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Monthly summary | Investment companies

March 2019

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 February, stocks were quite volatile but developed markets edged up a little, extending January's gains. Brazil gave back some performance but China was buoyed by renewed optimism of progress in trade talks with the US. Many investors came around to the idea that US rates had peaked for now; bond yields tightened.

Global

Global growth is slowing. With quantitative easing on its way out, and interest rates rising, money supply is contracting, causing global economic growth to slow down. This, coupled with Brexit uncertainties and trade tensions between the United States and China, has led to a volatile market atmosphere.

The managers of Tetragon say that, as quantitative easing is nearing its end, they are seeing increasing negativity in the leveraged loan market. Peter Burrows, UIL's chairman, highlights that populist leaders are challenging the political establishment while central banks are backing it and "normalising" their policies. US quantitative tightening contracts economies globally, as the dollar is the world's reserve currency. They expect an increase in volatility. Carolan Dobson, chairman of Brunner Investment Trust, notes that volatility was heightened in 2018. She is cautious about the UK market due to Brexit uncertainty.

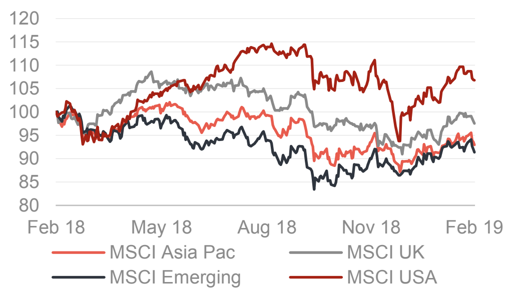
Douglas McDougall, chairman of Independent Investment Trust, draws attention to a number of uncertainties including quantitative tightening, rising interest rates, China's overextended credit boom and Brexit. Peter Moon, chairman of (continued on next page…)

Exchange Rate	28/02/19	Change on month %
GBP / USD	1.3263	1.2
USD / EUR	0.8794	0.7
USD / JPY	111.39	2.3
USD / CHF	0.9982	0.4
USD / CNY	6.6941	0.0

Source: Bloomberg, Marten & Co

MSCI Indices rebased to 100

Time period 28/02/2018 to 28/02/2019



Source: Bloomberg, Marten & Co

	28/02/19	Change on month %
Oil (Brent)	66.03	6.7
Gold	1313.32	(0.6)
US Tsy 10 yr yield	2.715	3.3
UK Gilt 10 yr yield	1.302	6.8
Bund 10 yr yield	0.182	23.0

Source: Bloomberg, Marten & Co

Global (continued)

Scottish American, expects growth to slow in part due to trade wars. He points out though that Brexit, China's slowdown and broader geopolitical risk make predictions challenging.

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UK

The looming departure of the UK from the EU has made investors unsure of the future of the UK market, making stock valuations more attractive. Most companies have remained in good health despite Brexit. The consensus in the UK is that, as yet, the UK's departure has not had as bad of an effect as was forecasted, yet nothing is final as at the time of writing

Naturally, Brexit is a hot topic for most commentators in the UK. James Henderson, Law Debenture's manager commented that Brexit uncertainties have made UK stock valuations more attractive. Michael Hughes, chairman at JPMorgan Mid Cap Investment Trust says that cash holding by UK companies is about 40% of GDP, and most UK companies remain in good health. US trade war and Brexit uncertainties loom, and their decision has been to position their portfolio for a 'hard Brexit'. The UK market remains out of favour, but the financial position of the British worker has improved. Rupert Barclay, chairman at Sanditon Investment Trust drew attention to the fact that UK stocks could recover sharply if Brexit is not economically catastrophic. Tighter monetary policy and slowing economic growth act as a drag on share prices, but market weakness has left good value in many sectors. The investment managers at Strategic Equity Capital, Jeff Harris & Adam Khanbhai, say share prices are beholden to negative sentiment about the overall financial condition in the UK.

Christopher Samuel, the chairman at BlackRock Throgmorton, said that trade tensions between the US and China, rising US interest rates, Brexit uncertainties, and inflationary pressures have resulted in an unstable, volatile market climate and the portfolio has been positioned defensively to negate some of the risk. The investment manager, Dan Whitestone, commented that recent volatility is a correction to previous levels rather than a start to a bear market. He talks about how industry is changing greatly, as barriers to entry are challenged by emerging companies.

Neil Rogan, chairman at Murray Income, said that hard to deny but easy to publish news headlines about outcomes/events hurting UK investments have been dominating investor sentiment. The outcome of Brexit dealings on UK economy has not been as bad as expected. Philip Remnant, the chairman at City of London, offered his comments on the slowing pace of US interest rate increases, which he says is helping investor sentiment. If UK exit is disorderly, sterling will most likely fall, helping UK companies with overseas earnings.

Diverse Income's chairman, Michael Wrobel, has drawn attention to the fact that access to risk capital becomes more valuable when financing is scarce. Globalisation has had the effect of a rise in asset prices and is the reason why international market indices follow each other. This is perfectly fine when the markets are on the rise, but a particularly a bad thing when they are falling, and the money supply is contracting. The interrelatedness causes decline in many markets.

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Asia ex Japan

China/US trade war could be terrible if prolonged but Asia is still growing

Baillie Gifford & Co, manager of Pacific Horizon, say that Asia is still booming despite the negative news and lower share prices. Even though Chinese growth is slowing, it remains one of the fastest growing economies in the world. If the trade war between the US and China is to be prolonged, it will have a terrible effect on both countries.

However, based on a growing demand for consumer goods and the digitisation of everything, Pacific Horizon expects solid earnings growth in 2019 for Asia. The chairman of Macau Property, Mark Huntley, said that Macau's attraction as a tourism and leisure centre has grown recently, and investors and profits rose steadily in 2018.

Europe

Investors are abandoning riskier assets but that makes valuations all the more attractive

Alexander Darwall, investment manager for Jupiter European Opportunities, commented that capital and talent is moving to public equity from private equity. A nationalist protectionism and governmental interference and regulation has led to differences in incentives and resource allocation, but certain companies have the agility to respond to changes in demand. Audley Twiston-Davies, chairman of TR European, said that fears of recession due to slowing growth during a period of recovery has led to investors' abandoning of riskier assets, but that valuations have become more attractive. Mispriced companies are being bought because of negative attitude around them, but solid balance sheets. There is still economic risk, but closed-ended funds don't have to sell holdings to meet redemptions, which is beneficial in this time.

Global emerging markets

Politics is weighing on some markets and, again, a resolution to the US/China trade talks would be beneficial. Foreign investors are very underweight this part of the market

Helene Ploix, chairman of Genesis Emerging Markets, commented on the US and China trade tensions, mentioning that emerging market development is not always smooth. There could be cause for concern as Chinese economic growth slows. More broadly, the chairman said that elections are affecting the economic landscape for some countries. Nicholas Wilson, Gulf Investment's chairman, said that the dispute between Qatar and the GCC brings uncertainty as oil and gas prices fluctuate. John Whittle, the chairman of Aberdeen Frontier Markets, said generally that investors should start to find good prospects in frontier markets again, as prices have become attractive compared to value. The managers of Aberdeen Frontier Markets are more optimistic and note that foreign investors are very underweight emerging markets. The managers of Aberdeen Emerging Markets point out that short term volatility and noise often creates attractive long-term entry points for investors. They also highlight the valuation gap between emerging and developed markets.

UK Property

Investors are chasing solid income from areas such as supermarkets, long-let property and student accommodation

Nick Hewson, the chairman of Supermarket Income, has commented that Tesco's debt was recently upgraded to investment grade. He mentioned that grocery retailers are adopting strategies of integrating offline and online shopping, and that supermarkets have had good performance and covenant strength. AEW UK Long Lease said that inflation will most likely grow towards the Bank of England target of 2%, and that the UK government looks increasingly unstable. The labour market remains strong, however, evidenced by an increase in pay. AEW UK's comments on the real estate sector include a strong investor demand for commercial property. Yields have been stable in high-demand areas, large logistics warehouses, prime industrial locations, and long lease properties. However, the strong competition for long-let properties has led to yield compression. Unite Group has said that the higher education sector is still going strong, with a slight fall in applications but the same acceptance intake. Participation rates are growing as people pick university study over other options available. They say there are prospects for investors in this space, because even though investment has increased drastically for student accommodation, there is still an inherent lack of supply.

Renewable Energy

Technological improvements are driving down costs for renewables. At the same time, the sector is being boosted by rising power prices

Helen Mahy, chairman of The Renewables Infrastructure Group, says there are three themes driving the expansion and relevance of renewables. The first is the acceleration of energy transition from carbon-based fuels to zero or low carbon substitutes. There is a reduced cost to produce as technology improves. There are many options for renewables to replace carbon fuels, and so diversification is an important concept in this sector. The final factor is falling development costs and the reduction of subsidy support for new projects. UK focus has shifted to offshore wind in recent times.

The managers of Greencoat UK Wind say the key factor affecting UK wind farms is the wholesale power price.

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Other

We have also included comments on biotech and healthcare from BB Healthcare; on financials, from Polar Capital Global Financial; on private equity, from Pantheon International; on resources, from Riverstone Energy; and finally on technology, from Herald Investment Trust.

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Global

(compare Global funds **here**)

Tetragon Financial: Despite increasing negativity in the leveraged loan market, the investment manager continues to be optimistic about its allocations to bank loans through CLO equity. Covenant deterioration in the leveraged loan market as well as increasing levels of debt generally should be of concern to long holders of corporate debt; however, CLO equity remains an attractive investment due to a number of factors, including that it may provide investors with optionality on spread widening. With fixed liabilities and floating-rate assets, CLO equity can benefit from spread widening, provided that loan defaults are well managed.

