provides investors with optionality on spread widening. With fixed liabilities and floating-rate assets, CLO equity can benefit from spread widening, provided loan defaults are well-managed.

The economic recovery in Europe still remains a few years behind that of the United States, with margins in Europe having room to expand further and with an increasingly stable political background.

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Robert Kyprianou, chairman, Polar Capital Global Financials: Conversations with shareholders and investors over the past year indicate that sentiment towards the sector has become more balanced and constructive. Markets are beginning to acknowledge that the toxic mix of poor behaviours, extreme leverage, excessive risk taking, lax regulation and insufficient capital that characterised the sector are being steadily and - in our view - structurally remediated.

The banking sector in the developed world has clearly been at the forefront of these difficulties and has been leading the rehabilitation. In general bank gearing has fallen considerably, operational efficiency has improved, risk hungry activities have been downsized or removed, governance and regulation strengthened and capital rebuilt to the point where capital is being returned to shareholders in some cases. This has been achieved at the same time as banks have had to deal with severe regulatory sanctions in the form of eye-watering fines, as well as a background of declining, low and, in some cases, negative interest rates.

The regulatory agenda shows little sign of easing up. IFRS 9 and MIFID II are realities in 2018; too-big-to-fail regulatory reform through MREL/ TLAC will require action; and Basel IV is under discussion again. However, it is now clear that the use of penal regulatory fines to moderate behaviours has passed its peak, and that the enactment of new laws and regulations is more sensitive to the imperative of a recovering and healthy banking system. In the US, banks are expected to be a policy beneficiary from cuts in the corporate tax rate and from the impact on growth, interest rates and loan demand.

Encouragingly, investors and analysts are talking again about growth in earnings. After a long period of low to modest growth, the global economic outlook is looking more propitious. Accordingly the interest rate trend appears more constructive for bank earnings than at any time in the past 10 years. The reduction in non-performing loans ("NPLs") has been a positive driver for US banks. Better resolution and provisioning capacity for NPLs is now in prospect in Europe as well. At the same time global capital market performance will flow to the bottom lines of asset managers and the balance sheets of insurance companies.

Further stress tests for banks lie ahead. However, there is a growing view that these may result in positive surprises. Overall, the headlines for financials are increasingly likely to refer to higher pay outs to shareholders, further share buybacks and growth in underlying earnings.

Memories of the 2007-08 financial crisis are long. For this reason, (we) believe that the better outlook for financials is not fully reflected in valuations as the sector continues to carry a legacy risk premium.

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Nick Brind and John Yakas, managers, Polar Capital Global Financials: While the sector's performance has picked up in recent months, it remains very reliant on

the outlook for economic growth and therefore interest rates. This stronger performance has also been driven partly by the expectation of US tax reform being enacted and the consequent earnings benefit that US financials will derive from the legislation. The potential for secondary benefits, for example stronger loan and fee income growth, are harder to quantify but expectations appear to remain low.

In the US, net interest margins of banks, the difference between what they earn on loans and pay for deposits and other funding, have risen following the recent increase in US interest rates. Similarly, European banks have highlighted the sensitivity of their earnings to any increase in Eurozone interest rates. Their performance over the last 18 months in part reflects that with expectations for interest rates having been so low. Not all European banks are beneficiaries of rising interest rates but, as with Japanese banks, any change in outlook will have a large impact given such low expectations and valuations.

Outside of selective pockets of weakness in auto lending and credit cards in the US and state/corporate lenders in India, asset quality remains very benign globally. Banks have consistently surprised by putting aside less in provisions to cover loan losses than had been expected, reflecting the relatively benign economic environment. In the short-term, the only area of concern, as highlighted earlier, is that some banks are expected to raise coverage ratios and accelerate the process of reducing bad debts.

New accounting rules (IFRS9) will force banks to take higher provisions for all loans starting in 2018, but these are not expected to be material for the large majority of banks and the capital impact will be phased in (and back-loaded) over a number of years. However, it does mean that earnings for banks will be more volatile in the future as banks are forced to provision earlier when they see evidence of a slowdown but conversely write back these same provisions more quickly as economic growth picks up.

