

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

Led by the US, which had its best month since January, equity markets had a strong June as confidence in the likelihood of a Fed rate cut grows. Gold also shone on the back of geopolitical tension in the Middle East while the US dollar lost value following softer economic data and the prospect of an interest rate cut.

Global

Caution rises following early 2019 flourish

Hamish Buchan, chairman of Personal Assets Trust, believes equity markets today offer investors the choice of overvalued quality and cyclically or structurally challenged 'cheap' stocks. He adds that it is a misconception that falling interest rates are good for equities, citing falls in 2002 and 2008. The managers of Seneca Global Income and Growth believe a global downturn will start some time in 2020 or early 2021, which would be preceded by a bear market beginning in 2020. Alec Letchfield, manager of Hansa Trust, says it is very hard to call how the US/China trade war will pan out, adding that whilst one may not always agree with his methods, market sentiment seems to be moving towards Donald Trump on trade. The managers of Monk Investment Trust believe the wider economic background remains largely unchanged from a year ago; to them, corporate sector progress is far more important to long-term value creation.

UK

Value and a resilient economy widely discussed

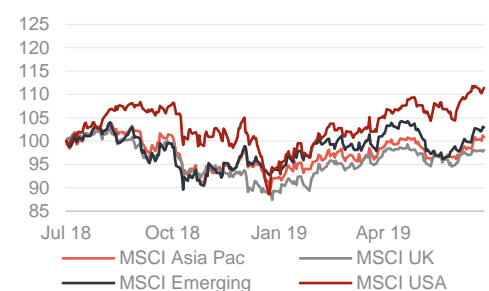
Mark Barnett, manager of Edinburgh Investment Trust, says the outlook for the economy is more resilient than currently implied ...

Exchange Rate	28/06/19	Change on month %
GBP / USD	1.2696	+0.5
USD / EUR	0.8793	(1.8)
USD / JPY	107.85	(0.4)
USD / CHF	0.9763	(2.4)
USD / CNY	6.8668	(0.6)

Source: Bloomberg, Marten & Co

MSCI Indices rebased to 100

Time period 02/07/2018 to 28/06/2019



Source: Bloomberg, Marten & Co

	28/06/19	Change on month %
Oil (Brent)	66.55	+3.2
Gold	1409.55	+8.0
US Tsy 10 yr yield	2.0051	(5.6)
UK Gilt 10 yr yield	0.833	(6.0)
Bund 10 yr yield	-0.329	61.3

Source: Bloomberg, Marten & Co

UK (continued)

...by sterling or equity valuations. The managers of Montanaro UK Smaller Companies note that since the global financial crisis, more than £2 billion has been withdrawn from UK smaller companies. They expect this to reverse once there is more clarity about the impact of Brexit. The managers of Schroder UK Mid Cap discuss surveys that show consumers to be more confident about their personal economic situation than about the country's economic prospects. In their view, the growth household spend is reasonably sustainable, underpinned by a strong jobs market, higher wages (the fastest rate since 2008) and beneficial tax changes. Jonathan Cartwright, chairman of BlackRock Income and Growth Investment, and Robert Robertson, chairman of Lowland Investment company, both agree that the opportunity set is widening.



Europe

More accommodative interest rate policy globally has brightened the mood but risks remain

While European equities have been performing well in the year to date, Francesco Conte and Edward Greaves, managers of JPMorgan European Smaller Companies, believe it is better to remain prudent given the lingering threat of exogenous forces including a potential escalation in the US/China trade war, potentially bringing the EU into the cross-fires. The chairman of Montanaro European Smaller, R M Curling, believes that the market's fundamentals remain largely positive, adding that the fund does not attempt to time shifts, preferring to invest in businesses that can thrive across a cycle.



Global emerging markets

Attractive valuations, modest earnings expectations and widening growth differentials with developed markets could strengthen confidence

Chetan Sehgal, manager of Templeton Emerging Markets, remains positive, believing that several catalysts could further strengthen confidence. These include widening economic growth differentials between EM and developed markets in the former's favour, relatively undervalued EM currencies in spite of balance of payment surpluses in several markets, undemanding valuations and a solid outlook for corporate earnings. John Rennocks, chairman of Utilico Emerging Markets Trust, says that one challenge for EM has been reduced US dollars in circulation, leading to a broad economic slowdown. This has placed pressure on EM economies and markets. Added to this, the continued rise in oil prices has had the effect of weakening several EM economies as energy costs rise sharply. The managers of Aberdeen Emerging Markets believe that the prospects for the EM rally to continue remain promising with valuations attractive on an absolute and relative basis, while earnings expectations remain modest. They add that global investors remain significantly underweight EM.



Asia Pacific

Asian markets remain vulnerable to trade fallout

Andrew Graham & Damian Taylor, managers of Martin Currie Asia Unconstrained Trust, are of the view that the earnings cycle in Asia appears to be bottoming after a torrid year of downgrades. They go on to discuss the why they believe the long-term secular growth opportunity across the region remains substantial. The manager of Schroder AsiaPacific, discusses the China/US trade war, saying it is unclear whether China has stepped back from what the US took to be firm promises, or whether strong domestic equity markets and economy emboldened Trump to seek more concessions.

Irrespective of the causes, the manager adds that while regional markets do not look expensive severe trade disruption has the capacity to lead markets substantially lower. David Shearer, chairman of Aberdeen New Dawn, makes the point that while corporate governance is still a concern in China, the manager has seen signs of progress, with more companies adopting better practices.

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India

Re-capitalisation of banking sector holds key to turning around earnings environment; Modi re-election to fuel pace of reforms growth

The mandate handed to the BJP government, following Prime Minister Modi's recent re-election, should result in an acceleration in the pace of structural reforms. This is the view of Hasan Askari, chairman of Aberdeen New India Investment Trust. He goes on to say that he expects the government to continue its capital expenditure-heavy programmes, which should provide some cushion from the tougher external environment. Elsewhere, Rukhshad Shroff and Raj Nair, managers of JPMorgan Indian Investment Trust, say that in the longer run they see no particular correlation between which party is in power and the pace of GDP growth in India. Over the past five years, nominal GDP growth has not fed through to earnings growth mainly due to the banking sector holding a lot of non-performing loans. With capital positions being re-built, the managers say that an earnings rebound is likely, which would clear up the path towards higher returns.

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Biotech and healthcare

Genomic powered medicine making exciting progress

Sven H. Borho and Trevor M. Polischuk, managers of Worldwide Healthcare Trust, take us on a tour de force of the sector, including detailed commentary around biotech, generic pharmaceuticals, and medical devices. There is also a discussion on how the US 2020 presidential election might shape policy. Martin Murphy, manager of Syncona, tells us that the Third Wave of advanced therapies, in particular cell and gene therapies, have continued to gain significant momentum this year. He describes these 'undoubtedly transformative medicines' as possessing the potential to drive decades of innovation in healthcare as personalised, tailored medicines come to the fore powered by advances in genomic understanding.

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Private equity

Expect to see new investment and realisation activity remaining buoyant

The manager of Standard Life Private Equity foresees the levels of new investment and realisation activity remaining robust over 2019 and into 2020. This is driven, in part, by Europe and North America having a large population of privately-owned businesses and a substantial number of corporates looking to divest non-core divisions, providing significant opportunity for private equity managers. European and North American private equity firms account for the significant majority of all private equity firms globally.

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Hunt for yield re-ignited as central banks move away from rate increases

Debt

Paul Read, Paul Causer and Rhys Davies, managers of Invesco Enhanced Income, say that the more dovish backdrop (the Fed has stopped raising interest rates) has re-ignited the hunt for yield and that investor demand for new issues remains high. That said, they note that the overall level of yield has fallen back towards recent averages and so the strong gains seen in the first quarter of 2019 will probably moderate. Elsewhere, the manager of Alcentra European Floating Rate Income expects issuance of €70bn to €80bn for the full year, lower than the €96bn in 2018. The strength of the issuances market is supported by private equity houses continuing to have excess capital to deploy. Finally, the manager of Chenavari Toro Income believes the current “goldilocks” weak economic growth background coupled with the U-turn in monetary policy should be supportive for European credit and especially structured credit where the default picture remains benign for now.

Social housing regulator offers view on leaseback model

Property UK

We hear from the manager of Civitas Social Housing, who discusses the current state of the supported housing sector, including commentary around the Regulator of Social Housing noting at a recent Social Housing Finance Conference that there was “nothing inherently wrong” with the industry model. Elsewhere, James Agar, manager of Ground Rents Income, tells us why continuing uncertainty relating to leasehold reform is contributing to transactional volumes remaining low.

Uncertainty creating UK opportunity comparable to Southern European real estate markets in 2008 and 2011

Property - debt

The manager of Real Estate Credit Investments tells us that European real estate markets continue to be polarised, with a marked difference in demand between long-term income assets and those which need asset management or development. Debt markets demonstrate a similar polarisation, with lending appetite (both banks and alternative lenders) focused on long-term core income lending and eschewing value-additive or development lending. The manager feels that the aversion to value-additive asset lending in favour of core income lending is misplaced. The manager goes on to say that German and Spanish lending markets demonstrate the greatest depth of competition and hence represent a weak risk adjusted investment proposition, with France representing the better proposition for lending. Brexit uncertainty is, in their view, presenting the UK real estate market as the destination for opportunistic capital, much like the opportunity presented in the Southern European real estate markets during the 2008 and 2011 crises.

Growing familiarity with alternative energy leading to competitive pressure for assets

Renewables

We hear from John Laing Environmental Assets, who say that in the context of sourcing acquisition targets, their main impression is of competitive pressure in asset markets. This pressure is felt more acutely in market sectors that investors are now comfortable with, such as wind and solar, but is present now across the spectrum of environmental infrastructure. Indeed, the board has noted increasing competition in sectors as diverse as energy-from-waste, biomass, flexible generation and hydro. Kevin Lyon, chairman of NextEnergy Solar Fund, tells us that they expect to continue taking advantage of the

new-build opportunities they have secured in the subsidy-free solar sector in the UK. The manager of SDCL Energy Efficiency Income tells us that the energy efficiency asset class is becoming an important component of energy supply and demand management. On electricity prices, they say that prices remain high in resource-constrained markets such as the UK and North-East USA. In combination with depressed natural gas prices, this continues to present an attractive incentive for alternative sourcing of lower cost and lower carbon energy through energy efficient or distributed generation solutions.

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Other

We have also included comments on North America from Gabelli Value Plus Trust and Blackrock North American Income; China from Fidelity China Special Situations; Japan from JPMorgan Japanese Smaller Companies and CC Japan Income and Growth; Russia from JPMorgan Russian Securities; property - Europe from Schroder European Real Estate; technology and media from Augmentum Fintech; commodities and natural resources from Geiger Counter; and the royalties sector from Hipgnosis Songs.

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Healthcare Disrupted

Greater efficiency is the catalyst for information technology to finally disrupt 20th century healthcare systems. Technology is transforming the way that healthcare is managed, delivered and paid for and so changing the competitive structure of the industry. This shifting landscape is creating investment opportunities that extend well beyond the familiar pharmaceutical companies.

Find out more about how the **Polar Capital Global Healthcare Trust** is seeking out and taking advantage of these investment opportunities.



London Stock Exchange Ticker: PCGH

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Global

(compare Global funds [here](#))

Nick Train, manager of Lindsell Train: As I write this report, I'm struck by how many of The Lindsell Train Investment Trust's (LTIT's) holdings are at all-time highs. It's true of nine of our thirteen quoted equities (or true to within a percent). LTIT itself was recently at an all-time high. What is this telling us - and you as shareholders?