There are many risks in the markets – market volatility and returns in 2018 exemplified these risks. With quantitative easing seemingly nearing an end (the pace and timing of which is still to be determined), global sovereign debt levels at historic highs and heightened political risks, Tetragon's investment manager remains cautious. On the other hand, achieving attractive absolute investment returns over time requires not just an acknowledgement of market risks, but a view on market pricing. Eventually, these risks become priced-in (and in some cases more than priced-in).

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Peter Burrows, chairman of UIL Limited: There are two opposing forces at work in global markets at the moment: populist leadership and Central Bank activity. Populist leaders have been elected to challenge the existing "political establishment" while Central Banks have been seeking to move policies back to a more "normal" setting. In the US, President Trump is pursuing a range of populist policies including tax cuts for corporates and a USA first policy. The US Federal Reserve on the other hand is pursuing a policy aimed at tightening financial conditions including Quantitative Tightening ("QT") and raising interest rates. The populists are looking to deliver policy changes with little regard for more traditional economic forces while the Central Banks are looking to contain the likely inflationary impact of the policies that are being implemented.

The US economy has been buoyed by President Trump's policies (including tax cuts) and has been tempered by the Federal Reserve (interest rate increases and QT). The currency and economic markets are caught somewhere in the middle; with good gross domestic product ("GDP") numbers but with rising financing costs. In addition, the US dollar has strengthened, underpinned by QT and rising rates. For the rest of the world the impact of US policies means that the cost of US debt is rising. In addition, the limited supply of US dollars is being exacerbated by the tax driven repatriation of offshore profits by US Corporates.

Given that the US dollar is still the world's reserve currency, fewer US dollars in circulation leads to broad economic contraction. This has put pressure on other global economies as has the challenge posed by the emergence of disruptive technology businesses, which dominate local and global markets. Much of the equity market growth has been driven by higher earnings, but higher debt levels across the world's economies have contributed as well. These three factors add to market volatility.

In my statement for the year to 30 June 2018, I noted that there had been a sharp increase in volatility and we expect this to continue, driven by the issues outlined above. While market volatility was anticipated, the extent of the market weakness that we have seen over recent months was not.

Carolan Dobson, chairman, Brunner Investment Trust: 2018 was a year of heightened volatility across global markets, against a backdrop of ongoing trade tensions. Equity returns were weaker and our manager anticipates that these market conditions, as well as weak economic momentum and a more elevated level of market volatility, will continue to prevail. On a positive note, however, increased volatility and lower company valuations should offer more attractive buying opportunities than they did a year ago. With these factors in mind, the manager's focus will continue to be on identifying those companies which can grow independently of economic cycles.

At the time of writing, the UK Government is yet to agree a trading arrangement with the European Union following the country's scheduled departure from the EU on 29 March. This has created a heightened level of political and economic uncertainty in the UK. Although the company has 26% of its assets invested in the UK, the majority of these UK listed investments are international businesses, meaning that overall exposure to the domestic UK economy remains modest.

Looking ahead, the board shares the investment manager's expectation that the resilience of overall company earnings in 2019 will be challenged by generally weaker global economic momentum, plus the great unknown of trade politics.

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Douglas McDougall, chairman of Independent Investment Trust: A sense that the US economy may now be approaching full capacity while running a budget deficit of around record proportions has provoked fears of monetary tightening, the consequences of which could ripple through markets around the world. For the last ten years markets have been sustained by quantitative easing and extraordinarily low interest rates, and it is difficult to assess the implications of a cessation, or reversal, of this experiment. More particular uncertainties include the apparent over-extension of a credit boom in China, the inherent design faults of the eurozone, and, with particular reference to our domestically based holdings such as housebuilders, Brexit.

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Chairman of Scottish American: Last year I suggested that the likelihood of continued economic growth around the world seemed strong, but that concerns relating to valuations and rising interest rates made share price progress less than certain. This year the opposite may be the case, both because economic growth is likely to slow as the cycle progresses and trade wars loom large and because recent falls make equity valuations appear more reasonable. Appearances may be deceptive however, particularly if corporate earnings growth slows dramatically from the strong levels of 2018.

Wild cards such as Brexit, the extent of any slowdown in China, international trade relations and the broader geopolitical risk around China and the US make predictions challenging as quite different outcomes are entirely possible.

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United Kingdom

(compare UK funds **here**)

James Henderson, manager, Law Debenture: Economic forecasting for the UK continues to be difficult. A large unknown looms in 'Brexit' and what it means for business is unclear. The global economy appears to be slowing and UK productivity growth remains disappointing. The dark clouds are considered to be mounting for the UK by many commentators. However, the UK companies we hold are not a proxy for the UK economy; they are strong businesses with good management teams. They are good at what they do and provide competitive products and services; they also earn around 65% of their revenues outside the UK. The negative sentiment towards these businesses has become extreme, which has made valuations and the dividend yield attractive. The intention over the next few months is to move the gearing up by buying UK stocks to take advantage of this dislocation. The US holdings have in aggregate performed well and where the valuation looks stretched they will be further reduced. The UK companies purchased serve a diverse number of end markets and we will likely add to existing holdings. It is important to use the weakness to position the portfolio for an improved investment background.

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Allister Langlands, chairman, Standard Life UK Smaller Companies: A focus of each outlook statement for the company for the last 3 years has been the implications on investing in smaller companies of the uncertainty surrounding Brexit. Although we are only just over a month away from the scheduled departure date of 29 March 2019, we still do not have much of the clarity that we have been hoping for since 2016. No doubt, this must be very frustrating for the managers of the companies in which the portfolio is invested.

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Michael Hughes, chairman, JPMorgan Mid Cap Investment Trust: The increased stock market volatility experienced in the second half of 2018 has been attributed to the expectations of tightening credit conditions and greater political and trade tensions. The net result was to see reduced forecasts for economic and profits growth for this year and possibly next. It is therefore reassuring to see Central Banks rein in their expectations of policy tightening. However, at the time of writing there is no confirmation of any softening in the US position on trade tariffs and a final Brexit deal is still awaited. While these global uncertainties have led to a more cautious stance by companies, it is worth noting that the holdings of cash by UK companies is now approaching the equivalent of 40% of GDP. This has steadily increased since the financial crisis of 2008 and accelerated sharply since the referendum result. There is therefore the scope for a boost to the economy when business confidence returns and companies are ready to re-establish their investment plans. It is also a timely reminder that most UK companies remain in good health.

It is also worth noting that increased stock market volatility did not lead to a reduction in M&A activity in the FTSE 250 universe. This is a feature we have identified before as being one of the attractions of this sector.

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Georgina Brittain, Katen Patel, investment managers, JPMorgan Mid Cap : At the time of writing, the day we are due to leave the EU is only just over one month away. At this stage in negotiations, the outcome remains very uncertain. As we have indicated before, our stance had been to plan, and to position the portfolio, for a 'hard Brexit'. We have softened this approach over recent months and increased our domestic exposure. In part, this action has been taken due to the decline in valuation of a number of domestic companies, but in addition recent data has shown a significant improvement in the financial position of the British worker. This was demonstrated by the Asda Income Tracker, which showed that disposable income had risen by +5.8% year on year in December 2018. Lower inflation, very low unemployment and this significant rise in real wages should in normal times be extremely positive for consumer-facing stocks. However, a recent collapse in consumer confidence, due to Brexit uncertainties, has cast a pall. There is a clear disconnect between these two data points. If the Government is able to negotiate its way out of the current impasse, we should see sterling rise, inflation fall further and consumer confidence rebound strongly, which would be very positive for the share prices of domestic-facing companies.

Further contradictions abound at present. The UK has just been rated by Forbes as the most business friendly of the world's biggest economies, but according to the Bank of England UK investment intentions have collapsed in recent months. Overall the UK remains out of favour, as evidenced by the valuation of the UK market, and the FTSE 250 in particular, and by a recent BAML fund managers' survey which showed that a net 38% of global investors are underweight the UK. If, and it is a big if, the UK can exit the EU gracefully, then the UK market will enjoy significant buying interest, and in particular the more domestically focussed FTSE 250 will reap the benefit.

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Arthur Copple, chairman, Temple Bar: So far this year there have been encouraging signs that the anti-Value stance of the market might be beginning to reverse and performance in January was impressive as a result. It is still, however, very early days.

We continue to face several political and economic risks over the short to medium term, not least the ramifications of Brexit negotiations. But haven't there always been uncertainties of some description?

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Rupert Barclay, chairman, Sanditon: Recent market weakness and fears over the outcome of Brexit negotiations has left many UK stocks on very low valuations. Many UK domestic stocks have been in an extreme bear market and should the performance of the UK economy post its planned exit from the EU in March prove not to be catastrophic for growth, the manager believes UK centric stocks could bounce sharply.

Tighter global liquidity conditions, slowing economic growth and a poor profit outlook may weigh on share prices in 2019, but significant market weakness in the last few months of 2018 has left pockets of value.

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Investment manager of Sanditon, Tim Russell: Should our thesis that a reversal in QE should lead to a reversal in market leadership prove correct, we would expect to make progress in 2019. We have not mentioned Brexit, because at the time of writing it is still unclear what form, if any, it may take. Our view all along has been that Brexit is very much a sideshow to the likely impact global QT will have on markets. In as much as it has had an impact on U.K. domestic stocks in Brexit baskets, we imagine any resolution will lead to a sharp recovery in some of those share prices.

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Investment managers of Strategic Equity Capital, Jeff Harris & Adam Khanbhai: We are mindful of the apprehension surrounding UK equity markets. In the near term, it is likely to remain testing as share prices are beholden to negative macro sentiment and a slowing down of the accommodative conditions of the post crisis environment. There has also been a harsh reminder around the importance of the valuation discipline when investing.