With respect to regulation, the oversight body of the Basel Committee on Banking Supervision was meant to meet in January 2017 to announce final proposals on capital requirements for the banking sector, so-called Basel IV. However, the meeting was postponed several times on the back of US and European regulators being unable to come to an agreement. At the beginning of December agreement was finally struck following a compromise. While European banks will see an increase in capital requirements, it was marginally better than expected and within most banks' capital plans, with significant discretion for national regulators. A number of banks have held back from returning surplus capital in the last couple of years because of the lack of clarity on capital requirements, so this should result in an increase in dividends and/or buybacks from banks in 2018.

For the most part the risk of further significant regulation in the sector has decreased, albeit MiFID II (Market in Financial Instruments Directive) regulation that came into effect in January 2018 for the asset management, wealth management and investment banking sectors has caused significant disruptions. In the US, the Trump administration's appointees for heads of key regulatory bodies are seen as more market friendly and there is bi-partisan support for reducing the regulatory burden for smaller and mid-sized banks. US banks have already been able to return more capital to shareholders, in some cases with payout ratios exceeding their earnings and this is expected to continue.

There has been a sharp fall in the yields of banks' AT1 securities (bonds that can be written down or converted into equity even while a bank is still solvent to reduce the need for state support) which should be very positive for the sector as they can be seen as a proxy for cost of equity. As yet equity analysts and the wider market do not appear to factor in the price at which credit markets are willing to lend to the banking

sector in their analysis despite the fundamental change in how the sector is viewed by credit markets, although some of this undoubtedly reflects the chase for yield.

There have been exceptions, with Banco Popular being the standout and one in which we did not have any exposure. Its shares and bonds were effectively written down to zero, following the announcement of its resolution and takeover by Banco Santander following months of speculation about the weakness of its balance sheet. The credit markets shrugged this off unlike in early 2016 when concerns about Deutsche Bank led to a sharp correction.

Technology will have a growing impact on the financial sector and is already impacting materially areas such as payments and remittances. The biggest expected future impact will be in the retail parts of the banking and insurance businesses. Nevertheless, there are diverse views from those who believe that many of the incumbents will be too slow to react, or their legacy IT systems will make it prohibitively expensive to do so, to those who point out, for example, that it is more common to divorce than change one's bank account. To date few balance sheet-driven "FinTech" models have proven to be successful as they have focused on the periphery, higher risk borrowers.

In 2018, PSD2 (EU Payment Services Directive) and Open Banking, in the UK, come into effect. This forces banks to provide access to customers' accounts and allow payments to third-parties where permission has been given. In the US, similar rules have so far had little impact but the risk remains of the banking sector being disintermediated as well as the potential impact to price competition as it should be easier for people to move bank account (disrupting the old model of free current accounts being used to upsell other products).

Nevertheless, those banks or insurers unable to invest the sums needed in their IT systems are likely to lose market share unless they have a cost structure lower than peers or their competitive edge is from operating in niche or specialist markets. In the US the largest banks are investing so much more than their smaller peers that it will likely force a wave of merger and acquisition activity as regional banks try and compete with the behemoths of the industry.

FinTech should not be perceived only as a one way street against the incumbents since there will be material cost benefits ahead as digital banking becomes the predominant means of transacting and so making large and expensive branch networks more redundant. Furthermore new technology driven financial companies currently have a regulatory advantage (i.e. they are less regulated than banks) which we expect will narrow. The growth and volatility of crypto-currencies (such as Bitcoin) and fears as to regulatory control of the financial sector are only likely to increase going forward and we have already seen some countries (such as China, which is arguably one of the most evolved FinTech markets) tighten regulations for on-line platforms.