Well, first it is at least a part rebuttal of the arguments you hear about consumer brands dying in the 21st century. Dying as a result of the changing tastes of younger consumers or the brand-destroying power of digital media. We own six branded goods companies - AG Barr, Diageo, Heineken, Laurent-Perrier, Mondelez and Unilever. And of these all but Laurent-Perrier have recently been at all-time high share prices. What's more, the four big global companies - Diageo, Heineken, Mondelez and Unilever have all delivered double digit share price gains so far in calendar 2019. It is clear that something about these brand-owning companies has surprised investors lately - and surprised them in a good way. What we'd say is that when you look at the business performance of individual brands owned by these companies - brands such as Johnnie Walker, Tanqueray, Heineken, Cadbury, Oreos, Dove and Magnum - then it becomes hard to sustain the argument that consumer brands are losing relevance and customer loyalty as we approach the third decade of the 21st century. In fact, these global brands are selling more than ever before; the pace of their growth is accelerating and, almost certainly, they are more valuable today than at any previous time in their venerable histories.

Actually, we're sure that's true too for the value of both IRN-BRU and Laurent-Perrier (now that would make for an effervescent cocktail, albeit tending to spoil each constituent), even though this pair have had dull share prices so far in 2019.

Also standing at recent all-time share price highs are London Stock Exchange (LSE), PayPal and, after a rally, RELX. This trio are each more or less digital "growth" companies - for this is what the LSE has transformed itself into. Over time these have been amazing winners for your portfolio. We have held them through periods of underperformance and through periods when the consensus has been that their shares had become overvalued. We've held on for a variety of reasons. First, we don't care if our holdings underperform the market. Next, we have disagreed with the worries about their purported overvaluation, because our thinking about valuation justifies very high valuations for exceptional companies. But, most important, we have not sold because of the lesson Mike and I have learned ourselves over the last 20 years. And that lesson is not to sell out of structural growth companies, for as long as the prospects for that growth still seem assured.

Now - we're not saying that last proposition is an eternal verity. We know that so-called "growth" has not and will not always outperform so-called "value". We well know that owning expensive "growth" companies has proven a gilt-edged way to lose money over stock market history. But it is important to reflect on two circumstances when considering where investment value lies in today's equity markets. First, it really does seem as though successful digital "growth" companies have bigger opportunities, with more favourable profitability, than most of us expected. And that the growth surprises delivered by digital growth companies have meant that their valuations have actually stayed persistently too low, despite looking "high" by conventional measures. Second, their success as businesses is actively undermining the relevance and profitability of many "value" industries and companies. Meaning that the ostensible "value" of those companies may be illusory.

As a result, we are not yet tempted to sell out of these digital winners. In addition, we are also content to hold on to the other three of our four holdings which are not standing at all-time highs. You remember from above that Laurent-Perrier is one of the four - currently 27% below its peak reached in 2007. The other three are also digital growth companies - or at least digital growth companies manqué. They are eBay, Nintendo and Pearson. Their share prices were recently 11%, 47% and 58% below their all-time highs in 2018, 2007 and 2000 respectively. Perhaps we have been too patient with these holdings. But if being patient is central to your investment process - as it is with us - then it is difficult to establish when you have become too patient. Suffice to say, we still see plenty of potential in these three investments. Particularly Nintendo is fascinating for us - as the valuations being placed on other global entertainment franchises keep going up and up.

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Hamish Buchan, chairman of Personal Assets Trust: The twelve months to 30 April 2019 was very much a 'game of two halves' with the UK stock market falling sharply from its peak last May, followed by a rally since the calendar year end. Our aim is to 'preserve and grow' the NAV, in that order, and - as shareholders would expect - the trust's NAV and share price volatility was considerably lower than that of the wider market. We believe conditions will continue to be challenging in a world of prospective low returns from all asset classes.

Equity markets today offer an invidious choice to investors: overvalued quality on the one hand and 'cheap' stocks on the other. In the latter category are cyclically or structurally challenged businesses. Earnings from financials, airlines, housebuilders and miners may well be close to cyclical peaks, while structurally challenged businesses are to be avoided as they will likely prove to be wasting assets. More often than not, high yields are an indication of future poor returns, not bargains. With interest rates having remained low for such a prolonged period, dividend growth has been rewarded by share price rises, but many company pay-out ratios are now unsustainable; they are acting as bribes to shareholders, converting capital into income. The temptation of high beta, low quality stocks should be resisted. Our preference remains for companies which invest to sustain good returns and which have a proven history of prudent capital allocation.

We are wary of management teams that allocate capital as if it were 'other people's money'. Regrettably, this becomes more common later on in the cycle, when capital becomes all too readily available.

We are at that dangerous stage in the market cycle when too much liquidity in the system has caused share prices to rise without much improvement to earnings, a sign of investor insensitivity to valuation risk. Corporate indebtedness is at record highs. This has brought forward demand and flattered margins but the economic cycle is at its peak, not a trough. To us, the prospective rewards look less than compelling when compared to the risks.

Markets have been buoyed recently by the reversal of the short-term, oversold position in December, a more dove-ish tone from the Federal Reserve regarding the outlook for monetary policy and 'travelling hopefully' in the expectation of a resolution for Brexit and US/China trade talks. The stock market has reacted positively to the pause in US interest rate rises but the less emotional and more rational bond market is more reliable and less swayed by short-term sentiment. Bond yields point to a weaker economic outlook.

There is a misconception that falling interest rates are good for equities. Cast your mind back to 2002 or 2008 when interest rates were being cut aggressively; those were

dreadful years for equity returns. A significant amount of underlying fragility and vulnerability lies beneath current levels of stock markets. In the words of the novelist Ian McEwan, 'the present is the frailest of possible constructs, in which a kaleidoscope of options remains possible'. We agree and are positioned accordingly.

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The managers of Seneca Global Income & Growth: As for economic and financial market performance over the year, it was particularly eventful, or at least more eventful than the previous year. Having been weak at the end of the company's previous financial year, equity markets as a whole performed well for the first five months of the period under review. Markets, though having been driven by a small number of tech stocks in the US, were ahead for the year. Rising bond yields reflected robust economic growth, as did the rising oil price. Furthermore, although there had been many angry words spoken by Presidents Trump and Xi on the subject of global trade, it had always seemed that compromise was not too far away.

Then, October saw equity markets fall sharply and while in November they stabilised somewhat, there was a resumption of the declines in December.

We believe that much of the weakness at the end of the calendar 2018 year can be traced to US President Trump's tax cuts that were signed into law in December 2017. Although they appeared regressive, favouring the wealthy, they were embraced widely, and markets initially responded well to them. However, although growth appeared to be slowing elsewhere, the tax cuts provided a thoroughly unnecessary boost to an already buoyant US economy. It is conventional wisdom that fiscal stimulus is required when private sector demand is weak, not when it is strong. President Trump chose to ignore this reality and pressed on with what had been a campaign promise.

Emboldened by his success at pushing a campaign promise through, President Trump then set his sights on China and its alleged unfair trade practices. Despite the wobble in markets in February and March last year that the resulting trade tensions caused, the US economy, equity markets, and currency were all enjoying the shot of adrenaline provided by the tax cuts. In relation to equities, investor exuberance focused on a small number of stocks, the so-called FAANGs (Facebook, Apple, Amazon, Netflix and Google).

However, both the dollar's strength and the trade frictions were negative for emerging economies and their financial markets. Weakness in emerging market equity, debt and currency markets for much of 2018 was pronounced.

At the beginning of October, investors may have woken up to the fact that the rise in the FAANGs was unsustainable and also that the tax cuts, rather than being a good thing, may simply have led to overheating, bringing forward the end of the cycle.

Thus, the last three months of the calendar year saw equity markets, the oil price and safe-haven bond yields all fall sharply. Yield curve flattening, particularly in the US, sparked concerns that the next recession was closer than many had previously believed. Optimism about trade talks turned to pessimism, with the arrest in Canada of Chinese government linked company Huawei's CFO coming shortly after the positive remarks made by President Trump at the G20 summit in Argentina.

Closer to home, Brexit related anxiety caused additional problems for UK financial markets. In December, Prime Minister May faced a no-confidence vote brought by hardliners in her party. She won, but her position was weakened.

The last four months of the review period - the first four months of the 2019 calendar year - saw a strong reversal of the declines at the back end of 2018. This performance

was driven by central banks becoming more dovish, in the face of inflation data that appeared to show price pressures subsiding. Indeed, the last four months were unusual in that safe-haven bonds as well as equities performed well. Normally, what is good for equities, namely growth, is bad for bonds. In this instance however, the good performance of safe-haven bonds appears to have been due more to changing expectations about longer term monetary policy than growth fears.

Outlook

As for the outlook, our expectation remains that we will see a global downturn start some time in 2020 or early 2021, which would be preceded by a bear market beginning in 2020. However, we are aware that things could happen sooner than this, which is why we began reducing the equity exposure of your company around two years ago, first from overweight to neutral in relation to strategic asset allocation, then by moving increasingly underweight. We also know that things could happen later than our base case scenario and so are ready and indeed will remain ready to stay defensive for longer.

Our premise for believing that the downturn is still a little way off is that global monetary policy is still very loose and thus will not be tight for at least another year or so. Even in the US, where the business cycle is most advanced, monetary policy has only recently stopped being 'accommodative' - according to Fed Governor Jay Powell, monetary policy is only around 'neutral' and it remains unclear at what point it will become restrictive. Furthermore, there may be a self-fulfilling element to any rise in growth concerns, so it is very possible that the Fed will continue to keep on hold future interest rate increases.

That said, global unemployment across the developed world is now at 40-year lows, with the US and the UK nudging at the half century mark. Although some argue that the relationship between unemployment and inflation - known as the Phillips Curve - may not be as strong as it was previously, it seems inevitable that at some point the tightness in labour markets will spill over into consumer price inflation. And anyway, the argument about the death of the Phillips Curve has a dangerous 'this time is different' feel to it. Also, there may be an underappreciation of the extent to which monetary policy was tightened as a result of the ending or reigning in of quantitative easing policies across the developed world. If monetary policy is in fact tighter than some might think on the basis of policy rate increases alone, the global economy could be more vulnerable to a slowdown than is generally believed.

However, we are living in a world in which deflationary pressures persist, and in which any inflationary pressures that do rise above the surface are being met with powerful negative feedback effects, the fall in equity markets in the fourth quarter of 2018 being a case in point.

Much has been made recently of the albeit-brief inversion of the yield curve in the US. An inverted yield curve has been a very reliable recession indicator, having in the US preceded every recession since World War II and not once giving a false signal. However, although they have fallen across the board in recent years, yield curves on the whole remain positive, and it may be a while before they make a firm move into negative territory.

Furthermore, although the headline unemployment rate is now very low in the US, this may be hiding some underlying weakness. The US participation rate - the workforce as a percentage of working age population - fell sharply after the last downturn and has never really recovered. Some of this will have been due to demographics associated with an ageing population, but some will also have been due to people giving up looking for work. If the economy can remain reasonably firm, disaffected workers may be

enticed back, allowing growth to continue but wage pressures to remain relatively subdued. However, any such effect would likely be minimal, serving only to postpone the inevitable.

In summary, we do not think the world economy has yet overheated as is usual before a recession. Inflation pressures have certainly risen in recent years, but they remain relatively benign. And they will have weakened as a result of the falls in equity markets at the end of 2018 and the related concerns about growth. We would not be surprised to see central banks remain dovish for a few months yet. This would argue for some sort of temporary recovery in equity markets in 2019, though it looks like that may all have been squeezed into the first few months of the year.

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Alec Letchfield, manager of Hansa Trust: The past year really has been one of contrasts for world stock markets. Having been weak for much of 2018, culminating in the worst December for many years, the first quarter of 2019 has been one of the strongest in the current cycle. Indeed, the S&P 500 saw its highest return since 1998, Chinese equities enjoyed their best quarter since 2014 and oil had its best quarter in a decade. Rather counterintuitively in such a risk-on environment, even bonds generated positive performance.

Market backdrop

Whilst vindicating our view that the extent of the sell-off in 2018 was unwarranted, the strength of the bounce seen so far in 2019 is surprising.