At the smaller end of the market the impact of current conditions has been exacerbated by decreasing liquidity and reduced dissemination of research. This poses a challenge to price discovery and has led to increased volatility of share prices; but it has also created anomalies which provide opportunity for investors with a long term horizon, or opportunistic acquirers.

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Christopher Samuel, chairman, BlackRock Throgmorton: In the UK, the ongoing Brexit related uncertainty has weighed on the performance of the equity markets during the year. This, coupled with global macroeconomic and geopolitical headwinds such as US/China trade tensions, rising US interest rates, inflationary pressure and increasing volatility, has affected market sentiment both in the UK and more widely. As you will read in the Investment manager's report which follows, the portfolio manager does not believe that the recent market correction, which has negatively impacted UK Small Cap assets, is indicative of the beginning of a bear market. However the portfolio is now more defensively positioned with market exposure having been reduced in anticipation of a general slowdown in global growth and the continuing political headwinds faced by the domestic economy.

Your portfolio manager believes that the UK Small Cap universe provides a great number of differentiated, high quality companies, which are well placed to prosper against this challenging backdrop. Moreover, rising volatility may create opportunities for an active manager, particularly one who has the ability to short those companies which he believes are vulnerable to cyclical pressures such as rising operational costs or those which have high levels of debt which may struggle as interest rates rise towards more normalised levels.

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Investment manager at BlackRock Throgmorton, Dan Whitestone: Our view is that recent volatility is more of a correction than the start of a 'bear' market or period of sustained GDP weakness; however we recognise the global growth outlook faces some notable challenges. We still think there is sufficient growth for differentiated companies to prosper, but the recent volatility we have seen is likely to persist.

We continue to believe the UK domestic economy is challenged. This has had a notable impact on the share prices of many domestic companies with several market participants highlighting the value on offer. However, many of these UK consumer shares we think are "bad value" and whilst many of these UK consumer shares may appear cheap on valuation metrics like "price to adjusted earnings", this fails to take into account the levels of debt and poor cashflow some of these companies exhibit. In many cases these same investments are also exposed to cyclical pressures (weakening demand or rising cost pressures impacting corporate profit margins), and/or structural pressures (digital disruption or competition from low cost or specialised formats).

The rate of industry change is accelerating in our view, with many barriers to entry protecting the profit streams and returns of established businesses and industries coming under intense pressure. This is an exciting time to invest as we try to identify the new wave of emerging companies, as well as the requirement to be vigilant in detecting any flaws developing in existing business models. We believe that industry change, often in some form of disruption e.g. in distribution or manufacturing, or indeed changes in consumer behaviours, will be a key driver of stock market returns in the years ahead, both positive and negative.

Another theme we think will be prevalent in 2019 is that the market will finally reappraise the value of over-indebted companies, particularly those that are paying dividends they cannot afford, something we have highlighted for some time and which is now gaining greater market scrutiny. There have been several high profile examples of companies having to reduce dividends as part of a wider restructuring and recapitalisation exercise, and we think there will be more to come.

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Neil Rogan, chairman at Murray Income Trust: With Brexit, trade wars, increased interest rate uncertainty, quantitative tightening and unstable governments, there continues to be no shortage of bad news. The media is full of headlines warning that various outcomes or events "could" have a materially negative effect on the UK. Hard to deny and therefore easy to publish, these warnings are dominating investor sentiment. But "will" they have a negative impact on Unilever's sales of Dove and Persil in the UK and Europe; "will" they affect Diageo's sales of whisky in America; "will" they affect Prudential's growing insurance business in Asia? These are the much more important questions that our manager has to address. Its focus on quality "could" be the answer.

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Investment manager of Murray Income: Worries around the impact of trade wars and protectionism, political concerns regarding Brexit and Italy, and rising bond yields at the start of the period and the prospect of a US recession by the end of the period, unnerved investors.

Although the outcome of Brexit is unknown, the impact on the UK economy to date has not been as severe as many expected, cushioned to some extent by the weakness of Sterling and lower oil prices (which declined from $74 to $45) over the period. In the third quarter of the year, UK GDP grew by 0.6%, representing the strongest growth rate since the final quarter of 2016. Household spending and exports were the main contributors of growth although business investment continues to be weak, likely a function of the uncertainty stemming from Brexit. Relative weakness over the fourth quarter in the Services Purchasing managers' Index (PMI) portends a likely slowdown in growth with UK GDP expanding by 0.3% in the three months to November. However, Brexit uncertainty has delivered a benefit for UK manufacturing as stockpiling helped the Manufacturing PMI to climb towards the end of the year. In August the Monetary Policy Committee voted unanimously to raise interest rates by 0.25% to 0.75% given concerns around the limited level of slack in the economy and increasing wage pressure. The latest data suggests that the annual growth rate of pay in real terms is at its highest level for two years aided in part by the rate of inflation of 2.1% in December being at its lowest rate for nearly two years, mostly due to the lower cost of petrol. The unemployment rate of 4% in the three months to November represents the lowest level for over 30 years. Apart from measures to incentivise business investments, the Budget was largely uneventful.

Overseas, not helped by concerns around trade and protectionism, the outlook for shorter term global growth generally deteriorated over the period mostly due to a slowing in developed economies, and the euro area in particular. In the euro area, growth in the third quarter of 0.2% was at its lowest level since 2014, mostly due to weakness in Germany and Italy. Euro area composite PMI surveys during the fourth quarter suggest that the poor economic performance has continued. In the United States, activity has been more robust with GDP growth of 0.9% reported in the third quarter, helped by private consumption and business investment. However, trade tensions and the federal government shutdown may well presage a period of weaker growth. In emerging markets, there were broad signs of stabilisation. Although, in China, there were mixed signals with fourth quarter GDP growth of 6.4% representing annual growth of 6.6%, the slowest pace since 1990 despite the likely front-loading of exports before the introduction of US tariffs.

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Philip Remnant, chairman, City of London Investments: The world economy is still growing, albeit at a slower pace than many predicted a year ago. As a result, the trajectory of US interest rate increases has flattened significantly which is positive for investor sentiment. The lower oil price will also be helpful for consumers.

There is still considerable uncertainty about the outcome of the UK's negotiations to exit the European Union. If there is a disorderly departure, it is likely that sterling will fall which would be beneficial for the many UK listed companies with overseas operations.

Equity valuations reflect the uncertainty about both Brexit and the global economic outlook.

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Michael Wrobel, chairman, Diverse Income Trust: International politics has become more nationalistic over recent years, which may lead to more unsettled markets. We believe this is a moment when a portfolio accessing a universe of small and microcap stocks, along with many well-established majors, may become of greater relevance to shareholders. Specifically:

At times of economic slowdown, an investment strategy investing in quoted companies may have the advantage. Sustained access to risk capital becomes commercially more valuable at times when finance is scarce, as competition for the best deals from debt-funded businesses falls back.

At times of change, corporate agility becomes more important. Frequently, this is found amongst the management teams of smaller quoted companies. Note that prior to globalisation, smaller quoted companies as a group had a long history of outperformance of the mainstream indices. Therefore, a strategy of investing across the full UK investment universe, including smaller companies, has scope to deliver better returns.

Selecting for quoted companies with resilient balance sheets can be disproportionately advantageous at a time when those with the heaviest borrowing burden may be forced to prioritise the needs of their lenders over their commercial interests.

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Investment managers of Diverse Income Trust, Gervais Williams and Martin Turner: During globalisation, in the UK, companies operating in the Pharmaceutical, Fast Moving Consumer and Commodity sectors have become very substantial parts of the FTSE 100 Index. In addition, those operating in the Insurance, Banking and Property sectors have been huge beneficiaries of the major rise in asset prices and their weights are also substantial.

Unfortunately, globalisation has had a similar influence within the mainstream indices in most other developed economies. This explains why international market indices currently tend to move in sync with each other.

At a time when markets are rising, this issue is not of great concern. However, as stock markets across the world have become more unsettled during 2018, the correlation of stock market indices is now seen as a major disadvantage; investors are now becoming a lot more interested in assets that offer a degree of diversification.

Over recent years, some of the best share price rises have been within larger, technology-related stocks. During this period, there has been less interest in more mundane stocks, most especially small caps with premium dividend yields. Now that the share prices of many technology stocks have disappointed, we anticipate there will be renewed interest in smaller quoted income stocks.

Lastly, over recent years asset allocators have naturally reduced their participation in UK listed stocks given the Brexit uncertainty. Thus, the valuations of UK-listed stocks have fallen back relative to, for example, those listed in the US. In time, we expect this differential to close, at least to some degree.

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Asia ex Japan

(compare Asia ex Japan funds **here**)

Baillie Gifford & Co, manager, Pacific Horizon: We began 2018 with a sense of optimism. Our reasons to be cheerful were numerous and included an expected improvement in global growth, China's accelerating emergence as a technology player, and inflection points in several economies and industries. Given this healthy backdrop for potential growth in corporate profitability, we were inclined to take an optimistic position. Whilst that has largely been reflected in the underlying operations of companies in the portfolio, more adverse macro-economic sentiments were broader drivers for Asia ex Japan.

Underpinning our assumptions is the resurgence of global growth. The International Monetary Fund's current forecast of 3.7% growth for 2018 will likely be confirmed, with the same forecast for 2019. This is the fastest growth since 2011 and should be positive for emerging Asia. The market, however, has taken a more negative position, focused in particular on the potential for a serious economic slowdown in China. Despite some of the negative news, and weak share prices, the reality is that Asia is booming. Regional GDP is set to grow by about US$2 trillion this year and exports are still very strong, growing 10% year-on-year.

We believe that Chinese growth will continue to slow gradually from its high base. Despite the slowdown in 2018, China's contribution to global GDP growth was over 40% and it has rarely been greater (only in 2017 and 2011). At 6% real GDP growth, China remains one of the fastest growing large economies in the world. It is growing more than twice as fast as the US economy and the state is pouring money into advanced technology industries, such as those based on artificial intelligence, quantum computing and biotech. China's 'Made in China 2025' project and 'Belt and Road Initiative' are of global importance.