Looking forward, it can be seen that regulatory and technological changes are leading to profound changes to the sector. In the short-term the impact of technology has been limited and the main drivers remain the outlook for economic growth and interest rates. While the sector has performed well, arguably far better than many would have believed a few years ago, its recovery relative to the underlying equity market remains limited.

The sector continues to offer considerable value, especially in Europe, where the overhang from regulation and litigation following the financial crisis is fading and the debate has moved on to the timing and pace of policy normalisation. These factors combined with the ability for banks, where our largest exposure lies, to sustain an attractive level of capital return, as well as other opportunities across the sector, underpin our confidence for a continued recovery

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Infrastructure

(compare infrastructure funds [here](#))

Geoffrey Burns, chairman, Premier Global Infrastructure: The infrastructure sector underperformed wider equity markets in 2017. Global equity markets continued to set new highs, and it is perhaps unsurprising that a defensive asset class such as infrastructure, and especially the utility segment, should lag behind.

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Investment managers, Premier Global Infrastructure:we are optimistic for prospects in 2018.

We continue to see increased earnings, particularly in many of the emerging markets, which trade at modest valuation levels.

UK and US utilities lost ground toward the end of 2017 and into 2018 as markets sold down stocks with valuations deemed to be more sensitive to movements in interest rates, so called “bond proxies”. Markets tend to include regulated utilities in this category. This, we believe, has created an investment opportunity. Markets have failed to recognise that in the medium to long term regulated utilities can actually benefit from higher interest rates, as their allowed returns are set partly by reference to interest rates, and higher rates therefore produce higher returns for investors over time.

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Private equity

(compare private equity funds [here](#))

Pantheon International: During 2017, the private equity industry hit a high point in terms of fundraising, investment opportunities, distributions and investor interest. Against a backdrop of global economic recovery, despite continued geopolitical risk and policy uncertainty, valuations remained high across a wide range of asset classes, including private equity.

The global economy performed well in 2017, driven by robust consumer spending across major industrialised countries. Most emerging economies and some resource-intensive developed countries (Australia and Canada, for example) also enjoyed better economic performance due to increased commodity prices. However, wage growth remains subdued and growth in average household incomes was minimal. In 2017, politics continued to dominate the news with important elections in the UK, France and Germany, and rising tensions related to North Korea.

Moreover, the question of how major Central Banks will gradually change course towards a more normal path for monetary policy and interest rates creates an uncertain outlook for financial markets over the next few years. The process of normalising monetary policy following the Global Financial Crisis has only just begun, and is likely to commence at different times and occur at different speeds in major developed countries.

Regional outlook

The US economy experienced stronger than expected growth in 2017 accompanied by a fall in unemployment and a boost in consumer confidence. In addition, as the year closed, the Senate approved the US administration's sweeping tax reforms. The reduction in corporation tax is designed to stimulate activity, therefore boosting the US economy, and should be helpful for private equity. It is too early to judge how the restrictions on the tax deductibility for interest expenses will impact private equity in the US.

In Europe, economic growth has generally surpassed expectations during the year and analysts have marked up their forecasts for many of the Eurozone economies. However, caution over Brexit has seen below trend levels of activity in the UK.

Economic growth was widespread across Asia during the year. China continued its campaign to achieve sustainable growth and to steer the economy away from relying on cheap debt, which analysts predict will result in a gradual slowdown in 2018. However, the Chinese consumer sector, a key area of focus for Pantheon, along with healthcare and education, remains attractive as it benefits from the uptick in global growth and the resulting trade boom. Structural reform was high on the agenda in India with the introduction of an important goods and services tax and a bankruptcy law. The path to reform and recovery was less straightforward in Latin America.

High levels of primary capital fundraising and steady deal activity in 2017

In 2017 fundraising continued apace across the US and Europe. However, it was challenging in Asia with the exception of a few managers at the large end of the market where record-sized funds were raised.