As a reminder, our stance coming into the New Year was one of a maturing cycle, but not the end of the cycle. Risk had risen for much of 2018, with monetary policy well into the tightening phase, Trump doing his best to unsettle markets and economic growth outside the US slowing for much of the year. Despite this, our central view was more sanguine, based on the fact that we just didn't see the normal metrics in play which typically pre-empt recessions (and with them a bear market).

Imbalances, which are key to the health of the economy, appear to be well under control. Household debt remains perfectly manageable, with the savings ratio at average levels compared to history. Housing, so often the cause of weakness in the household sector, is not causing us concern, with affordability good and housing starts normal. Banks, who can normally be relied upon to extend credit to those areas which are overheating, appear to have avoided doing so this time round, although the high yield credit market has expanded. We would love to say this is due to good management and the banks learning from past mistakes, but in reality, it more likely reflects the hangover from the Global Financial Crisis. The need to rebuild balance sheets, combined with a tighter regulatory framework, has curtailed their normal pro-cyclical exuberance.

That's not to say there are no areas of concern. Corporate borrowing has risen sharply, especially in more highly leveraged companies. Further, the quality of these loans has diminished with the rise of more risky practices such as covenant light loans. Even here though there are mitigating circumstances. The sharp reduction in interest rates seen post the Global Financial Crisis means it is entirely natural that companies should switch from expensive equities to cheaper debt. Instead, what is important is the level of the debt burden and with real and nominal rates still low we find that the ability of companies to service their debt remains well within historical limits. Importantly, corporates are spending these cash flows in a controlled manner ensuring balance sheets remain healthy.

We also worry about inflation albeit here the messages are a little confusing. Having recently spent time in the US seeing a wide range of companies, across sectors and sizes, one of the key issues currently faced is the ability to attract and retain staff and the cost of doing so. Interestingly, however, this wage pressure doesn't appear to be showing at the headline inflation level and, indeed, rather counterintuitively some countries have seen bond yields dip back into negative territory, which suggests deflation rather than inflation. This may partly be a function of timing but we think it is more likely due to a differing global picture, with Europe facing structural challenges versus a much more robust outlook for the US. We will continue to watch carefully to see how the situation develops but our main concern is that the US central bank and government are minded to let the economy run hot, potentially requiring them to slam on the brakes, through higher interest rates, if inflation does get out of control.

Interlinked with this is the changing monetary policy landscape. For much of 2018, interest rates and monetary policy were on a tightening trend. In the US rates have now been rising since 2015 and even Europe has started the process of exiting its quantitative easing programme. Japan is the only country still actively wedded to easier monetary policy. Markets, quite rightly, worried that this withdrawal of liquidity would ultimately weigh on asset prices with peak-fear reached when the US Federal Reserve chairman, Jerome Powell, stated late in 2018 that rates would need to rise significantly more given the strength of the US economy.

Then we saw an unusual about-turn. Central bankers, as a rule, try to be consistent in their messaging for fear of surprising markets and causing unnecessary volatility. The announcement in early 2019 by chairman Powell that rates would now be on hold hence came as quite a shock to markets given his earlier comments. Why the change? Well possibly this reflects Powell's underlying scepticism of economic models. Being a lawyer by training he is far less wedded to conventional economic theory and much more data sensitive. With data highlighting a slowing in growth in late 2018 it is perhaps less surprising that he should react in such a way. Unsurprisingly markets rallied sharply on this announcement, helping lift investors from the funk of the last quarter, with them now starting to question if the next US rate move might even be down rather than up.

The final area of concern for investors, trade, is much more difficult to call. Whilst one may not always agree with his methods, market sentiment seems to be moving towards Donald Trump on trade. Having turned his back on globalisation, Trump has argued that countries such as China are abusing their trading relationship with the US. This idea is now gradually becoming the accepted wisdom more broadly in Washington. Even if the Democratic Party were to gain power it looks unlikely there would be a significant shift from the current anti-China rhetoric.

We think there is a short and a long-term angle to how the current trade war evolves. In the short-term some form of deal and 'win' for Trump looks increasingly likely. With China already experiencing a period of economic weakness there is a real danger that a prolonged trade war could push China over the edge and into a downward growth spiral. China is now of such a size that the old adage of "when the US sneezes the rest of the world catches a cold" is likely to work both ways. Trump, who uses the stock markets as a barometer of his success, looks keen to head off such an outcome, recognising that a strong US economy is key to his future election success.

Whilst encouraged by this we remain troubled by the longer-term outlook for trade. We think there is growing likelihood that we sit on the precipice of a protracted trade war, with President Xi unlikely to give up on his aspirations to make China the pre-eminent global superpower with domination in a number of key sectors; part of his 'Made in China 2025' strategy. He may well be prepared to pacify Trump in certain areas in the

short-term, but we see a number of red lines over which he is unlikely to make concessions.

Pulling all together we remain firmly of the view that we are in late cycle territory. Undoubtedly, as highlighted above, this comes with all kinds of worries and concerns; it always does! However, our belief that we are not dipping into recession anytime soon means we viewed the derating experienced in Q4 as unwarranted. Valuations became cheap in a number of markets and for this reason the bounce seen so far this year is, in our minds, entirely justified.

What is perhaps more surprising was the strength of the snapback. Although hard to monitor, our sense is that the market was very conservatively positioned coming into 2019 with the trauma of the Global Financial Crisis fresh in investors' minds and with the current cycle unusually long by past standards. Therefore, the pain trade was for markets to rise and this is just what we saw. As is often the case this can result in larger and more powerful movements in prices than one would normally expect.

How do we see the cycle ending?

One of the most useful exercises to go through late in the cycle is to think about the scenarios under which we would become more cautious.

Here we see three potential outcomes, one less worrying, the other two far more damaging.

The first, less worrying scenario (and our core view), is that we see a conventional interest rate induced recession and bear market. As alluded to above the most common manner in which cycles typically come to an end is through excesses forming in certain key areas of the economy, which ultimately necessitate central banks to slam on the brakes and in the process induce an economic downturn and fall in markets. We are not overly worried about this, with this type of downturn normally short-lived and shallow, albeit such a scenario may require that governments to step up to the plate, with central banks having limited firepower. Going into a recession with low rates and extended central bank balance sheets will necessitate that fiscal policy is used more extensively, with the effectiveness of monetary policy almost certainly diminished under such a scenario.

Much more worrying would be systematic issues within China or Europe.

China represents one of the most remarkable development stories in recent history. From a low base it has become an economic powerhouse and the world's manufacturer. Around one third of global growth is expected to come from China in the coming years reflecting both the size of China's economy and the pace of its growth. This compares to a contribution of less than 20% from the US. From a non-economic perspective, China is also making huge progress especially technologically; earlier this year for example it became the first country to land a vehicle on the far side of the moon.

Unfortunately, this progress has come at a cost. Private sector debt levels have been growing at an alarming rate and have reached levels where other historically high growth countries, such as Japan and Korea, hit a wall and ultimately collapsed. Equally whilst the core banking system looks fine, the shadow banking system now represents over 50% of GDP. Affordability in many key Chinese cities is some of the worst globally and the working age population has started to decline as a proportion of the overall population due to the one child policy.

It's impossible to say if these issues will come to a head anytime soon, but one can't help but note that precedent is typically not good from other countries which have faced

similar problems in the past. The Chinese authorities appear to be well aware of these challenges, trying to tackle private sector debt levels for example, and one must hope the command economy structure will enable them to manage their way out. If they are not successful the implications for global stock markets could be dramatic.

Europe equally faces many structural threats albeit the opposite to the Chinese bubble. Whereas China is arguably suffering from years of excessive, possibly ill-directed, growth, Europe has barely recovered from the depths of the Global Financial Crisis. Growth has been lacklustre to non-existent in many European countries and the banking system remains mired in the same challenges the sector faced ten years back. Germany, the engine of the Euro area to date, suffered a worrying setback last year, highlighting just how important China has become to end-demand for German products. One can't help but think that if China is successful in transitioning from a low to high-end manufacturer it might cut the legs away from the Mittelstand, the heart of Europe's growth.

Near-term we see the outlook for Europe and China as interlinked. If China is successful in kick-starting its economy this would likely provide a much-needed fillip to European growth, albeit from very low levels. Longer-term we are far less optimistic. Unless Europe can take the necessary steps towards greater social, fiscal and banking integration, it is hard to see the union remaining in its existing form. We are already seeing chinks in the armour with the UK withdrawing (we think!) and the election of anti-EU parties in key countries such as Italy. Watch this space.

Summary

There is clearly a fragility to markets at present. The falls experienced late last year and the speed with which markets have rebounded are symptomatic of this. Hence whilst remaining biased towards equities and risk assets generally, our direction of travel is to systematically lean away from equities over time, especially if we see any deterioration in the issues highlighted.

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Harry Wells, chairman of Establishment Investment Trust: Markets suffered from volatility during the last financial year, primarily dictated by the US Federal Reserve's changes in monetary policy and interest rate expectations. Global markets sold off sharply during the latter half of 2018 as the Fed attempted Quantitative Tightening by selling bonds off their balance sheet and talking up potential interest rate increases. However, some slowing of the US economy, a global growth scare and deteriorating trade flows compelled the Fed to perform a "volte face" restoring confidence in a more benign monetary and interest rate outlook; hence providing the catalyst for a sharp rebound in markets in the first calendar quarter of 2019. Market sentiment has also been badly affected by US/China relations, the tit-for-tat imposition of trade tariffs and a general slide towards protectionism and regulation, threatening the landscape of free trade and the benefits of globalisation.

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Charles Plowden, Spencer Adair and Malcolm MacColl, managers of Monks Investment Trust: The financial year to end April 2019 saw global markets agitated by fears over trade wars, the misuse of technology and data and the possible stalling of a ten-year bull market. Such fears calmed during the early months of 2019 and markets recovered somewhat. In truth, the economic background has remained largely unchanged from a year ago, with a familiar list of concerns juxtaposed with continuing good progress from companies around the world. As previously, the headlines are dominated by the macro concerns, whereas we believe the progress of the corporate sector is far more important to long-term value creation.

Anthony Townsend, chairman of BMO Global Smaller Companies: This was a tricky year for investors at large and our manager to navigate. Interest rates rose in the US and the pace of global economic growth moderated. There were bouts of volatility in financial markets as the risks of a full-blown trade war between the US and China ebbed and flowed. More locally, the ongoing political saga of Brexit served to undermine visibility around the future prospects for companies operating in the UK. It was perhaps not surprising therefore that returns from equity markets were modest in the twelve months nor that smaller company shares tended to lag their larger peers over the period.

Since the end of the financial year, the US and China trade war has stepped up a gear, with additional tariffs being imposed in both directions. This is not helpful for investor sentiment or for the global economy even though the impact of these measures may be limited for most of our holdings. The UK political scene remains in a state of flux after the resignation of the Prime Minister. More positively from a market perspective, it is possible that fiscal and monetary policies may be eased in some parts of the world to take account of the slowdown and still low inflation.

While a more cautious overall approach to the management of the portfolio seems merited for now, the board remains of the view that the long-term outlook for the global smaller companies' market remains attractive.

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James de Bunsen and Peter Webster, managers of Henderson Alternative Strategies: As we write, it appears that there is much good news priced into equities and bonds. It does not follow necessarily that prices should fall from here but it does mean that the good news needs to continue for markets to make fresh highs. Certainly, the Federal Reserve's decision to put interest rate rises on hold was a large and unexpected fillip for markets in early 2019 as there was not much good news coming from elsewhere. Economic data was decidedly soggy and earnings were being downgraded across the board. Hence the sharp rally in markets was surprising and happened even as investors continued to pull money out of equity mutual funds, despite cash levels remaining historically on the high side. Moreover, bond yields fell sharply, thereby suggesting that the growth outlook was deteriorating significantly. It is very unusual for bond yields to fall and equities to rally sharply simultaneously. Either bond investors are too pessimistic or equity investors are too optimistic. Historically, it has been the bearish bond buyers who have been right more often than equity buyers.