Whilst a USA/China trade war could be destructive for both nations in the short term, and Chinese markets have reacted to the immediate economic implications, China has tools available to soften the impact of the potential political disruption to its economic growth. A growth slowdown was already expected, with exports and infrastructure becoming a smaller part of GDP growth, and the greater focus on current debt levels preventing a repeat of historic levels of fiscal stimulus. Exports have slowed by no more than we expected a year ago, returning to the underlying pace of global expansion (around 4% year-on-year) after the strong rebound in 2017. The import volume slowdown in the USA is the same as it is for China's other trading partners. It is worth noting that the USA accounts for only one-sixth of overall Chinese exports.

From a global commercial perspective, we believe that the trend of 'digitisation of everything' is becoming more pronounced. This is a long-term pattern driven by the accelerating pace and diffusion of technological change. Only 47% of the world's population used the internet last year and online trade accounted for just 10% of global retail sales; we therefore believe that there is considerable potential for growth ahead. Whilst China receives much of the attention on technological change because of the scale and significance of its leading online companies, the historic underdevelopment of offline alternatives across other Asian markets also provides exciting opportunities for investors. It took Alibaba just 85 seconds to reach US$1 billion revenues on China's Singles' Day; e-commerce penetration in China is currently in the region of 20%. In comparison in ASEAN markets, e-commerce penetration is a paltry 2.2%. It is expected that the growth of ASEAN e-commerce will compound at an annual growth rate of 33% by 2022.

Amidst the ongoing occurrence of geopolitical flashpoints and consequent market volatility, the underlying supply and demand trends in some energy and materials sectors may have been overlooked. We see significant developments in these sectors which should herald positive change for shareholders in coming years. We have continued to broaden the portfolio's exposure to oil and nickel.

The world is becoming more affluent; we are on average richer, healthier and have greater choice in how we spend our time. These trends are pronounced in the so-called emerging world and in Asia ex Japan, home to 50% of the global population.

In Asia, more people have been lifted out of poverty at a faster rate than ever in human history. In many Asian countries, large segments of the population are moving from a focus on economic survival to the relative safety of belonging to the "middle class". Savings and consumption are soaring, and there is growing demand for new goods and services.

Technology development and innovation are increasing rapidly. As more people, economies and businesses are connected, ideas will spread and multiply and new businesses will be created at the expense of older less dynamic firms. The adoption of the new is as rapid - and sometimes more so - in Asia ex Japan than in the West.

We are in the information age; besides matter and energy, information is now considered a fundamental building block for the global economy. Information requires huge commercial investments. It is likely that all companies wishing to succeed over the coming decade will need to either create and manipulate information in ever more complex ways or to produce the physical goods which will allow these processes to occur.

Investor sentiment may continue to be driven by geopolitical events in the immediate future. We expect solid earnings growth for Asian businesses in 2019 against a less demanding valuation backdrop. Market dislocations of the nature that we have experienced over the last 6 months tend to throw up opportunities.

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Mark Huntley, chairman, Macau Property: Much has been written about the growth of Macau and its enviable economic performance. It is important to consider the current headwinds in the context of how Macau, the only legal gaming jurisdiction on Chinese soil, has developed during the life of the company. Measures including visa restrictions for Chinese visitors and anti-graft controls have had an impact in the past, and yet longer-term growth has continued.

The Greater Bay Area's development as a world-class city cluster will have a powerful cascading effect on the wider Pearl River Delta region, including Macau. Ambitious infrastructure projects - which form a strategic component of the plan - have always been a key factor influencing the manager's approach to the timing of divestments. The

Hong Kong-Zhuhai-Macau bridge was opened by Chinese President Xi Jinping in October. Although its full benefits have yet to flow through to Macau's economy, we believe the relative ease, speed and comparably low cost of crossing the bridge will provide long-term support for Macau's growth.

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Investment manager, Macau Property: Macau's appeal as a tourism and leisure destination continues to grow, supported by an increasing number of high-quality integrated resorts and the government's promotion of the meetings, incentives, conferences and events (MICE) sector.

In 2018, visitor arrivals to Macau grew 9.8% YoY to 35.8 million, the highest ever. A total of 116 hotels and guesthouses were operating in Macau at the end of 2018, providing 39,000 hotel and guesthouse rooms, of which around 25,000 were five-star hotel rooms. The average occupancy rate had increased to 94.7% by the end of the year, up 1.1 percentage points YoY. The average daily room rate had risen to US$179 (MOP1,443) by December 2018, a 4.6% YoY increase. For full-year 2018, the average occupancy rate increased 3.9 percentage points YoY to 91.1%.

Macau's tourism office recently said that the city should add around 1,000 new guestrooms annually in order to drive more overnight visitors.

A total of 966 MICE events took place in Macau during the first three quarters of 2018, attracting around 1.39 million participants and attendees, up 14.8% YoY. This rapid growth reflects the government's efforts to prioritise the MICE sector as a major component of non-gaming revenues. Despite the uncertainties surrounding the future of their concessions, gaming operators continue to push ahead with expansion plans, with new integrated resorts set to open in 2019 and 2020, alongside additional capacity and facilities at existing resorts.

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Europe

(compare European funds **here**)

Alexander Darwall, investment manager for Jupiter European Opportunities: The more difficult investment conditions are not unexpected. Indeed, more difficult economic conditions will doubtless throw up opportunities for strong companies. The test is whether companies can strengthen through the cycle. There are serious challenges that go beyond the normal cyclical ones. The publicly quoted companies are assailed by insidious challenges to capitalism which subvert the proper purpose of business. It probably explains why capital and 'talent' is flowing from public to private equity. Good governance where directors act in the best interests of the company as distinct from acting to satisfy outside parties is vital. Protectionism in its many forms (including 'localism', increasing regulations and government interference) leads to distortions in incentives and resource allocation. Yet for all these challenges, there are undoubtedly companies that have the skills and agility to respond to changing demand. Companies that develop new technologies, or can harness such technologies, to shape new business models which effectively serve customer needs, will prosper. There are still good rewards for companies that innovate to meet customer needs; have the flexibility and mindset to embrace change; and work hard to stay ahead.

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Audley Twiston-Davies, chairman, TR European Growth: The backdrop of a slowing global economy, many years into an economic recovery has led to fears of recession and a flight from assets perceived to be more risky. However, valuations of European smaller companies have become far more appealing as a result.

We do not discount economic risk, but believe that it should not be overstated. A key benefit of close ended vehicles is the fact that we are not obliged to sell good companies in falling markets in order to meet redemptions. Our managers therefore have the opportunity to use the current contracting market to buy mispriced companies that have strong structural growth or self-help characteristics, and which our open-ended competitors may be compelled to sell as investors seek to place their funds elsewhere. Current conditions present interesting opportunities for the patient investor.

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Ollie Beckett and Rory Stokes, fund managers at TR European Growth: We underestimated the extent to which a rising cost of capital, combined with an escalating trade war, would weigh on global markets. The political backdrop remained noisy, from President Trump's aggressive trade stance with China/Europe and Italy's belligerent position, to Brexit uncertainty. There were plenty of other less tangible concerns as well, with Germany undergoing political transition as Angela Merkel steps back from the Chancellorship, France once again showing herself to be very hard to govern and Sweden now months without a government. These factors combined with a fear that the US Federal Reserve and European Central Bank would implement quantitative tightening ('QT') too early. We consider the economic backdrop to be weak, but not that different to most of the period since the global financial crisis, where anaemic growth has been the norm. It is far from certain that the global economy will see a recession in 2019 or that the pace of interest rate rises and QT will be aggressive enough to be a policy mistake. A trade deal between the US and China seems probable. The backdrop for European smaller companies is not bad in such an environment, not least with valuations looking so appealing.

After recent market moves, European smaller companies, especially towards the lower end of the market capitalisation spectrum, seem attractively valued. While pockets of the European economy have been faltering recently, we are confident, but not complacent.

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Global emerging markets

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

Helene Ploix, chairman, Genesis Emerging Markets Fund: Looking ahead, emerging markets still face challenges. Despite the recent softening in the US Federal Reserve's approach to interest rate rises, the prolonged trade dispute between the US and China is a reminder that emerging markets' development as part of an open and cooperative global economy is not always smooth. More data continues to appear offering evidence for a slowing of the Chinese economy, which given its central, dominant, position in emerging markets is a cause for some concern. Politically, the outcome of the recent election in Mexico has generated uncertainty for investors, while the reaction to Brazil's election may yet turn out to be over-optimistic. Major emerging markets India, Indonesia, Nigeria and Thailand will all hold elections in the next few months, with South Africa following later in the year: some surprises may result.

As a Board, however, we share with the manager a continued optimism on the long-term investment opportunity in emerging markets. Incomes in low- and middle-income economies should continue to converge with those in high-income economies over time, while institutional quality continues to improve - albeit stutteringly in some cases.

The emerging markets are home to many high-quality companies which volatile markets may cause to be mispriced in the short-term, creating opportunities for active investors. We remain confident that a straightforward approach of applying deep fundamental research to identify long-term investments in quality businesses at attractive prices remains thoroughly relevant.

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Nicholas Wilson, chairman, Gulf Investment Fund: Fluctuations in oil and gas prices will continue to impact GCC economies as countries deal with budget deficits. The geopolitics of the region and, in particular, the dispute between Qatar and other members of the GCC brings continuing economic uncertainty.

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John Whittle, chairman, Aberdeen Frontier Markets: We continue to believe, alongside the manager, that frontier markets offer good value. An increasingly uncertain outlook for more developed markets and a more dovish US Federal Reserve stance should entice international investors to start to rediscover the merits of frontier markets with their different return drivers and attractively valued markets and companies.