Deal activity has remained steady over the past year and has been reasonably consistent with the prior few years. Managers are deploying capital more cautiously as a result of the highly priced environment, particularly across the US and Europe. Overall, exit activity has held up well although strategic buyers in the US have been slightly more cautious as they waited for clarity on the outcome of some of the major legislative reforms relating to healthcare and taxation.

Concern has risen over the levels of "dry powder" in the market but it should be noted that a significant proportion of new capital raised last year was committed to the large multibillion dollar and euro funds. Nevertheless, the deployment pace in the mid-market is commensurate with investment periods in the underlying funds of four to five years. Dry powder has grown the fastest in North America and Asia.

A record volume of deals in the secondary market

The global secondary market was extremely active in 2017. A record volume of deals were transacted during the year, with a number of market participants estimating \$50bn of transacted deal volume. During the year, the market has seen a full range of deal flow and transaction types: large diversified portfolios; large, concentrated fund positions; structured transactions involving combinations of funds and individual company assets; and GP-led end-of-fund liquidity solutions including tender offers, fund preferred capital investments and fund restructurings

Secondaries are attractive given the opportunity to deploy capital and the potential to mitigate the J-curve. Market estimates indicate that after a healthy fundraising year, available dry powder is equivalent to around two years supply of deal flow, suggesting that the market remains broadly in equilibrium despite a higher priced environment.

The co-investment market is flourishing. A variety of institutional participants such as sovereign wealth funds, pension funds, family offices and professional fund investors have expressed a continuing appetite for co-investment participation from their private

equity managers, many of whom now utilise this form of flexible capital quite systematically.

Despite the political uncertainty during 2017, public markets continued their upward march and private equity valuations increased in tandem, particularly in the US and Europe. Low interest rates with the risk of high volatility have become the norm and the search for higher returns has made private markets increasingly attractive for investors with a longer timeframe.

History suggests that investors acquiring public equity securities at such high prices as currently prevail face a greater probability of low or even negative real returns over the long run. Private equity investors are similarly affected since valuations for private businesses are determined to a large degree by comparing them with similar companies listed in public markets. However, lower interest rates are providing strong support for private equity with debt markets being very favourable, with loose covenants on new borrowing.

At the same time, the pressure on private equity fund managers to deploy capital is high given buoyant fundraising and correspondingly large amounts of dry powder. Competition for deals is therefore high and both the volume and pricing of deals in private markets have increased.

Summary and outlook

We can say with a growing degree of conviction that as market valuations have become more disconnected from their appropriate risk premiums, the chances of a significant correction occurring have increased markedly. In early 2018, the indications are that such a market correction may have started to occur. The private equity ownership model focuses on acquiring active, control positions that are aligned with long-term value creation. Managers are able to hold companies for a long time and are not under pressure to sell them. Therefore they can react to market conditions, continue to build value in their portfolio companies and wait for a more favourable exit environment if necessary.

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Property

(compare UK property funds [here](#))

Derwent London: London and UK economic growth has slowed since the EU referendum result but overall the outcome has been better than initially expected. Looking forward, most estimates predict ongoing low levels of UK GDP growth in the next couple of years in the order of 1.0% to 1.7% pa, as Brexit and political uncertainty continue to weigh on business decisions. We have seen the first increase in base rates in over 10 years when the Bank of England raised them 0.25% to 0.5% and stated that it expected to continue to move these up gradually over a number of years as the economy recovers.

Continuing economic expansion has seen central London office take-up remain good with CBRE estimating that 13.2m sq ft of space was let in 2017, which was an increase of 7% on 2016. This was in excess of the long-term average but below the recent trend. The West End remained strong with 4.8m sq ft of lettings, the highest level since 2007.

A notable feature last year was the amount of space taken by the serviced office providers in total 16.5% of total market activity. Technology and working practices will

mean that going forward the serviced office sector will continue to have an important position in the London office market.

The overall vacancy rate rose from 4.1% to 4.7%, and the West End by a lesser amount from 3.3% to 3.7%. Vacancy rates have risen now for two years but still remain below long-term average levels. JLL is estimating current office demand at 12.5m sq ft, which is lower than last year and the long term trend, but active demand of 9.6m sq ft is at its highest level since June 2016.