As mentioned at the outset, we do not make market forecasts and we will not start now. We believe some caution is warranted. We believe similarly that we have adequate risk exposure across our six categories, in areas that would benefit from an ongoing environment of positive market sentiment. We, however, are not wholly reliant on such a scenario. We will continue to take profits in assets that are looking more fully valued and recycle the proceeds advantageously into more attractive areas where we identify improving fundamentals. We will also continue to search for less correlated strategies which will provide ballast in more volatile market episodes. We do not need a crystal ball to be confident that there will be more of those around the corner and volatility normally provides opportunity.

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Mark Whitehead, manager of Securities Trust of Scotland:

Market review

The 2019 fiscal year for Securities Trust of Scotland started with a rebound after the rather weak start to equity markets in early 2018. As we moved through the summer

and into autumn, volatility began to pick up again, and the fourth quarter proved to be a very weak period for equities, followed by a strong rebound in the first quarter of 2019. There was political upheaval, macro- and micro-economic volatility, combined with tariff threats and implementations - to name just a few of the drivers of meaningful dispersion in equity market performance.

Before we highlight some of the most significant influencing factors, it's important to understand that the global synchronised growth recovery, witnessed for much of 2017, dislocated in 2018. The US remained the best performing G10 country, with strong real GDP growth, but even this began to wane as we moved deeper into the second half of the year.

This contrasts with the Euro Area, where GDP growth decelerated early last year - a trend that has continued. Elsewhere, Emerging, Pacific and Frontier markets have also struggled with growth slipping.

The strong US dollar, poor budgetary and liquidity conditions, large levels of US dollar-denominated debt and weakening commodities were all highlighted as causes of the slowdown. When combined with higher inflation, this was most acutely felt in countries such as Argentina and Turkey. China has also slowed, no doubt exacerbated by the shock of escalating trade tensions with the US, which had threatened materially to curb GDP growth. Policy interventions, such as tax cuts and looser monetary controls, have been announced and enacted, and the first signs of a pickup in economic activity are becoming evident. This has certainly tarnished sentiment towards Chinese equities, which suffered acutely in the summer, but then rebounded strongly in late 2018 and early 2019.

The speed and magnitude of the collapse in stock markets in December and recovery in January 2019 was breath taking. For the S&P 500, it was one of the worst Decembers since 1931 and the best January since 1987! Very rarely have we seen such an aggressive fall in markets followed the next month by such a violent reversionary bounce back.

The causes of this dramatic change in market sentiment revolved around the macroeconomic activity witnessed in quarter four. Tightening financial conditions and slowing growth across the world, most notably the more recent deterioration in the US, caused sufficient market disruption, particularly in credit and cash-funding markets, to persuade the Federal Reserve to take a much more dovish tone. Bombed-out equity markets, with investor sentiment at rock bottom in late December, combined with the prospect of looser monetary and fiscal conditions, provided the boost investors needed to drive equity markets back toward long-term fair value by the end of January.

The flip flop in Federal Reserve Chairman Powell's policy was also fascinating. It occurred very quickly, with some arguing that he caved in to Mr. Trump's pressure to rein back his tightening policy path. A cynic might conclude that the volte-face has everything to do with Mr. Trump positioning the economy for another surge of growth as we move deeper into the last half of his first term in office. Certainly, one could argue that it was a response to the deteriorating macroeconomic data, which has been buckling under the weight of the China-US trade war.

What is clear, is that global growth is now rather lacklustre. There have been a decent number of industrial activity indicators and PMI surveys across regions that point to a period of more sluggish growth. It seems that the strength in US activity early last year was enough to offset Emerging Market and Euro Area softness, which allowed the global economy to plough an above-trend growth rate. Unfortunately, the recent slowdown in the US has now taken its toll, driving global growth below trend.

Most recently, in March the US 10-year bond yield fell below the three-month Treasury bill yield for the first time since 2006. Commentators have been quick to point out the significance of this. Since the 1960s, seven out of the eight US yield-curve inversions were followed by a recession.

Germany has also seen its economy stagnate - the trade war has affected auto and component sales (among other exported goods) as China has slowed. Consumer confidence is also waning. Elsewhere, Italy's extreme left-wing and right-wing coalition government doesn't seem to be working all that smoothly. Italy is big enough to destroy both the European Union and the euro, and this risk has certainly risen. European risk asset aversion has risen in tandem and, to make matters worse, Italy is now in a technical recession. Encumbered with far too much debt and a fractured political system, it is unclear how they can wade through their own bureaucracy to stimulate activity through supportive policy. Spain, on the other hand, is the odd one out in Europe, and seems to be operating at robust economic activity levels.

Brexit negotiations continue to prove challenging, most likely driving lower growth across Europe, not just in the UK. The weird anomaly is that despite such turgid UK growth, the economy is running at near-record full employment! This is a lagging indicator, so we may see some weakness in the coming months. It might also be due to British business residing in a state of paralysis until clarity on the exit terms is forthcoming, causing productivity to contract.

Yet global equity markets remain firm and could do well for some time yet. For us, this calls for even greater diligence in stockpicking. We don't expect strong appreciation from here, and bouts of volatility should be anticipated. This should provide a much better backdrop for high-quality, cash-generative businesses that are able to distribute sustainable growing dividends to investors. In other words, the perfect income stocks.

Outlook

With global macroeconomic data sluggish in most regions, the question is whether or not we are entering economic recession, or this is just a blip in activity caused by the trade wars and tightening fiscal and monetary conditions? In simple terms, have the central banks, particularly the Federal Reserve, got their hawkish policies wrong? The answer would appear to be 'yes'. In response to weaker data, the Federal Reserve has responded by shifting its policy path, so rather than the two further rate rises we expected in 2019, there is now the prospect of rate cuts going into 2020 and the stance of 'easy money' looks set to be extended. The Federal Reserve highlighted the risks investors are well versed in: slower growth in major economies and heightened political uncertainty, including trade tensions and Brexit. This more accommodative stance may well continue to fuel equities throughout the rest of 2019 and in 2020.

The China-US trade dispute continues to rumble on with the focus now on the meeting between Donald Trump and Xi Jinping when the two leaders attend the G20 summit in Japan in late June. There are hopes that the US and China will increase efforts to end their trade war. The question is how this has impaired the long-term economic relationship between the US and China. China is certainly seeing slower growth and is already putting in place its own policy response in the form of its own bank bailout, combined with tax and interest-rate cuts to try to stimulate domestic activity. As a result, we could continue to see a good rebound in Chinese and related equity markets after a terrible year in 2018, as sentiment and activity improve.

In Europe, Brexit is now delayed to October 31. Much will depend on who becomes the next UK Prime Minister and what their stance will be regards this date being immovable. The risks have certainly increased that Britain could be heading for a no-deal Brexit.

Were this to be the case we would likely see pressure on sterling and UK domestic equities. The markets, as with business generally, would benefit from more clarity.

German macroeconomic data is bleak, but we assume that politicians will be putting pressure on Brussels to agree a Brexit deal to prevent a slide into recession. Private investment has been weak and faltering Chinese growth has not been good for exports. A paltry 1.3% GDP growth forecast* for 2019 could improve later in the year if the fiscal backdrop is more favourable.

Global corporate earnings expectations look to have come down a long way since September. This has been driven by a combination of margin pressure, top-line deceleration and the loss of tax stimulus. Earnings estimates are falling, driven by energy, materials and technology sectors. Two negative year-over-year earnings growth quarters would, of course, signal an earnings recession. The market does, however, expect a rebound in earnings later in 2019, but we should not expect that to be too exciting in the face of rising costs for transport/logistics, labour, funding, tariffs and materials.

Now that the S&P 500 has climbed back through fair value, as measured by long-term P/E multiples, we believe we really need to see earnings hit a trough before markets move higher from this point. It is certain that central banks, with a more dovish stance, will hold off on tightening policy and further fiscal stimulus may even be put in place.

In conclusion, the market outlook in our view demands a much more careful stockpicking mentality, a laser focus on corporate margin pressure, and a keen eye on valuation. We don't expect strong moves from here, and bouts of volatility should be expected. This will surely be a much better backdrop for high-quality, cash-generative businesses that are able to distribute sustainable, growing dividends to investors. These may well make up most of the real equity market return for some time.

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Mike Brooks and Tony Foster, managers of Aberdeen Diversified Income and Growth: The performance of global equities during the six months to 31 March 2019 can be split into two distinct halves: a precipitate fall until Christmas Eve followed by an almost equally sharp recovery. During the first half of the period, investors reacted to the unhelpful combination of tightening monetary policy, deteriorating trade relations and a weakening outlook for both global economic growth and corporate profits. The United States was at the centre of all of these concerns, reflected in the initial decline of 19% in the S&P 500 index from its all-time high reached in late September. The fall in global equities seemed to ameliorate some of our long-held concerns on equity market valuation levels but, once the deteriorating earnings outlook was considered, our medium-term forecasts for equity returns were broadly unchanged. As a result, we made no change to our equity exposure during the period.

The global equity market rebound at the beginning of 2019 was largely prompted by dovish comments from the US Federal Reserve. Our colleagues in the ASI Research Institute now expect US interest rates to increase by 0.25% in each of 2019 and 2020. Some of the other concerns, such as the outlook for US-Sino trade relations, also eased.

The factor-based investment approach of the Aberdeen Smart Beta Low Volatility Global Equity Income Fund, which predominantly focusses on high quality, good value businesses, was not well suited to the market conditions which prevailed during the reporting period and the fund lagged behind the 1.5% decline in sterling terms of the MSCI All Countries World Index. The fund's largest positions are shown in the table below.

Emerging market bonds performed strongly during the period. Initially, investors reacted positively to specific newsflow in a number of countries. Of particular note were: the election of Jair Bolsonaro in Brazil; increased financial support from the International Monetary Fund for Argentina; and the tightening of monetary policy in Turkey. After the New Year, the change in the U.S. Federal Reserve's policy stance, mentioned earlier, was reflected in a particularly sharp rally in higher yielding bond markets as part of a more general pick-up in investor risk appetite. We maintain our view that local currency emerging market bonds are the most attractive of the larger, more liquid asset classes. This is primarily due to the attractive nominal (and real) yields on offer relative to developed market bonds. Currencies remain generally undervalued and, in many countries, underlying economic fundamentals are supportive. We are encouraged by the relative resilience and independence of returns exhibited by the asset class over the past year although we do bear in mind that this will not hold true in all potential scenarios.

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James Will, chairman of Scottish Investment Trust: The tentative steps taken by the US Federal Reserve to normalise monetary policy suffered a partial reversal during the period as a programme of interest rate increases has been put on hold. The change in course was prompted by the combination of a sharp, but short-lived, market decline and a series of characteristically pugilistic tweets from President Trump.

It is clearly no easy matter to unwind this era of cheap money as too many asset prices are now apparently supported by low interest rates. This is unfortunate because high asset prices and low interest rates have brought unintended consequences. The most notable of these is an increasing sense of disillusionment with the economic system among many people, particularly the younger generation.

The economic pendulum appears to have swung too far and the counter-swing is more likely to be prompted by events within the political arena. A new breed of politician has tapped into feelings of economic marginalisation and there is a greater willingness to rip up the rule books and question the current state of capitalism. At a minimum, it seems likely that support for the free-spending politician will continue to grow.

The outlook for the global economy has deteriorated since my last commentary although, as yet, not drastically so. The recent escalation of the dispute between China and the US arguably extends beyond trade and could augur a multi-faceted deterioration in the relationship between these two countries with potentially profound implications for investors. The increased tension between the US and Iran risks a disruption to the oil market and has prompted a potentially damaging split between the US and the EU.

An abundance of commentary exists on Brexit and I would simply add that UK assets appear unloved in an international context and we continue to expect the value of sterling to act as a proxy for the state of negotiations.