At the stock level, our manager believes that valuations remain appealing, supported by an improving outlook for corporate earnings.

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Aberdeen Frontier Markets manager's report: While news flow continues to be mixed, we see reason to be more optimistic about the near future. Firstly, from an economic as well as political point of view, many of our core markets continue to progress various structural reforms, several under the direct auspices of the IMF, which is very encouraging. This provides an element of policy clarity to the cyclical recovery that is underway across a number of our markets. Secondly, while foreign investor participation in most of our markets has fallen to very low levels, such a lack of engagement will have to revert in due course, and in the meantime valuations are at very attractive levels in absolute terms, underpinned by a reasonable corporate earnings outlook. As discussed above, we believe that rising volatility in advanced markets, which is a symptom of an increasingly uncertain outlook for the world's largest economies as well as corporate earnings, and a weakening US dollar, could provide a more conducive environment for frontier markets as investors seek uncorrelated and absolute return opportunities. We expect the frontier region to be rediscovered as global investors recognise the attractiveness of the asset class's idiosyncratic drivers, cyclical positioning and attractively valued markets.

As ever, the portfolio retains its clear quality bias, which is reflected in the portfolio's statistics: a high blended return-on-equity, low corporate leverage and double digit corporate earnings growth. In all, we believe these fundamentals provide cause to be optimistic about the coming year.

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Managers, Aberdeen Emerging Markets: The catalysts that prompted the decline in emerging markets in 2018 were numerous (higher US interest rates, US dollar strength, the US/China trade dispute, domestic crises in Turkey and Argentina), but as we enter 2019, the backdrop for emerging markets has started to improve as those issues abate.

Early in 2019, markets witnessed a meaningful shift in the likely policy trend of the Federal Reserve, as the central bank took note of recent volatility and rising economic uncertainty and acted to temper investor expectations for further tightening. Such a pause would be very positive for emerging markets, and particularly emerging currencies. This, we believe, is a major driver of the improved relative performance of the asset class in recent months and has the potential to continue.

While we cannot predict how the US-China trade discussions will evolve, the economic impact of tariffs has thus far been limited and current discussions point to a compromise becoming more probable than further escalation, as was initially feared by investors. In addition, officials in Beijing have demonstrated their willingness to support the economy through monetary and fiscal measures. We would expect this support from policymakers to continue, as and when required. Despite the short term uncertainty therefore, we view China as an improving story after a challenging 2018, and a market that still has long term potential.

Whilst losses in Argentina and Turkey were significant, they amount to less than 1% of the emerging index, and both markets have now stabilised. Contagion to other emerging markets now seems unlikely. Indeed, even at the time, we viewed this as unlikely given most emerging economies are now materially better equipped to withstand such episodes than they were in crises of the past. Debt levels are relatively low as a proportion of GDP, and maturities are longer. Central banks hold substantial hard currency reserves, as well as operating flexible exchange rate regimes, which prevent the buildup of imbalances. A much greater proportion of debt (both corporate and sovereign) is issued in local currency, reducing the potential for mismatches and debt markets in general have matured and deepened. Finally, whilst many emerging countries ran large current-account deficits in the past, most countries now benefit from either smaller deficits, or run surpluses.

Short term volatility and noise often creates attractive long-term entry points for investors. Over its 30 years as a distinct asset class, the performance of emerging markets has been driven by earnings growth and dividends, and this will remain the case in the future. Consensus expectations are for corporate earnings in emerging markets to grow by 9.3% in 2019, with a dividend yield of 2.9% (at the time of writing the Company's own shares yield 3.9%). Investors are able to access these potential returns at an attractive valuation, with emerging markets trading on a forward price to earnings multiple of 10.5 times and a price to book of 1.5 times. Following the declines of 2018, these metrics are now below their ten year averages and offer compelling value when compared with developed markets which trade on 13.5 times earnings and 2.2 times book value.

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Biotech and healthcare

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

Professor Justin Stebbing, chairman, BB Healthcare: The calendar year 2018 was again somewhat challenging for healthcare investors, due to various macro-political uncertainties. Healthcare outperformed the wider market during the year, in part because of its perceived safe-haven status and the visibility over medium-term earnings irrespective of the economic cycle.

With macro-political uncertainties set to continue, healthcare should also remain a relative safe haven. Not only because the demand for services is not linked to the economic outlook, but also because the system has to change in order to remain viable for the longer-term.

We are investing in those changes and the trends that drive them. All other factors being equal, this should allow the portfolio to grow its sales and profits faster than the aggregate of a benchmark-aware strategy. We begin the year again hopeful that the healthcare sector's 2019 performance will be more driven by stock fundamentals.

Nonetheless, we always set out to follow an investment strategy guided by a medium to long-term approach and not waiver with the fashions of the moment or the whims of the market. This has served shareholders well to date and we continue to believe it is the right approach for generating continued performance into the future.

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Paul Major, Daniel Koller and Brett Darke, managers of BB Healthcare:

Biotechnology: this sector continues to see surprising levels of volatility. In US dollar terms, the NASDAQ Biotechnology Index is currently around the level it finished in 2017 (and 2015), having declined almost 10% in 2018 and then making it all back again in a matter of days during 2019. If one takes a step away from all of the noise and focuses on fundamentals, it was another year of solid scientific progress in terms of novel therapeutic modalities and new products for unmet clinical needs (a record 55 novel drugs were approved by FDA in 2018, plus seven biosimilars).

Biotech M&A was a much hoped for theme in early 2018, but it failed to materialise. Things do look different in 2019 though, with more Large-Cap Pharmaceuticals and Biotechnology struggling to convince the market they have adequate pipeline depth and relatively lower asset valuations (Small/Mid-Cap Specialty Pharmaceuticals and Biotechnology have lagged their Large-Cap brethren). This makes deals more easily NPV accretive over time and thus, activity has picked up. In recent months, we have seen the oncology companies Tesaro, Loxo and even large-cap Celgene acquired by Large-Cap Pharmaceutical companies.

At some point, one has to think the continued scientific progress will be more appropriately rewarded by the market.

Conglomerates and Pharmaceuticals: dreary old pharmaceuticals came into its own in the second half of 2018 as a safe haven, with the MSCI World Pharmaceuticals sub-index returning 3.8% versus 0.4% for the wider MSCI World Healthcare index. We have written many times about the structural issues facing these large companies given their seemingly intractable Research and Development ("R&D") productivity issues, with returns persistently below any reasonable assessment of the cost of capital.

Despite many years of considered reflection on the topic, we are none the wiser as to how the R&D productivity conundrum can be solved. Until it is, we feel better served to make focused bets on specific drugs through small/mid-cap Specialty Pharmaceuticals and Biotechnology stocks.

Diagnostics: compared to the year-end 2017, the two biggest changes in the composition of the portfolio have been the reduced exposure to Medical Technology and an increased exposure to Diagnostics. The latter sits at the centre of the axis of our core thesis for the evolution of the healthcare industry namely, that we must make better decisions to allocate capital more judiciously and intervene earlier before chronic conditions lead to acute episodes. This sub-sector typifies how technology can ultimately revolutionise the delivery of healthcare (alongside telemedicine, wearable diagnostics and population health).

The patient must sit at the centre of this decision tree and the easier it is to identify the problem, the faster all the other pieces of the puzzle can come together. Genetics lies at the heart of this not just your inherited lifetime disease risks (genome sequencing) but also gene expression (the 'coding transcriptome', also known as mRNA sequencing) - the question of what is your body doing right now and why? Rather like computing, the rapidly falling cost of this diagnostic data is opening up ever greater usage. This is an almost unquantifiable growth opportunity finally coming of age.

Nor is it just high tech sequencing that is growing. The emergence of multiple rapid point of care panel tests that can identify pathogens is another huge opportunity to speed up treatment decision-making. With potentially life-threatening conditions like sepsis or respiratory disease, this can save lives and reduce time in expensive high-dependency care settings.

Distributors: 2018 saw a continuation of the three themes ailing this segment; potential disruption/disintermediation from new business models (Amazon/PillPack and alternative models from Pharmacy Benefit Managers ("PBMs") vis-a vis-pricing), legislation to curb drug price inflation and possibly even lower drug prices in the US and ongoing generic price deflation, which has a limited impact on some contracts and on inventory values. Let us consider the latter two (and arguably related) issues first.

Since a proportion of contracts for these distributors are still on a margin basis, it is a truism that any lowering of prices is a negative, as would lower price inflation be a drag on future earnings growth. The question though, is one of relevance.

And what about the threat of competitive disruption? It would be unfair to characterise the dominant companies as 'Luddites' with a poor grasp of the transformation power of IT systems to allow just-in-time inventory management and thus improve cash conversion. Indeed, when your core business has sub 1.5% operating margins, the quest for efficiency is unrelenting. As such, we find it difficult to accept the argument that the existing model is ripe for disintermediation.

Moreover, the requirements to meet customer needs in a timely fashion requires the holding of significant inventory, making this a business where scale becomes essential to effective service, creating high barriers to entry. Whilst the market frets, these companies are trading at valuation levels well below historical norms and we are happy to hold the shares until we feel that an appropriate re-rating has occurred.

Facilities: the hospital and clinic setting remains challenging. All payors are striving to move patients down the acuity curve (the so-called 'in-patient to outpatient' shift) and, as a consequence, overall capacity is shrinking. Rather like shopping centres, the repurposing of hospital capacity is not easy. These are global issues (cf. the weakness in Fresenius SE's German hospitals business) but, in the US market, we have the additional complication of Republican meddling with the Affordable Care Act ("ACA") ('Obamacare') casting a shadow over the outlook for elective procedure volumes and the risks around uncompensated emergency care provided to uninsured people. The overhang relating to the Texas court ruling on the ACA exchanges and Medicare expansion is unlikely to be resolved in the coming year.