New office supply of 5.7m sq ft was delivered in 2017, which was 20% lower than predicted one year ago. There is currently c.12m sq ft under construction for completion in the next three years. Given that 47% of the space under construction is pre-let, available new space for delivery in the next three years remains at c.6m sq ft or under 3% of the total market. The West End has only 1.1m sq ft or c.1% of the local market stock under construction that is available.

CBRE estimates prime central London office rents fell 2.9% in 2017, the first fall in almost seven years. However the performance varied by location. The West End was weakest, down 4.5% led by Mayfair & St James's and Victoria, but rental levels stabilised here in the second half of the year. At the same time, Fitzrovia and Paddington, where we have substantial interests, saw rents rise by over 3%. GVA estimates that rental incentives have increased to about 20% of headline rent from 15% in most central London locations during 2017. Given the short term outlook for supply and demand, we would expect a similar mixed pattern for 2018 with headline rents continuing to drift but certain markets, particularly those impacted by Crossrail, performing better.

Investment activity rose 26% last year to GBP16.4bn reversing three years of decreases, but all of the last six years have witnessed very liquid markets with significant foreign investment. Two high profile City deals, each over GBP1bn and at substantial premiums, took the 2017 headlines and stimulated increased second half supply, as other investors tested the market appetite. Despite widespread demand not all these properties have found buyers but, as there appears limited financial pressure on vendors to sell and there is a lack of income-producing alternatives, we expect to see values remain broadly stable in 2018. Recent reports continue to highlight significant investor appetite from the same regions that were active last year.

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Hammerson: The retail property market is affected by a number of structural trends.

- **Multichannel retail:** Consumers increasingly use instore and online channels in various combinations for their retail journey, leading to 'multichannel' retail journeys. The store remains the cornerstone of the retail journey. Our survey confirms that retailers measure the productivity of stores based on 'total sales' combining instore and online. Therefore, the role of the store is evolving with an emphasis on showcasing products, providing service and fulfilling click & collect.
- **Retailer and brand preferences:** There is growing demand from retailers for stores in large, higher-footfall locations. Retailers prefer to be clustered together in the same locations to optimise their interaction with customers. Consumer brands are taking space to directly control the brand experience with their end customers. This drives a convergence by retailers and brands towards the same leading locations driving higher rental growth.
- **Enhanced consumer experience:** Successful retail destinations provide customers with a mix of shopping, dining and leisure; retail may not be the primary driver for a visit. These destinations create an experience which attracts more customers and encourages them to stay longer.

- **Frictionless retail:** Time-short lifestyles and multichannel retail increase expectations for faster access to goods and services. Retail locations which are well-connected to transport links, make it easy to identify and locate items, and offer convenience are performing well.
- **Global shopping tourism:** The level of global tourism is increasing, driven by growth of the middle-income demographic in emerging economies and falling travel costs. Shopping is increasingly being enjoyed by these international tourists as part of a travel experience.

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Vikram Lall, chairman, F&C UK Real Estate: Although there were some signs of progress in the EU negotiations as the period drew to a close, the outlook continues to be dominated by Brexit considerations and wider political uncertainty. Interest rates were raised during this reporting period and the timing and magnitude of further increases is also likely to be a consideration for property investors moving forward. Within property, performance has been buoyed by investment, especially from overseas, but the impact of proposed new tax regulations on foreign buyers in 2019, if implemented, is unclear. The economy is recording positive, if modest, growth, which is expected to persist on consensus forecasts. Sentiment is adjusting to the changed political and economic environment, however, our outlook on the market remains cautious.

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AEW UK Investment Management LLP, managers, AEW Long Lease REIT: December 2017's inflation rate, measured by the Consumer Price Index stood at 2.7%, slightly down from the 2.8% in November. Inflation has picked up over the course of the year amid a drop in pound sterling resulting in import costs linked inflation. We expect inflation to gradually move towards the Bank of England target rate of 2% in the period 2018-2019.