Although I have spent the last few paragraphs outlining risks, our portfolio consists of investments which we believe are both undervalued and unreasonably out of favour. The long-term merits of our investments give us confidence that our portfolio is well placed for the evolving investment environment.

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John Scott, chairman of Jupiter Emerging & Frontier Income: As explained in more detail by our fund managers, many of the companies into which JEFI invests are performing strongly and growing their earnings; in isolation, they look attractive from an owner's perspective, but there is no doubt that several of the regions and sectors into

which we place our shareholders' money are facing macroeconomic and political headwinds when it comes to investor confidence and trade prospects. The cautious stance adopted by many emerging market investors derives to a considerable extent from the prospect of trade wars, the current dispute between the USA and China being one example, and the recent threats from the White House directed at Mexico being another. The extent to which these disputes have an immediate bearing on some of our holdings in (for example) Brazil and Kenya is by no means clear, but wars of words and the imposition of tariffs between some of the world's largest economies do not boost the morale of the international investor.

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United Kingdom

(compare UK funds [here](#))

Mark Barnett, manager of Edinburgh Investment Trust:

Market Review

The UK equity market provided a positive return over the twelve-month period to 31 March 2019. However, the market's mid-single digit rise masks periods of significant volatility. The UK equity market rallied strongly in the second quarter of 2018 and, having peaked in May, the FTSE All-Share Index sold off sharply in the second half of 2018. The principal causes of this change were the outlook for US interest rates, heightened fears of a global economic slowdown and the escalation of US-Sino trade tensions. Against a backdrop of declining global equity markets, the UK equity market fell to an eighteen-month low in December 2018. However, a shift in the stance on interest rate policy from the US Federal Reserve and a cooling of the previously negative trade rhetoric between the US and China, laid the foundations for a strong equity market rally during the first quarter of 2019. This resulted in a positive UK equity market return for the period under review.

Against this challenging global backdrop, the question of the UK's exit from the European Union continued to dominate the domestic agenda. The extended political uncertainty saw the value of Sterling fall materially through the year, reaching a twenty-month low of US\$1.23 in December 2018, as a vote of no confidence against Theresa May was called over the terms of the negotiated EU Withdrawal Agreement.

The Bank of England's (BoE) Monetary Policy Committee voted to increase the UK's base interest rate by 0.25% at its August 2018 meeting, but kept rates on hold for the rest of the period as the political impasse continued. In February 2019, the BoE cut its UK growth forecast from 1.7% to 1.2% for the year. Despite this, economic data proved remarkably robust in 2018. We saw a return to real wage growth, whilst the number of people in work increased by 350,000, more than three times the increase in the size of the working age population.

Manager outlook

The portfolio's positioning has evolved incrementally over the past year to take advantage of the best risk-adjusted opportunities at the most interesting valuations. The portfolio continues to offer a sustainable flow of diversified income, with stronger dividend cover and better growth prospects compared to the wider market. However, these qualities have been largely ignored by a market that has rewarded momentum over fundamentals, such that on a price-to-book basis the portfolio is significantly

undervalued. This suggests that there is an opportunity for material revaluation in the portfolio from current levels.

The performance of the UK economy continues to confound most forecasts by recording steady growth. Over the course of 2019 the overall level of growth is expected to remain solid, supported by improvements in household cash flow and rising employment, which will benefit consumption activity and economic growth. Given that the outlook for the economy appears to be more resilient than currently implied by the currency or valuations of domestic sectors, it is anticipated that political resolution will see this material differential start to close. However, valuations in the UK market as a whole remain polarised between a basket of multi-national companies, which command high valuations, and a basket of UK domestic equities, which are valued significantly lower. Given this wide valuation disparity, the portfolio has retained a large exposure to sterling revenues, which are undervalued due to the persistent caution towards the UK economy as evidenced by the weakness of the exchange rate.

The portfolio has also maintained exposure to a number of global industries, namely oil and tobacco, which despite yielding significantly higher than average dividends, remain attractively valued in a market that seeks out new disruptive business models within the context of perceived sunset industries. In many respects, the stock-market's current sentiment towards these industries resembles behaviour that was seen during the last tech bubble. It would appear that the market is happy to discount a future decline in the cash flow from these businesses, which is much more rapid than appears likely.

Patience is an essential characteristic of successful long-term investing. Over the past 12 months this quality has been severely tested. The trend towards momentum stocks has been exacerbated by exogenous economic and political factors – primarily the sustainability of global economic growth and the protracted Brexit negotiations. As a result of these persistent uncertainties, the market has focused on supporting premium valuations for growth or highly disruptive companies, which has not suited the core investment themes of the company. It is frustrating that the capital and income growth potential of the company is not currently reflected in capital values, however the inherent strengths of the portfolio, detailed above, remain robust. It remains crucial that in such times of extreme momentum and somewhat irrational market pricing, the company remains rooted in the fundamental investment process, which has worked over many stock market cycles.

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Patrick Harrington, manager of Value and Income Trust:

UK Equities - Market Background

Global equities gained ground steadily during the first six months of VIT's financial year to the end of March 2019, encouraged by widespread economic growth. As the summer progressed, trade tensions grew between President Trump and China, whilst the Federal Reserve continued to tighten monetary policy. The positive economic background outweighed these negatives and markets made good progress. In the first half of VIT's year the UK market rose by 6.0% and gave a total return of 8.2%.

In the second half of VIT's year stock markets were more volatile. The final three months of 2018, the third quarter of VIT's financial year, saw UK equities fall by 11.0%, as the combination of rising interest rates and the potential for a damaging trade war between the US and China began to hit economic growth expectations and undermined investor confidence. At the end of the year, the Federal Reserve indicated that it would halt its programme of monetary tightening as evidence of weakening economic growth mounted. No further interest rate rises from the current Fed Funds rate of 2.5% are now expected in 2019. Consequently, share prices have rebounded strongly since the turn

of the year and have recovered much of the ground lost in the previous quarter. Over the six-month period the UK stock market fell by 3.6% and gave a total return of -1.9%.

Over the year as a whole, the FTSE All Share Index rose marginally by 2.2% and, including income, the total return was +6.4%. The MSCI World Index, which is measured in US Dollars, also registered a small increase of 2.0%, but to sterling-based investors the capital value rose by 9.6%, as the pound weakened from \$1.40 to \$1.30 during the year as Brexit concerns came to the fore. Within the UK market, high yielding companies performed in line with the FTSE All Share Index, rising by 2.2%. The FTSE 100 Index of largest companies, which rose by 3.2%, outperformed the more domestically focused FTSE 250 Index of mid-sized companies and FTSE Small Cap Index, which fell by 1.8% and 2.3% respectively. In the bond market, ten-year gilt yields ended VIT's year at 1.0%, down from 1.4% a year earlier and twenty-year gilt yields also fell to just 1.5%. The total return on the FTSE All Stocks Gilt Index was +3.7%. Commodities reflected the general background in financial markets and were volatile over the year. The price of a barrel of oil traded between \$50 and \$86 but ended little changed over the year at \$68. Metal prices generally fell as Chinese growth slowed but iron ore rose substantially after the dam disaster in Brazil caused a large reduction in supply.

Brexit has dominated the UK political scene over the last year and, at the time of writing, it is no clearer what the UK's eventual relationship with the EU will be or even if the Brexit referendum result will be implemented at all. Despite this uncertainty, the Bank of England followed the Federal Reserve's lead and increased the UK base rate by 0.25% to 0.75% in August 2018. This is the first-time base rates have been above 0.5% since the financial crisis. Given the weakening economic outlook and ongoing Brexit difficulties it would be surprising if UK interest rates were increased again in the near future. The fall in sterling over the last year has not fed through to inflation; the most recent reading of the Consumer Prices Index gave an annual figure for inflation of 1.9%, just below the Bank of England's 2.0% target.

UK economic growth moderated to 1.4% in 2018, which was lower than in America, which grew by 2.9%, and in the Eurozone, which grew by 1.8%. Recent economic surveys suggest that Eurozone economic growth has slowed sharply with even Germany posting disappointing readings. Even though UK growth has not been especially buoyant, the Chancellor has been successful in reducing the Government deficit to the lowest level seen since the financial crisis. It is perhaps unsurprising that the UK economy has not grown rapidly given this significant fiscal squeeze and the background of rising interest rates, although much of the blame is often placed on "Brexit uncertainty". Even though the rate of UK economic growth has fallen, the UK employment market has remained buoyant. As a result, the total number of people in jobs is at record levels and the rate of unemployment in the UK has fallen below 4%, the lowest level for several decades. This is putting some upwards pressure on wage inflation and giving hard-pressed UK consumers a welcome boost.

Outlook

The overall investment outlook remains mixed. Global economic growth is undoubtedly slowing as a result of the monetary tightening seen over the course of the last two years. The economic outlook in Europe has deteriorated the most sharply with economic surveys now suggesting that growth in the Eurozone has completely stalled and that several major European countries may well be in recession. The ECB has softened its monetary stance as a result, but to little effect. Even in the US, the rate of economic growth has tempered as the effect of the Trump tax stimulus has worn off. Deteriorating economic growth will put pressure on company profit forecasts but monetary policy has become more accommodative and this should be supportive for investment markets. In the UK the interminable Brexit process grinds on and, at the

time of writing, it remains highly uncertain as to when, or indeed if, the UK will leave the European Union or what form our future relationship with the EU will take.

However, the valuation of the UK stock market in particular remains attractive even after the recent bounce. The market dividend yield of over 4% is rarely seen outside of recessionary periods, suggesting longer term investors will be well rewarded from current market levels. Additionally, the gap between the 10-year gilt yield of 1% and the dividend yield of 4.2% has not been wider for over 50 years. This level of yield differential, combined with expectations for another above inflation increase in overall dividends this year, makes UK equities look exceptional value when compared to gilts. In addition, it should not be forgotten that the UK stock market provides a wide degree of international diversification and its constituents are relatively well insulated from any adverse effects of a "hard" Brexit. Furthermore, any Brexit-related devaluation of sterling would be of direct benefit to income investors as over half of the stock market's dividends are now declared in either US Dollars or Euros.

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Manager's report for Baillie Gifford UK Growth Fund:

Why invest in UK equities?

This is a question we are often asked. The inference is that the UK market is dominated by large, dull, boring businesses that any self-respecting growth manager would be crazy to look at. We happen to agree with this. However, where we take issue with the doomsters is that this generalisation applies to all of the market. The reality is that if an active stock picker is prepared to look beyond the well-known names, then there are plenty of UK businesses with tremendous growth records and others that show great promise for the future. We make no apologies for this optimism. Despite its many critics, one of the great attributes of capitalism is the creative destruction engendered. Society changes over time which allows for the emergence of new markets and services. New firms emerge to capitalise on this and existing businesses must adapt or face the consequences. If this seems fanciful or overly theoretical then simply take a walk around a town centre outside London to see one such adjustment occurring around us. This constant dynamism presents both huge opportunities and significant threats to investors (as well as admittedly inflicting short term pain on many blameless individuals and families). Our belief is that we want to be on the 'right' side of history for our investors and we look for businesses that are on that upward trajectory and own them for as long as we can. That is why, in simple terms, we prefer to own the likes of Boohoo rather than Marks and Spencer. We think that the risk of disruption has never been greater for many of the stalwarts of the UK stock market so, for example, we have no holdings in oil & gas exploration, banks or tobacco names. In contrast, we have assembled a portfolio of what we believe are exceptional companies that can capitalise on a myriad of growth opportunities both in the UK and globally. So, to answer the question posed at the start, we invest in UK equities because we do find plenty of companies that generate attractive growth.

Outlook

Political developments, whether Brexit or the prospects for US/China trade, have been a key factor for equity markets during the past year. We simply do not have a crystal ball and therefore cannot claim to have any expertise in forecasting political outcomes. What we do know is the recent operational progress of the portfolio's holdings has generally been encouraging despite the apparent doom and gloom espoused by the media.