The offsetting Democratic agenda to expand Medicare will not go anywhere whilst the Senate and White House are in Republican hands, but could be a positive on a 3-5 year view. However, we are not yet at a point where we are prepared to invest on such a basis. The direction of travel should become clearer from Q2 2019 as the various potential challenger candidates for the 2020 Presidential race emerge and set out their stalls. Clearly, we would favour a proposal based on the current public/private model.

Generics: this remains the most fiercely competitive area of healthcare; volume producers living order-to-order, with buying groups playing off suppliers to secure the lowest possible prices. A multi-year backlog of generic approvals at the FDA is finally being cleared and the laws of supply and demand do not augur well as one moves from a dynamic of perhaps one or two suppliers of a product to five or six. Price deflation in the US market is showing signs of moderation, but this is merely the potential absence of a negative rather than a positive. Significant growth opportunities exist in markets like China, but we are unconvinced that multi-national companies will be allowed to compete fairly to take advantage of these opportunities. In China for instance, the government has piloted a centralised tendering process that has the potential to consolidate market share in domestic hands.

Healthcare Technology: this is a sub-sector categorisation of our own making; defined in essence as a 'software as medical device', where it is the power of the algorithm that creates the product. Our investments in this area are selective, but compelling, and share the common feature that an ever-evolving continuum of patient data enables product innovation. The value here is very intangible (in the best possible sense of the word) and thus the barriers to entry are higher than perhaps appreciated- it's not so easy to copy algorithms and the more data one has showing something works, the more compelling a proposition it becomes (cf. Google search). The newly proactive FDA is seemingly supportive of the 'software as devices' concept, having approved two App-based products with medical claims in the past two years, with another two under review as we went to press. We continue to be very excited about this area and feel that we could be, if anything, a bit early into the opportunity.

Healthcare IT: related to the above, this grouping covers 'software as a service' and is a very broad church, including interesting areas such as telemedicine, MIS systems for healthcare providers, through to programmes to deliver value based care and predict patient behaviour. Pareto's law applies as much in healthcare as to anything else in life, and it is generally the case that a small proportion of patients with complex chronic needs account for the bulk of healthcare costs.

Identifying these patients and then prophylactically managing such patients is undoubtedly critical to the broader aims of lowering overall healthcare costs. We made our first investment in this area during 2018 and our second in early 2019. We continue to see Healthcare IT as a necessary piece of the jigsaw for a more efficient healthcare system and it is an area under active consideration for future investments.

Managed Care: the corollary to our concerns over shifting payor requirements impacting the Facilities sub-sector is of course the potentially positive impact on the payors themselves, i.e. the Managed Care companies. Although many private and government schemes have capped returns that require improved management to be recycled into benefit design, the growing array of tools to better manage cost trends are allowing the bigger players to reap the rewards through improving the relative attractions of their products, driving market share gains as their offer becomes more compelling. With our holdings now largely inured to any ACA-related risks, we see managed care as an inexpensive and a serial compounder.

The commercial health insurance industry is potentially at some risk from progress on the 'Medicare for all' agenda. As a worst (highly unlikely) case, the government cuts insurance providers out of the loop entirely (NHS-like model) and they essentially cease to exit. More likely is an expansion of the existing arrangements, where Medicare expansion gradually replaces the market for employer and individual policies (c.90m lives). We are aware of this possibility and feel that our two holdings are well placed to win share in such circumstances, being already materially exposed.

Medical Technology: this is our broadest sub-sector in healthcare, covering everything from disposable single use items to $20m pieces of capital equipment. What do we like within the scientific smorgasbord? We tend to favour small, highly focused specialists that are leaders (in growth or market share terms) in their categories. We prefer smaller ticket procedural items to larger capital equipment given aforementioned constraints around hospital economics. Demographic trends globally favour continued procedure volume growth and pricing trends are already deflationary. We also try to focus only on market segments where we see the potential for continued innovation (such as complex joints, interventional cardiology, neurology, robotics and critical care).

There continue to be attractive opportunities in this space on an absolute basis, we just find better ones right now on a relative basis.

Services: this is another broad category covering companies who serve the industry as suppliers (contract research, manufacturing or packaging, laboratories, PBMs etc.) or directly deal with patients (dialysis companies, emergency services etc.). On a GICS basis, this grouping would include Managed Care and the Distributors, which we split out. Even with a narrower definition, it is difficult to make generalisations about such a disparate group of companies.

We find some other areas of what we would characterise as the outsourced supply chain interesting and see a very positive longer-term trend for the providers of outsourced R&D and manufacturing capabilities. The future for drug innovation belongs to those who can think out of the box and move quickly. We expect to see more and more academic spin-outs and these companies need not waste time and money building up capabilities in these areas when they can effectively rent them.

We are much less interested in the more directly patient-facing areas, which we see as facing many of the same challenges ascribed above to the facilities operators. The fast-paced race down the acuity curve offers lots of opportunity for new business models and does not bode well for those with substantial legacy tangible assets.

Specialty Pharmaceuticals (ex. Generics): this is also somewhat of a catch-all category, and a much-maligned one at that. We would describe it as including non-diversified drug companies and those who tend not to do basic research (the 'buy in, develop and promote' model). Many of these would prefer to call themselves biotechnology companies and some are in the NASDAQ Biotechnology Index. In our classification system though, if it does not utilise recombinant genetic material to make its products then it is not a 'true' Biotechnology company.

Our holdings are very much away from the 'buy in, develop and promote' model and toward the focused innovators, with strategies focusing on areas including cardiovascular, respiratory and neurology. In addition to having compelling products of and in themselves, we believe there are multiple strategic options to unlock value for these companies, as 'big pharma' is perennially on the hunt for new products to support growth.

Life Science Tools: these are the companies supplying the equipment that enables research and development - the picks and shovels of R&D. Normally this group would include companies like Illumina, but we carve these out into our Diagnostics category. We have been zero weighted in this area since inception, feeling that the levels of growth implied by current valuations (ex. Diagnostics) are unsustainable in the longer-term. Whilst there has been some moderation in longer-term growth expectations over recent months, we still do not see a compelling risk/reward balance in this area.

The key message we would like readers to take away is that, despite the extreme volatility and macro-driven market drawdown through Q4 2018, we enter 2019 with an undiminished belief in the medium-to-long-term opportunity for change and innovation in healthcare to generate material investment returns. The market is famously fickle in the short-term and we are trying to look past the volatility and noise and remain focused on the fundamentals.

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Financials

(compare financials funds **here**)

Chairman at Polar Capital Global Financials, Robert Kyprianou: It is unusual for a discussion of the outlook for financials to begin with a focus on the broad political environment. However, as the company enters a new financial year we see changing political paradigms wherever we look. An unorthodox populist Republican US President about to take on a Democratic controlled House; the changing nature of international relations from one defined by globalisation to new drivers of nationalism and bilateralism; the rise across Europe of an increasingly strident nationalist, 'me-first' populism challenging post War Europeanism; power paralysis at the very heart of Europe from an apparent Brexit impasse, streets on fire in Paris, growing tensions between the EU and one of its largest core members, Italy, and a 'lame duck' Chancellor in Germany struggling to deal with the rise of the far right and a growing isolationist movement.

This political backdrop, coupled with doubts over global growth and its impact on interest rate expectations, has damaged sentiment broadly in global equity markets and for financials in particular. Banks, the asset management and life insurance sectors have all been casualties of the general market setback as the company's financial year begins. Lay on top of that evidence of an institutionalised money laundering scandal spreading across Scandinavia and the Baltics and you have had a perfect storm for European banks in particular.

Investment managers at Polar Capital Global Financials, Nick Brind & John Yakas: Looking back, the reasons for the banking sector's underperformance post the financial crisis up until a couple of years ago are easily understandable. The significant increase in capital requirements, regulatory costs, conduct issues and litigation, on top of a shallower economic recovery than previous cycles and finally an interest rate environment that has put significant pressure on net interest margins together are unprecedented.

But the degree of underperformance against underlying equity markets over the last year looks anomalous. Valuations have fallen sharply. For example, US, European and Japanese banks have seen their valuations on a P/E basis for 2019 fall by between 25–40% to less than 9.0x, 7.7x and 7.1x respectively, suggesting a far more substantial fall in earnings over the next few years than we believe is likely.

Nevertheless, in the short-term there is a lack of catalysts for banks to rerate until the outlook stabilises. US and European banks, where the largest percentage of the portfolio resides, have produced steady results with US banks seeing a significant boost to their earnings from the fall in corporate tax rates. Loan growth though has not picked up as expected, with increased competition in the US from non-bank lenders.

Asset quality, outside some emerging markets such as India and Turkey, remains resilient and, if anything, has continued to surprise by being better than expected, reflecting the relatively benign macro background. It is likely that in the next downturn more losses will occur off-balance sheets where direct or nonbank lenders have taken on more risk than banks as the latter no longer want to take certain risks or are no longer allowed by regulators to do so.

The underlying trend of banks continuing to return capital to shareholders through buybacks and dividends has continued and with significantly more clarity on the outlook for capital requirement this should help to underpin sentiment towards the banking sector. Bank balance sheets remain solid, particularly in the US where one would have to go back to the 1930s to find a time when banks had more capital than they do today.

In the US, after receiving Senate approval, the House of Representatives, earlier in the year, approved a series of banking reforms which roll back part of the Dodd-Frank post financial crisis legislation and continues a trend of gradual easing in financial regulation. One of the key aspects of the bill is a reform to increase the threshold for a bank to qualify as systemically important (raised to US$250bn in assets from US$50bn previously) which will materially reduce the cost of regulation for smaller banks.