UK GDP growth for 2018 might be upgraded from the current 1.5% forecast, after Q4 came in above expectations at 0.5% to lift actual full year 2017 growth to 1.8%. Despite the agreement before year end on a two-year transition, further delays in the Brexit transition negotiations are likely on the back of internal government disagreements further prolonging the uncertainty for businesses. With the pound sterling reversing most of its weak post-Brexit run against the US dollar and oil prices expected to stabilise, inflation is projected to moderate from its recent five-year record level in 2018. The UK labour market remains strong with unemployment at a more than 40-year low of 4.3%, after 102,000 jobs were added in the three months to November 2017. Annual pay growth ticked up in October to 2.3%, but with higher inflation real pay still fell over the year. As a result, consumer spending remains under pressure, which resulted in an unexpected 1.5% decline in retail sales in December 2017. Despite this monthly decline, UK retail sales for the full year 2017 were still up 1.9%. However, this represents a four-year low in growth.

As a result of stronger than expected growth in the US and the recent bond and stock market volatility, there is now an increased consensus expectation that the Bank of England's Monetary Policy Committee will adopt a more hawkish tone in its upcoming February meeting. Still it is expected to keep rates flat. After raising its base rate in November 2017 for the first time in over 10 years, policy rates are now expected to stay flat for 2018, as GDP growth is forecast to slow during 2018 and 2019 to 1.5% and 1.6%, respectively. Over the longer term, UK GDP growth for 2020-2022 has been downward adjusted to 1.9% pa, assuming that its government will successfully negotiate its two-year transition, final separation and ultimately a free-trade agreement with the EU.

UK Real Estate Outlook

The UK property market continues to show healthy spreads over 10 year government bond yields, both in absolute terms and relative to other markets, at 200bps in London and 300bps elsewhere in the country, such as in Manchester and Birmingham. However, we are monitoring inflation and interest closely as they will ultimately impact the relative pricing of property. Widening yield curve and therefore lower yield premium are expected going forward, albeit not in the short term. For "traditional property", we are a long way through the cycle and property is still in the advantageous position of offering one of the highest yields from traditional asset classes and the yield gap is relatively high. In our view a key risk is that many investors might not recognise that this is more because fixed-income yields are expensive and unattractive, rather than because property yields are cheap on a historical basis. Any future rise in interest rates could see the yield gap start to close and relative value investors reduce their allocations to real estate.

We are conscious that there is strong competition amongst investors looking to buy in the limited universe of long-let inflation-linked income properties. We have seen this first hand when acquiring properties and this has led to yield compression and increasing prices of available stock. Furthermore, we have seen a couple of higher profile REIT flotations being cancelled in recent months that highlight the difficulty in raising and deploying capital in the current UK market. Nevertheless, we are optimistic.

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Renewable infrastructure

(compare renewable infrastructure funds [here](#))

Greencoat UK Wind: The regulatory outlook for operational wind farms in the UK remains stable owing to the UK Government's policy of "grandfathering" for operational projects.

There is currently 12GW of operational onshore wind capacity plus 6GW offshore. Installed capacity is set to grow to 13GW onshore plus 12GW offshore by 2020, as assets currently in construction come into operation. In monetary terms, the secondary market for operational UK wind farms is approximately GBP45 billion, increasing to GBP70 billion by 2020.

As an owner of operational wind farms, the key risk faced by the Group is power price. Power prices in 2017 were in line with budget. In general, independent forecasters expect UK wholesale power prices to rise in real terms from current levels, driven by higher gas and carbon prices.

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Alexander Ohlsson, chairman, Foresight Solar Fund: There is now a total of over 12GW of solar capacity in Great Britain, with over 8GW of ground mounted solar.