So, what we are doing? As long-term investors, we try and focus on topics such as the competitive position of the companies in which we invest, and whether there are sound

reasons why that business should be significantly larger in five- and 10-years' time. We think those are the key drivers to any successful investment strategy over the long term. A further comfort for us, in a period of uncertainty, is that as patient backers of skilled management teams we implicitly benefit from their ability to nimbly adapt or seek out new opportunities. This is an attribute that too many stockmarket investors overlook with their short-term focus and much higher portfolio turnover.

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Manager's report for Montanaro UK Smaller Companies: According to the Investment Association, the worst selling asset class among UK retail investors in 8 of the last 10 years has been the UK All Companies sector. Similarly, since the Global Financial Crisis, more than £2 billion has been withdrawn from UK smaller companies. We would expect this to reverse once there is more clarity about the impact of Brexit.

UK SmallCap valuations are well below their long-term average with the Price-to-Earnings ratio of the benchmark at 12.6x. This does not feel expensive. SmallCap is 5% cheaper than UK Large Cap and 20% cheaper than its European counterpart, close to an historic low. History suggests that now might not be a bad time for Sterling investors to address significant underweighting to the UK. We would not be surprised to see an increase in mergers and acquisition activity as overseas trade buyers take advantage of attractively valued UK companies made even more enticing by a weak pound.

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Peter Jones, chairman of Henderson Opportunities Trust: The UK economy continues to grow but at a subdued pace. This is in spite of the macroeconomic uncertainties, in particular the fear that Brexit would be detrimental for UK economic growth. Some of this is priced into UK equity prices and accounts for the fall of Sterling and the underperformance of the UK markets since the referendum. A continuation of open trade across borders with Europe would be positive. There are UK companies that are trading on reasonable valuations and yet have strong growth prospects because of dynamic management teams, and such companies remain the focus of the portfolio.

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Robert Robertson, chairman of Lowland Investment company: In times of uncertainty, opportunities for profitable investment occur. The fund managers are becoming increasingly confident that stock prices are discounting most of the problems facing the economy. Value is evident and therefore borrowings are being increased. We are net buyers of equities, utilising current uncertainties to refresh the portfolio with good-quality companies on reasonable valuations.

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Jonathan Cartwright, chairman of BlackRock Income and Growth Investment: Market volatility is expected to continue throughout 2019 and there remain a number of downside risks; not least a further deterioration in the economic outlook, but also various geopolitical risks, including the outcome of the Brexit process, political instability in the UK and a further escalation of US/China trade tensions. The UK has recently seen some robust employment figures and positive wage growth. However, the economic climate remains volatile.

Our managers continue to believe that market volatility is likely to continue during the remainder of the financial year, although this should provide the opportunity to identify high quality companies at attractive valuations and to increase their holdings where

they have the greatest conviction. The focus remains on bottom-up stock selection, assembling a portfolio of individual companies which, taken as a whole, should prove capable of delivering attractive returns and supporting dividend growth into the future. Your Board remains fully supportive of this approach.

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Manager's report for Schroder UK Mid Cap Fund: Recent surveys indicate that UK consumer confidence remains stable. The data show that UK consumers are more confident about their personal economic situation than about the country's economic prospects. It is perhaps not that surprising therefore that Brexit uncertainty has yet to have much of an impact on UK consumers' outlook and household spending. In fact, household spending rose by an estimated 4.0% in 2018, following similar rises in prior years (*source: Lazarus Economics*). While spending on vehicles has fallen for structural reasons, UK households have spent more year-on-year on each of clothing, furniture, restaurants and their pets in both 2017 and 2018.

It would appear that this growth in household spend is reasonably sustainable, underpinned by a strong jobs market, higher wages and beneficial tax changes. Wages are growing at the fastest rate since 2008, outstripping the rate of inflation which has moderated. There has historically been a close correlation between real wage growth and retail sales, and labour market data suggests that the backdrop for wages remains supportive. The UK unemployment rate is at its lowest since the 1970s.

Consumers should also get a boost to their disposable income this year from tax changes in last autumn's Budget, in part funded by an improvement in the UK's fiscal position as tax revenues have been strong. The chancellor significantly loosened the purse strings, with the Autumn Statement described by the Office for Budget Responsibility as the "largest discretionary fiscal giveaway" since the economic advisory body was created in 2010. Mortgage approvals in April were the strongest month since before the Brexit vote. We are cautiously optimistic about 2019, and our move to 2.1% net gearing reflects this.

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North America

(compare North American funds [here](#))

Manager's report for Gabelli Value Plus Trust: During the first quarter of 2019, the stock market had its best quarter in roughly a decade, with the S&P 500 Index up over 13% on a total return basis. This, of course, was after a very weak fourth quarter, when the market was down by about 13%. As has been the case for many years now, growth stocks have continued to outperform value stocks. In the first quarter of 2019, growth stocks, as measured by the S&P 500/ Citigroup Growth Index, were up 15% on a total return basis. Value stocks, on the other hand, were up by about 12% in the quarter, as measured by the S&P 500/ Citigroup Value Index. The good news is that, although value investing has been out of favour for many years now, we feel the market is poised to start favouring value stocks once again and we believe the portfolio is well positioned to benefit when that rotation occurs. During the last few years, large caps stocks have also outperformed small and mid-cap stocks in the U.S. Since "trees do not grow to the sky" and smaller cap quality stocks tend to have better growth prospects, we expect our bias towards small and mid-cap value stocks will start to pay off in the years ahead.

The economy

The U.S. economy is in its 117th month of expansion, just four months short of the record. Just as impressive, the bull market in U.S. equities recently celebrated its 10th anniversary. Although both of these statistics are reaching records in terms of longevity, it is important to note that the expansion and bull market have both been somewhat muted in terms of strength. We continue to believe the U.S. economy will expand, although at a somewhat slower pace. The economy grew in real terms at approximately a 3% pace in calendar year 2018 - in calendar year 2019, we expect the economy will grow by approximately 2%, still a healthy growth rate but down slightly year over year. Unemployment in the U.S. is near all-time lows, and wage inflation is slowly starting to pick up, which we think is a good thing. Against this backdrop, we believe bottom-up, fundamental stock selection of the type we have practiced for over forty years remains more important than ever.

The political – economic context 2019

The salient issue for the market is growth - with corporate tax cuts behind us and little slack left in the economy, growth will almost certainly slow from the approximately 3% posted in 2018. That does not necessarily imply a recession is on the immediate horizon. How far above or below the 2% real growth trend line we have been experiencing over the past few years depends on many factors, including what we have described variously as the Three T's: Trade, Treasuries, and Trump.

Trade

President Trump made "fair trade" the centerpiece of his election campaign, and he has thus far made good on his promise to challenge the prevailing post-war "free trade" orthodoxy (however illusory that reality might have been). Negotiations with China continue to be at the heart of new trade deals and, until a new trade deal is signed, the stock market will be jumpy and continue to have a lot of volatility. We remain hopeful that, after all the posturing and negotiations, a deal can be reached, which will force China to comply with the World Trade Organization deal it signed years ago and reduce barriers, spurring economic growth in both the U.S. and China. If the U.S. can bring down trade barriers and cut down on the theft of intellectual property, we feel the stock market will respond positively to such a trade settlement with China.

Treasuries

Also critical to the outlook for the economy and stocks are the level and trajectory of interest rates. Since the Federal Reserve began its taper over four years ago in October 2014, the 10-year U.S. Treasury rate breached 3% in mid-2018 and drifted down to about 2.4% at fiscal year-end on 31 March 2019. All else equal, higher rates reduce the value of risk assets by making the alternative home for capital, "riskless" Treasuries, more attractive. Some other major economies of the world, such as Japan and Germany, have ten-year government bond yields of essentially zero. The Federal Reserve has moved to a "pause" approach to further interest rate increases, but the administration and some pundits have started to suggest the next move in U.S. short term rates should be down instead of up. Part of the reason for the big dip in the stock market during the calendar fourth quarter was that the Fed indicated the balance sheet runoff was on "autopilot", and another interest rate hike was coming. However, the Fed quickly pivoted in another direction in December 2018 to soothe the markets and indicated they would be patient and flexible. Most Fed observers now expect no more interest rate hikes in 2019.

Trump

While there has always been a healthy interplay between markets and political figures, President Trump's Twitter habit and other actions make him a major player for the markets. With the House of Representatives now under the control of the Democrats, many issues will be front and centre and have an impact on the markets, not the least of which will be various investigations the Democrats will initiate against the President and his administration. Even though the Mueller report found no evidence of collusion or conspiracy regarding the Russians and Trump, the Democrats will no doubt continue to push for various investigations against the administration, all of which add instability to the markets. In short, we should expect another year of volatility in the U.S. market.

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Simon Miller, chairman of Blackrock North American Income Trust: Whilst, for the most part, economic indicators continue to point to modest expansion in the U.S. economy, the extension of tariff barriers in the U.S./China trade war continues to have the potential to unsettle sentiment and create unintended economic consequences. Whilst the 2020 Presidential election campaign should provide an incentive for the administration to settle the current dispute, the final outcome remains uncertain. For this reason, our managers continue to favour those companies with sound balance sheets and those which have the potential to grow their dividends.

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Europe

(compare European funds [here](#))

Francesco Conte and Edward Greaves, managers of JPMorgan European Smaller Companies: 2018 started in ebullient mood as the world celebrated the first synchronised global recovery since the mid-noughties. However, by late summer 2018 the mood became progressively more cautious - US tax cuts risked overheating an already strong US economy, a trade war between the US and China curtailed corporate investment and central banks not only ended quantitative easing ('QE') but in some cases began raising interest rates. Optimism unravelled with fears of a synchronised global slowdown taking hold. In the final quarter of 2018, the company's benchmark Euromoney Smaller European Companies (ex UK) Total Return Index fell by 16%, peak to trough.

With negative economic data accumulating, the Chinese authorities began aggressive monetary and fiscal easing, which combined with dovish statements by the US Fed Chair about limiting rate rises, reversed the market falls. By the end of the first quarter of 2019, the US S&P 500 index all but recovered the near 20% fall experienced during the final quarter of 2018, making it one of the strongest first quarters on record.

Despite these violent market gyrations, in the twelve months to March 2019, the MSCI Europe (ex UK) Net Return Index rose by a muted 2.2% and the company's benchmark Euromoney Smaller European Companies (ex UK) Total Return Index fell by 3.6%.

Outlook

European equity markets have made a strong start to 2019 after the weak performance seen in 2018. This has been driven primarily by falling inflation expectations which have reduced the risk of excessive interest rate tightening by the US and by the Chinese

economic stimulus which has cemented the view that we could be nearing the bottom of the current economic downturn. Additionally, valuations remain close to their long-term averages which we believe are attractive given the continued strong earnings growth outlook for European smaller companies. As such we have reduced our underweight sector positions to industrials and automotive components.

However, we are remaining ungeared as risks remain. Should US economic growth continue to beat expectations it could lead to renewed fears of excessive interest rate rises. Trade war concerns could also resurface between the US and China or even break out between the US and European Union. Finally, the outcome of the UK's vote to leave the European Union remains very uncertain.

On balance, we believe that the balance of risk is to the upside but we prefer to remain prudent at this stage.

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Stephen Macklow-Smith, Alexander Fitzalan Howard, Michael Barakos and Thomas Buckingham, managers of JPMorgan European Investment Trust:

Introduction

During the company's financial year ended 31st March 2019, one of the key features was the underperformance of value investing as a style. Given that our Income shares invest in stocks with a high dividend yield and that our Growth shares invest in stocks at cheap valuations, the underperformance of these cheap stocks was a headwind for us during the year. The company's benchmark managed a small positive return, although it was also a year of volatility with the benchmark up 10% at its best and down 6% at its worst. Performance is analysed later in this report.