Over the next couple of years, we expect to see a pick-up in M&A activity in the US. There are still around 5,000 banks in the US, a reduction from some 12,000 prior to the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, which lifted the restrictions on banks operating across state borders. One of the key drivers for increased activity will be the need for smaller banks to compete with their much larger peers where they are being outspent on technology. Mergers between large banks remain unlikely.

We remain constructive on the sector and while the short-term outlook remains uncertain and the sector is not without risk, it is vastly better capitalised than the last time it went into a downturn and shares have fallen to extremely low levels so offering tremendous value.

The Financial Times' influential Lex Column discussing US banks in December stated, "The banks' harshest critics worry that the economy is slowing. If so, that will trigger the dual effects of both the Fed backing off rate rises in 2019 and increasing losses. But the probability of this worst case scenario does not quite match up with such low equity valuations. Unless one just hates the banks".

As if on cue, in January, the Federal Reserve backed down on its hawkish commentary about interest rates and the speed with which it would reduce its balance sheet. Equity markets have rallied sharply and with them financial shares have performed well. Nevertheless, the rally has not removed the large discount the sector trades at to the underlying equity market and we would argue that even if not hated the sector remains unloved, undervalued and misunderstood.

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Private equity

(compare private equity funds **here**)

Sir Laurie Magnus, chairman, Pantheon International: The global economy performed well during 2018 but geopolitical challenges and trade tensions show no sign of abating. This, together with the volatility seen in the public markets towards the end of 2018, mean that the outlook for 2019 is less positive.

In the event of a downturn, there may be a fall in the valuation of private equity assets and a slowdown in deal activity as business vendors and purchasers adjust to the changing environment. However, this could also be an opportunity to acquire some assets more cheaply, particularly if some investors come under pressure to trim their private equity exposure.

The private equity market has continued to grow against a more sombre and complex economic backdrop as investors increasingly recognise that top quartile private equity funds have historically generated returns that consistently outperform public markets.

However, as we approached the end of the year, financial markets started to show signs of weakness and the economic outlook for 2019 appears to be on shakier ground.

In 2018, the global economy outperformed market expectations. Growth was strong and more globally synchronised, while inflation remained largely quiescent on the back of subdued wage growth. However, the challenge in sustaining this is greater than it was last year. More than a decade since the Global Financial Crisis ("GFC"), the true costs arising from that period have yet to be calculated. The long-run effects of global financial imbalances that have arisen from Central Bank efforts to stem financial uncertainty, as well as the emergence of populist political sentiment, are still major uncertainties.

The USA continues to enjoy a strong domestic economy and US companies are generally experiencing a period of robust earnings growth. Furthermore, the tax changes signed into law have encouraged the repatriation of profits previously held overseas by US corporates and have helped finance a share buyback boom in the US public markets. The stimulatory effects of the easier US fiscal policy will decline going into 2019 and, while robust US corporate earnings growth and share buybacks will likely continue for some time, we believe that on balance these trends have been largely reflected in current stock price levels. While alert to political and macroeconomic developments in the USA, Pantheon continues to believe that the more developed and sophisticated US private equity market will be the most significant source of compelling deal flow in 2019.

The initial strong economic growth in the Eurozone lost momentum towards the end of the year, with political turbulence, faced by several countries during 2018, weighing on sentiment. On 29 March 2019, the UK is expected to leave the European Union and, at the time of writing, it is still not clear which Brexit scenario will occur. From a private equity perspective, the UK continues to be a relatively attractive jurisdiction for investment on a long-term basis. Nonetheless, Pantheon and its managers are taking a careful approach to deployment of capital in the UK.

China's economy experienced a slowdown in 2018, and the outlook for 2019 is for lower GDP growth. However, the growing trade disharmony between the USA and China is even more concerning and the implications could be global. This is especially true of the technology sector, which has been one of the main beneficiaries of the bull run in global equity valuations over the latter part of the current financial cycle. Technology also forms a large part of the investment focus for private equity investors, particularly those actively investing in venture and growth capital. There are cross-border technology businesses with exposure to both the US and Chinese markets and they could be adversely impacted as a result.

There are indications that, although the wider Asian region benefited from solid domestic demand, it is likely to be negatively impacted by US-China tensions, and economic growth may decelerate from the level projected for 2018.

It appears that Latin America's economic recovery slumped towards the end of the year and, following a busy year of elections across the region, the focus is now on how policymakers will respond to try and reverse this trend.

UK property

(compare UK property funds **here**)

Chairman of Supermarket Income REIT, Nick Hewson: We believe that supermarket property presents a significant investment opportunity for investors.

Supermarket operators have continued to improve performance and covenant strength, augmented by good management, delivering on strategies focussed on improving competitiveness, productivity and capital returns. In recognition of their stronger balance sheet, Tesco were upgraded to Investment Grade during the period by Fitch Ratings agency; we believe both Moody's and Standard and Poor's are likely to follow suit in the medium term.

Grocery retailers are increasingly adopting a strategy of integrating online and offline shopping, with all the big 4 operators now utilising well located stores as last-mile fulfilment centres, the Group plans to predominantly acquire stores that operate both as physical supermarkets and online fulfilment centres via home delivery and/or click and collect.

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AEW UK Long Lease: In the second half of 2018, inflation slowed to 2.2% per annum (RPI/CPI) as both import cost-linked inflation and oil price appreciation were moderate. This is in line with our expectations that inflation is to gradually move towards the Bank of England inflation target of 2%. This will enable the Group to continue to grow its rental income stream as 92% of its rental income as at 31 December 2018 is inflation linked.

UK GDP growth for Q4 2018 is now expected at 0.3%, down from 0.6% in Q3 2018. This brings the full-year 2018 growth expectation to 1.4%, down from 1.8% earlier in the year. GDP growth is, however, forecast to rebound to 2% by 2020, based on a strong chance that the current political indecision could lead to a softer Brexit and an extension of the date on which the UK leaves the EU. That said, the real possibility of a no-deal Brexit remains and, with the UK government looking increasingly unstable, it is expected that GDP growth in this eventuality would remain subdued, albeit in positive territory.

The UK labour market remains strong with unemployment remaining at a more than 40-year low of 4.1% in October 2018. The tightening labour market has finally lifted annual pay growth to 3.3% in the three months to October 2018. Combined with 2.2% inflation for 2018, this does provide for some real pay improvement. Despite this, consumer spending is expected to slow slightly to 1.4% in 2019 from 1.7% projected for 2018.

UK Real Estate

Both in absolute terms and relative to other markets, UK property market returns continue to show a healthy spread over 10-year government bond yields. Strong investor demand for commercial property continues and for the time being we continue to see yields remaining stable in the most sought after areas of the market, predominantly in large logistics assets, prime industrial, and in the long-leased market.

On the tenant demand side, we see a rather polarised position highlighting to managers and investors alike the importance of robust and informed stock selection. Despite an uncertain outlook surrounding the UK's exit from the EU, we have seen strong take up in the industrial sector leading to rental growth of 4.2% throughout 2018 according to MSCI, down slightly from 5.3% in 2017, but outperforming other major property sectors for the ninth consecutive quarter. The regional office sector has also recorded healthy recent performance with GVA reporting a 4.3% rise in net effective rents over the year to September 2018 across the 9 largest centres. Take up for Q3 2018 exceeded 2 million square ft which is 63% ahead of the ten-year quarterly average.

A contrast to this is seen across the majority of the retail sector, where the impact of declining footfall continues to hit the headlines, with the exception of a few large dominant centres where rental growth has been recorded at modest levels.

We are conscious that there is strong competition amongst investors looking to buy in the limited universe of long-let inflation-linked income properties and we have seen this first hand when acquiring properties. This has led to yield compression.

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.

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Unite Group: The outlook for the student accommodation sector remains positive, with structural factors continuing to drive a demand-supply imbalance in the cities where we operate. The UK Higher Education sector is recognised globally for the strength of its Universities and the contribution it makes to research, innovation, talent development and the UK economy more broadly. The UK is the second most popular destination for international students and has 11 out of the world's top 100 Universities and 58 of Europe's top 200 Universities.

Total student numbers again reached record levels at over 1.8 million. The number of applicants and the number of students accepted into courses in 2018 was at 696,000 and 533,000 respectively (2017: 700,000 and 534,000). Despite a fall in applications of less than 1%, Universities were able to recruit from the excess of applications, resulting in intake remaining in line with the previous year and applicants still outstripping acceptances by 163,000. The small reduction in applications was driven principally by the demographic decline in the UK, with international students once again growing.

The initial applications data for the 2019/20 academic year is encouraging, with overall applications up by 0.5% with growing participation rates and increased numbers of international students more than offsetting the impact of the demographic decline that continues until 2021.

Going forward, the gap between the number of applicants and University places could be impacted by some external factors, including the impact of the UK leaving the EU and the demographic trend that has seen a 60,000 reduction in the number of 18-year-olds over the past four years. Whilst the impact on student numbers of the UK leaving the EU is difficult to predict, EU students only make up around 2,500 of our direct-let customers and EU student numbers have continued to grow over the last two years. We are nevertheless forecasting a 20-25% decline in EU undergraduates by 2023, equating to a fall of around 1% of total students.

However, participation rates continue to grow as more young people are choosing University over other alternatives and this, together with the reversal of the demographic decline, means that the outlook for UK student numbers looks increasingly positive. With demand from international students also growing, up 9% this year, a more positive visa environment and a relatively small impact from Brexit, we feel equally positive about international demand.

The Government's review into post-18 education through the Augar Review is expected to report in the next few weeks. The review is expected to propose a number of changes to the way Higher Education is funded. Whilst the outcomes remain unclear, we expect to see the review recommend some reduction in the fees that students pay and potentially create some restrictions for Universities or courses that are assessed to offer lower-quality outcomes. We continue to focus on higher-quality Universities determined by a variety of measures such as TEF rankings, league tables, student outcomes, entry criteria and financial strength. This is demonstrated as less than 4% of our income is generated from lower financial-strength universities and only 3% of our students are at Universities with entry requirements lower than three Ds at A level. This strategy of focussing on higher-quality universities positions us well to withstand any impact of these changes. Any changes could also put pressure on university finances and we will continue with our dialogues with Universities as to how we can best support them through our partnership activity.