While the ROC scheme was replaced by the Contract for Difference ("CfD") subsidy regime, solar PV and onshore technologies were both excluded from the most recent auction round, and are highly unlikely to feature in future auction rounds. The Investment Manager/Board expects future growth in the UK solar energy market to be driven by falling installation costs. In addition, the prospect of co-locating battery facilities with solar projects should further support this trend as capex costs for this technology reduce.

Australia, in contrast offers a rapidly growing solar sector, with solar projects accounting for over c.900MW of total installed capacity in 2017. Further significant growth is anticipated, as 4.5GW of new large-scale projects are due to be installed by 2020. Through the Paris Agreement on climate change, the Australian Government has committed to reducing the country's carbon emissions 26-28% below 2005 levels by 2030.

While criticism has been levelled at the lack of Federal support for renewables, support from State governments has been robust, with many implementing ambitious individual renewables targets as well as holding competitive auctions for renewable energy capacity.

Although the Australian Solar market is forecast to grow significantly over the next few years, the power purchase agreement ("PPA") market in Australia has become more competitive in recent months reflecting the number of PPAs expected to be written by the most relevant local utilities.

Overall, the global solar market is expected to see significant growth over the coming years as solar project costs continue to fall and grid parity is achieved in more geographies.

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Infrared, manager, The Renewables Infrastructure Group: In 2017, for the second year running, more than 50% of newly installed electricity generating capacity globally and approximately 85% in the EU was in the form of renewable energy infrastructure. The direction of travel in Europe and beyond is towards a low carbon economy. In April 2017, Britain had its first ever working day without coal power since the Industrial Revolution.

Previously commissioned UK renewables capacity still owned by developers is expected to continue to provide deal flow for the Company for several years ahead. Future acquisition opportunities also lie in other areas which may include further offshore wind and storage, as well as projects that may become commercially viable without subsidy, such as onshore wind projects and solar PV as deployment costs continue to fall.

In the UK, the rapidly growing offshore wind sector is likely to match the capacity of onshore wind and solar once current construction is built out. UK operating offshore wind farms now have a combined 5.1GW of generating capacity with further build-out being projected; Germany, another leader in the sector, has a further 5.3GW of operating projects. Other technologies include other types of generation infrastructure, for example hydropower, landfill gas or supporting technologies such as storage, back-up / peaking power generation or demand-side response.

Renewables Growth Drivers

Globally, the renewables sector is enjoying impressive growth on the back of national government policies and supra-national agreement via the United Nations' climate change initiatives. It is also being stimulated by reduced costs of renewable deployment, the imperative to secure energy sources in a volatile international political climate and, in many places, real concern about local levels of pollution emanating from fossil-fuel based energy sources.

Creating a system capable of delivering clean, secure and affordable energy to consumers is a key challenge for policy makers worldwide. Known as the "energy trilemma", the need for carbon mitigation, cost effectiveness and energy security continue to underpin expansion in renewables.

Carbon Mitigation

The Company expects the deployment of renewable energy as an alternative to polluting fossil fuels to continue to play a vital role helping countries to achieve their decarbonisation targets.

There is a general consensus that continued high levels of carbon emissions (whether for power, transport or heating/cooling) are unsustainable and there remains widespread public and political momentum to implement policies to mitigate the effects of climate change.

Notwithstanding the US administration's notification of their intention to withdraw from the Paris Agreement, as announced in June 2017, significant headway has been made in other areas. For example, in December 2017, less than one month after the successful conclusion of the UN Climate Change Conference in Bonn (COP-23), the French President, Emmanuel Macron, hosted "The One Planet" summit in Paris. The gathering marked the second anniversary of the Paris Agreement and was the first in a series of international summits to help countries reinforce their national climate action plans. Over the course of the summit, Climate Action 100+ was launched, an initiative where 25 of the most influential institutional investors worldwide (with over USD \$26.3 trillion of assets under management) agreed to engage with the world's largest 100 largest corporate greenhouse gas emitters to encourage them to address climate change.