Economic Overview

The economic background deteriorated as 2018 went on, despite starting with a vertiginous rise in stock markets around the world in January, which then gave way to a correction into the beginning of the company's financial year. The driver for the correction was a reaction to the deceleration from what had been a particularly positive growth environment in late 2017 and early 2018 around the world. Most developed markets had been growing above trend, and emerging markets economies were continuing to recover from the fall in commodities prices that had negatively affected them two years previously. This positive growth environment deteriorated during the year under review, largely as a result of an uncertain political background. The United States of America decided to implement tariffs and other measures on trade with most of its major trading partners. In the case of Mexico and Canada a new trade agreement was reached fairly quickly, but the attention of the USA then switched to other markets such as China and the Eurozone. Again in the case of the Eurozone, an initial agreement was reached fairly quickly, but in the case of China, a fairly aggressive stance was taken by the USA and this seems to have undermined confidence among companies involved in global trade and also to have undermined confidence about capital investment outside the USA. The indicator for this fall in confidence was purchasing manager indices which came off their best and outside the USA continued to fall. The rate of growth of global trade also contracted, and uncertainty about the global supply chain appears to have led to a deferral of investment decisions by global companies. Global equity markets improved in the first quarter of 2019, although since then sentiment has weakened following faltering US-China trade relations.

The fall in confidence was particularly marked in the European Autos industry, which is a substantial employer in Germany and a key player in the European economy. New

emission standards led to an accelerated inventory cycle but at the same time it became clear that demand from China was decelerating fast.

Political Overview

Elsewhere in the political sphere we had the continuing negotiations between the United Kingdom and the European Union about the UK's withdrawal, and we also saw the appointment of a new Italian government comprised of two populist parties who announced their determination to adjust the spending limit imposed by the Stability and Growth Pact which had been agreed by all Eurozone countries. In France, Emmanuel Macron faced protest from the gilets jaunes movement, triggered by his introduction of taxes on fuel, which were designed to meet France's undertakings under the Paris accord on climate change.

The impact of the slowdown in industrial confidence, and of heightened political risk in Italy made itself felt in bond markets, where supposedly safe assets saw yields moving down to zero or into negative territory, while Italian government bonds began to attract a growing risk premium against other Eurozone assets. Falling long-term interest rates and flattening yield curves are a classic indicator of a challenging growth environment and given all of the uncertainty it would not have been unreasonable to expect analysts to slash their expectations for company profitability. In the event though, while analysts revised modestly lower their predictions of profits, we actually saw a year of positive earnings growth in Europe which meant that the decline in equities prices made valuations more attractive. If anything, this phenomenon of falling valuations was at its most acute in the USA, where the stock market finished 2018 flat or slightly down despite the fact that earnings were growing by around 20%. In Europe, in 2018, the stock market fell by 10% despite earnings growing by around 7%. Dividend payments also grew in Europe and combined with falling equity prices this meant that dividend yield became considerably more attractive, especially when comparing the yield available on equities to those available on government bonds or in cash.

During the year the European Central Bank adjusted its program of support for the economy, committing to keep interest-rates low for the foreseeable future, but backing away from purchases of sovereign debt. Despite the absence of the European Central Bank as a buyer, yields remained extremely low. One of the features of the regulatory environment that has been put in place since the financial crisis of 2008 and 2009 is a huge appetite among banks, pension funds and insurance companies for what are referred to as safe assets. In addition, savers in Japan, which runs a large current-account surplus, are keen to invest money in other bond markets around the world which might give them a positive yield compared to what is available to them on domestic Japanese bonds, and this competition to buy safe assets seems to be keeping yields at an ultra-low level, even though central banks in the USA, UK and the Euro zone are no longer buying.

In an uncertain growth environment profits are expected to grow further in 2019, on top of the growth experienced in 2018, and an optimist would say that if trade tensions can be defused the global economy may be due another leg up. For that to happen though we probably need a more stable political environment, and it is clear that political incumbents on the Continent are under pressure. During the year, we saw Chancellor Merkel's power eclipsed in Germany as she suffered a string of local election setbacks. This precipitated her announcement that she would be standing down as leader of her party which is widely viewed as presaging her standing down as Chancellor. The European Parliamentary elections presage a wholesale changing of the guard at European institutions. The Presidents of the European Council, the European Commission, the European Parliament, and the European Central Bank will all be standing down before the end of the year, and especially in the case of European Central Bank, investors will scrutinise any potential appointees for clues as to the likely

direction that policy will take in the next few years. Mr Draghi famously stated that the European Central Bank would do whatever it takes to preserve the Euro and this opened the door to extraordinary monetary policy in the shape of zero interest rates and purchases of sovereign bonds. His replacement will have to reconcile the pressure from some European countries for a loosening of fiscal rules in an attempt to boost domestic demand against the demands of others for an end to ultra-low interest rates which they view as penalising savers.

Earnings

Against this background European companies continue to make progress in profitability terms. Earnings for our investable universe struggled to grow in the aftermath of the financial crisis and we have discussed this in previous annual reports. In many cases this was because of factors which specifically affected certain sectors such as banks, and energy and other commodity companies. Consensus profits in 2019 are expected to be a little over 10% below their historical peak having been at their worst 50% below that peak in 2010 and very nearly as bad again in 2016. Margins, which are a good indication of the underlying health of the business are also recovering. Outside the financial sector margins are within touching distance of their historic highs, and this against a background in which growth in most parts of the world outside the USA has been disappointing. Balance sheets also look respectably healthy: for instance, in the financial sector, banks look very well capitalised as a result of the pressure put on them by regulators, and outside the financial sector, although net debt has drifted higher the low interest environment means that the affordability of debt is good.

Sector Performance

During the year under review, there was a substantial spread of return between individual sectors. The best performing sector in Europe was Utilities, followed closely by Consumer Staples (this includes companies in Food and Beverages and Personal and Household Products). Healthcare also did well and one of the key characteristics of these three sectors is that they are all viewed as beneficiaries of lower interest rates, so in an environment in which long-term interest rates were falling it is not a surprise to find these sectors in favour with investors. It raises the question, though, of how they would behave in an environment in which interest rates normalise. At the other end of the performance table, we had Financials where in particular, Bank stock prices came under pressure because the low interest rate environment was viewed as putting pressure on their ability to make a return from lending (when lending rates are very close to funding rates it is difficult to extract a decent margin on new loans). Autos also came under pressure for reasons described above, although valuations in the auto sector are now very close to levels that we see at the trough in the cycle rather than towards the peak in the economic cycle.

Outlook

We live in politically turbulent times and making predictions about the outcome of trade policy is challenging in the environment in which many of the previous norms are being overturned. Assuming that the policies of increasing liberalisation of trade which have bought prosperity to many on lower incomes both in developed economies and in emerging economies are likely to continue to be pursued by politicians, there is scope for the investing background to improve. In this environment we also expect that returns to Value investing will improve, especially since the underperformance of cheap stocks has meant that the spread between cheap and expensive stocks is now as extended as it ever gets.

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R M Curling, chairman of Montanaro European Smaller: We continue to believe that the fundamentals behind the market remain positive. Global economies are still growing and monetary policy remains accommodative. However, leading indicators of global growth have generally weakened over the last year and it remains to be seen whether these deteriorate further or rebound in the next 12 months. Brexit and the increased risk of global trade wars also add to the uncertainty. We do not attempt to time such market shifts, preferring to invest in companies that can thrive irrespective of the economic cycle.

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Global emerging markets

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

Chetan Sehgal, manager of Templeton Emerging Markets: Emerging markets equities recovered in the latter part of year under review, offsetting earlier losses to end the 12-month period unchanged. The MSCI Emerging Markets Index returned 0.1% for the year to 31 March 2019, while TEMIT delivered a net asset value total return of 1.8% (all total return figures in sterling). Full details of TEMIT's performance can be found on page 1 of the full annual report.

Emerging markets found themselves under a cloud of gloom over most of the reporting year as concerns over rising US interest rates, heightened global trade tensions—especially between the US and China—and worries about global economic growth weighed on market sentiment. Fears that contagion from issues in several individual countries such as Turkey and Argentina could spread to other emerging markets also played a role. These factors impacted investor sentiment and the market ignored the cheap valuations and solid long-term fundamentals of emerging markets companies.

Headwinds faced by emerging markets in 2018, however, became tailwinds in early 2019, as markets responded positively to easing US-China trade tensions and indications the US Federal Reserve (Fed) would slow its pace of interest-rate increases. The Fed confirmed its dovish stance at its March meeting, following indications of slowing rate hikes in January, after raising rates in 2018. The pause in rate hikes saw risk appetite return to emerging markets, contributing to the rally in the first quarter of 2019.

Trade tensions between US and China have simmered over the last few years and had resulted in tariff introductions before US President Donald Trump's decision to delay additional tariff hikes following progress in trade talks between both countries which subsequently boosted expectations of a new trade agreement. However, in May 2019, the US raised tariffs citing slow progress in trade talks, following which China retaliated with the announcement of further tariffs on US products. The markets experienced increased volatility as a result of the increased uncertainty surrounding an eventual trade deal between the two countries.

Despite being underweight versus the benchmark, China was TEMIT's largest market position at the end of the reporting period and we remain comfortable with the exposure. Even after a double-digit return in the first quarter of 2019, Chinese stocks declined over the full reporting year. The trade dispute with the US coincided with the Chinese government's efforts to curb borrowing, raising concerns about the prospects for economic growth. China's economy grew by 6.4% year-on-year (y-o-y) in the final quarter of 2018, the slowest since 2009, but in line with market expectations. To cushion its economy, China eased monetary conditions and introduced fiscal stimulus

measures—a trend that we expect to continue as the Chinese government continues to support the domestic economy, especially in line with the continuing trade tensions. While growth in China has eased recently, we do not expect a hard landing if the government maintains adequate liquidity and maintains a positive capital account. The economy is still growing at a robust rate, making the country one of the fastest growing major economies in the world.

South Korea's stock market lagged its peers over the year as a trade conflict with the US (a revised free-trade agreement was reached in September), lacklustre earnings momentum and a worse-than-expected decline in computer memory prices and demand outlook weighed on investor confidence for most of the year. However, expectations of a US-China trade deal and an anticipated recovery in the computer memory market in the latter part of 2018 coupled with undemanding valuations resulted in significant foreign investment inflows in early 2019. While a historic meeting between the leaders of the US and North Korea in June 2018 raised hopes for a denuclearisation of the Korean peninsula, a disappointing summit in February 2019 doused expectations. Domestically, fourth-quarter GDP growth accelerated to 3.1% y-o-y supported by fiscal stimulus, while consumer sentiment and domestic demand also improved. We continued to witness corporate governance improvements as companies continue to enhance their shareholder returns, which could help raise the appeal of South Korean companies to investors globally. South Korea accounted for the second-largest market position in TEMIT's portfolio at the end of March.

TEMIT's exposure to Taiwan was largely attributable to Taiwan Semiconductor Manufacturing company (TSMC), one of the portfolio's largest holdings. TSMC is one of the world's leading semiconductor makers and counts major technology companies amongst its clients. The company has built a strong technological lead and has a large number of marquee clients. We believe that it is well-positioned to benefit from rising silicon content in smartphones as well as to benefit from strong demand growth due to the rapid development of artificial intelligence, autonomous driving and the Internet of Things. Additionally, TSMC's commitment to delivery of advanced technologies ensures that it maintains its leadership position thereby protecting its market share and supporting long-term earnings growth. We continue to see technology as a structural driver of global economic growth and maintained positions in several Taiwanese electronic component makers. Shares in TSMC ended off their year-high despite a late rebound in the reporting period.

Another key market for TEMIT, Russia, fared significantly better than its peers, ending the year with a double-digit return, showing resilience in the face of US/EU sanctions and volatile oil prices in the second half of the year. We remain constructive on the oil price over the medium to long term but recognise that volatility in prices could lead to elevated earnings risk and therefore we focus on companies with low production costs and strong balance sheets. We believe that because the

Russian economy is less dependent on the West and is, rather, more self-sustained, it is still possible to find companies that can flourish and do well. Thus, in addition to energy companies, we also favour companies such as Sberbank and Yandex that are more exposed to the domestic economy. It is also important to note that the corporate governance practices of many Russian companies have improved quite significantly. We also saw many companies implement policies, including share buybacks and increasing dividend pay-outs, to improve shareholder returns which boded well for investor sentiment in the market. Russian equity valuations were amongst the lowest in emerging markets, while dividend yields were amongst the highest. TEMIT's exposure to Russia reflected our conviction in select companies with strong underlying fundamentals and prospects.