The student accommodation sector has attracted significant levels of capital investment over the last four years with over £16 billion of investment activity. This increased investment activity has seen the new supply of accommodation increase and the total number of purpose-built beds (including University-owned beds) grow to over 600,000, representing around one-third of the UK's student population. At this level, there still remains a shortage of purpose-built accommodation compared to the numbers of first year and international students, before taking account of the increasing numbers of second and third-year students who are choosing this type of accommodation. The outlook suggests that the rate of new supply will continue at a similar rate of around 20,000-25,000 beds in 2019, before starting to reduce. Supply in 2020 and beyond is currently limited to a further 20,000 beds. A large proportion of the new supply is focussed in markets where we do not have a presence and on the premium end of the market where we believe the competitive threat that it poses to our more mainstream proposition is limited.

Our exposure to changes in student numbers and increases in supply is mitigated by our alignment and relationship with high-quality universities where student demand remains strongest, underpinned by nominations agreements. We remain confident that well-located, mid-range, direct-let student accommodation will continue to support high levels of occupancy and rental growth.

Whilst the Augar Review could present some new challenges for the sector, UK universities continue to demonstrate their ability to adapt and respond to a changing landscape and retain their globally recognised status. Growing participation rates highlight the very significant value that young adults place on a University education and the opportunities that it creates. This trend continues to drive the demand for high-quality higher education amongst both UK and international students as seen by the latest applications data.

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Renewable energy

(compare Renewable Energy funds **here**)

Helen Mahy CBE, chairman, The Renewables Infrastructure Group: The Renewables asset class represents a growing and important segment of the rapidly evolving energy market and, accordingly, a compelling investment opportunity. Furthermore, [*it*] is well placed over the longer term to take advantage of the drive towards global de-carbonisation and continued investor appetite for long-term yield from sustainable asset classes.

We can identify three fundamental themes driving the expansion and the increasing relevance of the renewables sector:

The first is acceleration of the energy transition from fossil fuels to zero/low carbon sources, enabled by significant reductions in the cost of producing renewable energy. This drives electrification of new sectors, such as vehicle transport, increasing further the demand for renewable electricity.

The second key theme is the increased diversification of renewables. Offshore Wind and battery storage technology are adding increased diversification to renewable energy solutions. The diversification of exposure to different power price markets, weather systems and regulatory frameworks increases the resilience of the portfolio to localised risks.

The third theme is the reducing subsidy support for new projects as renewables reach grid parity. Development economics in Europe are favouring windfarms in the windier north, and solar parks in the sunnier southerly latitudes. Falling development costs are leading to projects being developed without recourse to government subsidies, for example wind in Scandinavia and solar in Spain. In removing the risk of retroactive loss of subsidy in these territories, there is a shift in focus from sovereign risk towards different means of hedging power price risk coupled with less geared capital structures.

In addition, the UK is focussed increasingly on offshore wind, with little new development of onshore wind and solar.

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Greencoat UK Wind: The key value driver affecting operating UK wind farms is the wholesale power price. In general, independent forecasters expect the UK wholesale power price to rise in real terms, driven by higher gas and carbon prices.

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Resources

Richard Hayden, chairman, Riverstone Energy: Crude oil prices experienced a significant recovery during the first three quarters of 2018, with the West Texas Intermediate ("WTI") price surpassing $76 per barrel in early October and reaching levels that had not been seen since 2014. The recovery was largely supported by market sentiment around a potential shortage in oil supply as a result of industry underinvestment throughout the downturn and geopolitical factors including sanctions on Iran and instability in Venezuela. However, the market quickly reversed during the last quarter of the year, with the WTI price closing the year at $45 per barrel. This sharp decline was driven by concerns around potential excess inventory levels as Iran received sanction waivers and U.S. production grew.

The broader equity market also faced headwinds as investors reacted to news of global trade tensions, rising U.S. interest rates and potential slowing economic growth. Energy in particular remained out of favour, with limited inflows to the sector as investors continued to evaluate producers' ability to generate cash flow and operate with capital discipline. As a result, while the S&P Index declined by 6 per cent. over the course of the year, the S&P Oil & Gas E&P Index declined by 28 per cent.

Despite last year's market volatility, recent events suggest that there is potential for an improving macro environment for energy. Demand for oil is expected to continue to grow after surpassing 100 million barrels per day for the first time in 2018. In an effort to bring inventory levels to equilibrium, OPEC and its oil producing allies have continued to signal their support of higher oil prices, agreeing to cut production by 1.2 million barrels per day. Meanwhile, U.S. shale production, a key driver of concerns around oversupply, may face challenges in growing production at levels previously predicted in light of limited energy capital markets activity, depletion of top quality inventory, and a slowdown in technical improvements versus previous years.

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Investment manager, Riverstone Energy: A tumultuous macro environment has continued to weigh on valuations for North American energy companies. There are several reasons for weakness in valuations, which have affected E&P companies in particular. While current commodity prices have been volatile, valuations do not necessarily move in lock-step with the spot market. The more impactful factor has been that the forward curve for oil prices, which underpins valuations, remains at muted levels in the mid-$50s per barrel. Capital markets activity and as a result, M&A and exit activity, have also stalled. As a result, companies have been largely unable to access public equity to finance growth and acquisitions, while the debt markets have demanded cash flow neutrality and balance sheet discipline. Meanwhile, trading multiples across subsectors have steadily continued to decrease as investors turn their attention away from energy.

However, we believe a number of key factors can steady the market, influence a recovery in valuations and increase deal activity. Inventory supply continues to be an ongoing question and will depend largely on the decisions of OPEC and the rate of U.S. production growth. OPEC has indicated output cuts which could potentially be extended for a more prolonged period in an effort to put pressure on prices. In the U.S., the ability to grow production could potentially be hindered by the lack of capital availability in the public markets as investors prioritise producers' ability to generate cash flow over growth. On the demand side, China will be a key area to watch as it continues to negotiate trade agreements with the U.S. and determines its domestic fiscal policies to support economic development.

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Technology

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

Julian Cazalet, chairman, Herald Investment Trust: The most pressing issue today is the trade and tariff war between the US and China. It appears that President Trump's aggressive stance is supported by the US electorate, and even more by the US security departments, so tensions are unlikely to abate. We may be seeing the start of major structural changes with a Western US centric sector diverging from China, and China developing an indigenous self-contained sector. This has already become apparent in the telecoms sector where it appears that Ericsson and Nokia will dominate supply of 5G in the West, versus Huawei and ZTE in China.

The challenge will be for hardware companies dependent on a China supply chain, such as Apple. China is currently a big importer of semiconductors from Taiwan, Korea and the US and is clearly intent on developing indigenous capacity, which will present other challenges.

It is already evident that sub-contract manufacturing is moving out of China at the commodity end for cost reasons, and further up the value chain for tariff and political reasons. Herald focuses on investing in small companies, so we are only marginally exposed to this dynamic: we have a modest weighting in Asian manufacturing and no exposure to the large semiconductor companies.

The only effect will be secondary, if the US/China tensions inhibit global growth. Trump might be an unpredictable mouthpiece to trade negotiations, but it is certain that there is a wider 'US establishment' alarm at the growing strength of the Chinese technology industry, and the US dependency on it as a supplier, for security reasons more than the balance of trade. It seems wise to assume that this will be an evolving issue for months and years to come. If China still has to develop leading edge semiconductor technology, it is already leading edge in many internet technologies.

Although some valuations are discounting considerable growth, and are stretched when adjusted for share-based payments, the sector is still dynamic, and small companies continue to emerge at sensible valuations. The UK has entrepreneurial creativity and continues to be an interesting market. It is constrained by a shortage of institutional co-investors, but that helps Herald in terms of value at the point of entry. Valuations remain more challenging in North America, but the economy and sector remains world-leading.

The implementation of MiFID II has clearly not helped. Successful institutional small company investment managers tend to move up the size scale ignoring microcaps, and illiquidity is increasing due to market breakdown. This is a greater concern for open-ended funds with unpredictable cash flows.

There has been a wide divergence in performance between stocks. A few have disappointed at the trading level, while others have just been de-rated. The subset of the technology sector that has experienced downgrades has mainly been exposed to volume markets, such as mobile phones and automotive. This has hit the semiconductor sector in particular where increases in capacity combined with lower growth in demand have led to price cuts and margin pressure. However, the appeal of the sector is that it is not homogeneous, and in all markets, there are some that grow.

The US economy, and consequently the global economy, has benefited from tax cuts which have provided a tailwind to corporate profits. However, this has been offset by the Federal Reserve moving towards normalising interest rates, which the market worried about in the fourth quarter. This, as much as the tariff war, has spooked the markets. Of concern is that the UK has hardly started to normalise interest rates with the Bank of England fearful over slowing the economy around Brexit uncertainty. The housing market already recognises that easy money will not endure forever. However, the macroeconomic environment is less relevant to the technology sector than almost all others. We continue to be in an exciting phase where companies have to adapt or be disrupted. In addition, cybersecurity, data protection (GDPR) and regulation all require compulsory expenditure for Governments and businesses alike.

Several references have been made to regulatory changes. Metaphorically this is what keeps me awake at night, not the US/China trade war, not Brexit, not politics, but the trends in public markets.

If recent trends persist then quoted markets, for small companies anyway, will cease to exist. The private investor will be marginalised, and private equity will own everything.

We discuss this challenge ad nauseum. Wise elder counsel tells me the darkest hour is always just before dawn.

QuotedData

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