Cost Improvement

Across major markets, renewables technologies have benefited from subsidy regimes, helping to create the necessary market conditions to drive cost reductions to the point that renewables are now competitive with fossil fuel generation. In turn, there have been increases in economies of scale, supply chain efficiencies and technical innovation, all of which have increased competitive pressures that drive innovation. This may lead to future renewables becoming viable for developments without subsidies.

Energy Security

Growth of the renewable energy infrastructure market is supported by a long-term global shift towards achieving economic growth with sustainability. Continuing increases in human population, urbanisation, industrial and agricultural production and consumption offset the benefits of ongoing energy efficiency improvements and demand management.

It is important that there remains a sufficient capacity margin and flexibility of electricity supply to meet demand as other technologies, including coal-fired power stations, are phased out, while addressing the intermittency of renewables themselves.

The late 20th century focus on fossil fuel and nuclear generation as the mainstay of power generation (government-controlled or recently privatised and heavily regulated) has given way to a phase where renewable energy is replacing coal and to some extent nuclear following the Fukushima disaster in 2011. The future is expected to see a continuation of the shift away from coal, while the penetration of the power market by intermittent renewables will require significant amount of flexible power - for example from batteries as well as from standby gas generation.

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Technology

(compare technology funds [here](#))

Katie Potts, manager, Herald Investment Trust: The bottom line is not complicated. Companies will be funded by those that pay the highest price. For now, private equity and venture capitalists in North America have the money. There is allegedly a trillion dollars in uninvested cash in private equity hands, so a reversal will take time.

The UK has not shrunk at the small end by number of companies. In practice larger companies have gone and smaller companies emerged, so it has shrunk by value. AIM is vibrant. There is a surprising level of entrepreneurialism in the UK relative to other countries, as well as skills. In a world awash with cash the area of conspicuous value is small companies that need cash, because debt funding is not available.

Against the gloom of fiscal deficits, trade deficits and politics, there is one area of the economy conspicuously growing. The technology sector has been strong globally in 2017, and it has been remarkable how much growth there has been in London. In part this reflects a bubble in San Francisco and Silicon Valley, which has led to the big internet companies expanding elsewhere, and London has emerged as a hub that has attracted leading-edge talent, and in consequence companies. Google, for example, has received planning permission for a new 1m square foot office at Kings Cross following a submission in June 2017, and Facebook is allegedly negotiating to take a further 400,000 square foot nearby. These have followed announcements from Apple, who are building a new 500,000 square foot UK HQ in Battersea, and Amazon who have taken 514,000 square feet in Shoreditch. In addition, London has become an important technical centre for the traditional financial sector, and is a hub for start-ups. A concern that we have had for a number of years is that the evaporation of larger technology companies in the UK would leave the UK with a diminishing skill base. I am therefore excited by the scale of investment into the UK by these vast US technology companies who are training people in leading edge skills.

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Robert Jeens, chairman, Allianz Technology: Since the end of the reporting period, markets were initially buoyant but volatility has recently increased significantly and confidence appears to have waned. The chances of a significant market correction remain a high possibility. Indeed 2017 may have created false hope in certain sectors and it is realistic to assume that the path ahead may be less smooth. There is also concern on the implications of rising interest rates around the world, rising labour costs in China and, in the US, tax cuts.

However, we should not let the concerns highlighted above detract from the likelihood that technology should continue to grow its influence over the global economy. The case for strong relative performance from the technology sector remains robust.

While some investors assume technology companies may only see a small benefit from US tax reform, we believe this can significantly help the sector. New tax rules will allow companies to repatriate cash balances held offshore at lower tax rates. Cash repatriation can lead to larger cash returns to shareholders of large technology companies, and it could spark M&A activity in the tech sector, which should benefit smaller companies. Additionally, companies across the economy will likely spend at least some of the tax savings to invest in their businesses.

We expect more spending to flow to technology companies that offer innovative products and services designed to help businesses increase productivity and improve efficiency. In their opinion, these factors should lead to continued strong earnings growth for technology companies.

QuotedData

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