While political uncertainty and concerns that labour strikes could impact economic activity weighed on the Brazilian market, equity prices rallied in the latter part of the year on expectations for, and the subsequent victory of, a more market-friendly candidate in presidential elections. Optimism surrounding the government's economic agenda including the key social security reform, has resulted in a more favourable climate where higher consumer and business confidence could lead to an acceleration in domestic economic activity. Looking forward, we believe that this should be positive for earnings growth and for the Brazilian equity market generally. The local market is trading at what we view to be reasonable price-earnings ratios and should have more scope for improvement as the economic situation improves.

We continue to have a favourable view on domestic-oriented themes including financials and consumer-related sectors. TEMIT had a considerable position in Brazil, supported by our positive outlook for the country.

Market Outlook

We continue to maintain a positive view on emerging markets. Market sentiment towards the asset class improved significantly in early 2019, as the headwinds in 2018 eased. A conciliatory stance by the Fed and advances in trade talks between the US and China were among the key drivers of this renewed optimism in emerging markets. While indications that the Federal Reserve will no longer raise interest rates in 2019 is supportive of this trend, the possibility that a trade agreement is not eventually reached remains a major risk. We believe that for the market rally to be sustainable, earnings need to improve. Improved corporate governance in emerging markets could also provide a basis for a longer-term rerating.

We believe that confidence in emerging markets could strengthen further based on several factors: economic growth differentials between emerging and developed markets are widening in the former's favour, emerging markets currencies appear undervalued despite balance of payment surpluses in many markets, ongoing reforms, solid underlying fundamentals, a robust emerging markets earnings outlook and undemanding valuations.

Emerging markets valuations have become increasingly attractive due to weakened confidence and performance in 2018, while cash flows and earnings generally remain resilient. Emerging markets earnings growth is expected to match or exceed that of the US and developed markets in 2019, resuming the trend witnessed in 2017. These conditions, when paired with improving corporate governance that includes dividend pay-outs and buybacks, present an increasingly attractive long-term buying opportunity and should contribute to renewed confidence in the emerging markets asset class.

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John Rennocks, chairman of Utilico Emerging Markets Trust: The past year has seen rising economic and stock market volatility and presented a challenge for UK domestic EM investors, especially in the face of continued Brexit uncertainties. Volatility was magnified by geopolitical concerns, trade skirmishes initiated by the Trump administration, concerns over Central Banks' withdrawal of Quantitative Easing and a firming interest rate outlook, all of which heightened market risk. In this context, the positive performance of UEM is a good achievement.

As at the half year, UEM's NAV total return per share was down 7.5%, which partly reflected our strong conviction in Brazil. The Brazilian Ibovespa Index (GBP adjusted) was down 17.9% for that half year period. I am pleased to report that our conviction paid off as the Brazilian Index was up 24.4% in the second half of the year. Pleasingly, the current year's performance for UEM of 3.5% was ahead of the MSCI Emerging Markets Total Return Index (GBP adjusted) (MSCI) which was unchanged over the

period. UEM also continues to receive strong industry recognition, which included being selected again as one of Money Observer's 'rated funds' for 2019. The fund was also featured in the Daily Telegraph's Investing Fund of the Week.

As we noted at the half year stage, there are two opposing forces at work in global markets at the moment: populist political leadership and Central Bank activity. Populist leaders are elected to challenge the existing political establishment, while Central Banks are seeking to move policies back to a more "normal" setting. In the US, President Trump is pursuing populist protectionist policies that include import duties, sanctions, tax cuts for US corporates and a USA first policy. The US Federal Reserve on the other hand is pursuing a policy aimed at tightening financial conditions that include Quantitative Tightening and raising interest rates. The populists are looking to deliver policy changes with little regard for more traditional economics while the Central Banks are looking to contain the inflationary policies that are being implemented.

Over the year we have seen a continuing rise in populism from the election of Andres Manuel Lopez Obrador in Mexico through to the Five Star Movement in Italy, and more recently the election of Volodymyr Zelensky in the Ukraine. We expect this trend to continue. The Central Banks have collectively had to moderate their fiscal policies as economies have slowed down. While the US Federal Reserve continues its reversal of QE, it has moderated its interest rate outlook, as has the European Central Bank, the Reserve Bank of Australia and the Chinese Central Bank. All are being more accommodating in their messaging to the market.

The combination of weaker Central Bank positioning and firmer than expected global growth has seen the stock markets recover much of the ground in 2019 that was given up in late 2018. The S&P at the time of writing is close to its all-time high.

One challenge for EM has been reduced US Dollars in circulation, leading to a broad economic slowdown. This has placed pressure on EM economies and markets. Added to this, the continued rise in oil prices has had the effect of weakening several EM economies as energy costs rise sharply.

The level of market volatility that has resulted from these activities has been much higher. As a general statement Sterling was down versus Asian currencies but up against Latin American currencies.

China remains a key driver of the EM economies and there is no doubt that Trump's relentless focus on China trade is having a negative impact. China's desire to pivot away from a capital investment-driven economy towards a more consumer-led economy is proving to be a challenge. It will be some time before we understand the full impact of the economic confrontation between the US and China. However, we are hopeful that an agreement is reached between the world's top two economies and that investment markets will respond favourably. For its part, China has softened a number of factors domestically which should stimulate both consumer demand (lower taxes) and SMEs activity (easier access to capital). Both the US and China are expected to see firmer Gross Domestic Product growth this year.

We expect populism to continue to rise and influence the global agendas. This is likely to result in continuing volatility in investment markets as political positions harden or change sharply. The outcome of the US China trade talks is now enmeshed in a deeper conflict around technology and security. This heightens the risk of sharp divisions and outcomes are more volatile. Against this, the World's central banks are for the most part looking to soften their stance, which should help to moderate the political impact of the populist governments.

I would note that, in the EM world, Bolsonaro is leading Brazil in the right direction on government costs, pensions and privatisations. Modi has been returned with a stronger

mandate and President Xi is committed to growth. These economies, which account for 55.1% of UEM's portfolio, should respond to this.

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Manager's report for Aberdeen Emerging Markets: The closing months of 2018 witnessed sharp declines in developed market equities, with the MSCI USA and World Indices falling by 7.3% and 6.5% respectively in the final two months of the year. Emerging markets outperformed significantly, gaining 1.4% over the same timeframe. Moving into 2019, equity markets globally recovered sharply, helped by the accommodative stance adopted by the Federal Reserve in response to market volatility and the prospect of a resolution to the US-China trade spat.

Given the latter point and the impact of domestic stimulus efforts, it is perhaps not surprising that China was the epicentre of the rally in emerging markets, with the MSCI China Index 18.8% higher over the period. The Indian market also performed strongly (MSCI India +16.3%), despite uncertainty in the build up to the country's general election. The strong performance of these two markets ensured Asia was the best performing emerging market region (MSCI Emerging Asia +12.8%) despite lacklustre returns in markets such as Korea (MSCI Korea +4.6%), Thailand (MSCI Thailand +3.9%) and Malaysia (MSCI Malaysia -2.1%).

In Europe, the Middle East and Africa, the South African market stood out (MSCI South Africa +19.2%), helped by the strong performance of mining companies, a number of which rallied by over 50% as supply disruptions in Brazil and Australia drove commodity prices and related currencies higher. The Russian market continued a stealthy recovery (MSCI Russia +9.1%) with the strength of oil prices in 2019 proving supportive. Smaller emerging and frontier markets within this broad region delivered mixed returns, with Egypt (MSCI Egypt +20.1%) and Kenya (MSCI Kenya +17.6%) both rallying, while Nigeria (MSCI Nigeria -7.7%) and Romania (MSCI Romania -6.0%) declined as a consequence of political and policy concerns. In Romania, these stemmed from proposed new tax proposals. In Nigeria, February's general election was considered by most to be a sham, with the incumbent President Buhari returning to office amidst widespread allegations of electoral fraud.

Latin America delivered modest returns. The dominant market of Brazil made only a marginal gain over the period (MSCI Brazil +1.2%), as it retreated sharply from all time high levels (in local currency terms) that were reached in February. In another instance of frontier markets diverging from their emerging neighbours, Argentina (MSCI Argentina -11.1%) performed poorly, with the possibility of Cristina Fernandez de Kirchner displacing Mauricio Macri in elections towards the end of 2019 serving to spook investors.

Outlook

At the time of writing, emerging markets have given back some of their year to date gains following an unexpected ratcheting up of US-China trade war tensions. While it is impossible to say whether this is a negotiating tactic from President Trump or a more significant development, investors have reacted negatively to the added uncertainty.

As for the other supportive factors of the recent rally, they remain largely intact, with the US Federal Reserve looking more likely to cut rates than increase them over the remainder of 2019 and Chinese domestic policy stimulus still in place. Valuations in emerging markets remain attractive on both an absolute and relative basis, while earnings expectations are low, meaning that the risk of significant disappointment on that front is largely absent. All the while, global investors remain significantly underweight emerging markets. If a fully blown trade war ensues then these factors

may count for little but if that is not the outcome then the prospects for the rally to continue appear promising.

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Asia pacific

(compare Asia Pacific funds [here](#))

Andrew Graham & Damian Taylor, managers of Martin Currie Asia Unconstrained Trust:

Market review

The near flat performance of Asian stock markets over the year to end March disguises a quite turbulent environment. While the MSCI AC Asia ex Japan Index, as a proxy for the markets in our region, delivered a total return of 2.3% in sterling terms over the period, the market endured a peak to- trough decline of over 18% between mid-June and late October 2018, retesting the October low in early January 2019, before rebounding nearly 11% by the end of March. Reduced expectations for global growth caused downgrades to earnings forecasts, which gathered pace from September. Successive increases in US interest rates (from an extremely low base), and Federal Reserve efforts to trim its balance sheet, pushed bond yields higher, squeezing global liquidity. This combined with concerns over the effects on global growth of the China/US trade dispute to pressure markets at the start of the year. In the ensuing shakeout, earnings optimism was replaced with considerable pessimism and stock market valuations slipped below long-term averages.

More recently, the environment has again changed. The pressure on global liquidity is starting to ease and it is likely to ease further. In response to weak asset markets and softer economic data in the second half of 2018, the US Federal Reserve (Fed) has signalled an earlier-than-anticipated exit from its balance sheet normalisation process and other central banks seem to have become more 'dovish' too. We could debate the extent to which central banks are evolving to 'new policy frameworks', perhaps in response to a new understanding about how asset markets and the real economy affect each other or are simply being bullied into dovishness by populist presidents. While we believe that persistent interference with the workings of markets, particularly to limit the pain inflicted by market corrections, not only protects the imprudent but ultimately results in a structural misallocation of capital, this is not the platform to debate the ethical dimensions of policy. Rather, our goal is to grasp the runes of policy direction and understand the extent to which it could derail the long-term fundamental drivers of the Asian economic story or influence the oscillations of the business cycle as the region's longer-term secular dynamics play out. In turn, this leads us to consider the earnings cycle and market valuations.

The most important change since publication of our interim report is that our comments regarding the direction of travel regarding monetary policy tightening, including a tightening bias among Asian monetary and regulatory authorities, are no longer valid. At the same time, elections in India, Indonesia, Thailand and the Philippines have inclined policymakers there to be more constructive in terms of supporting their respective economies. While not subject to the rigours of the electoral cycle, China's government has become sufficiently concerned about the deceleration of economic growth at home to resort to meaningful fiscal stimulus, as well as pressuring big banks to lend more - especially to small and medium-sized enterprises. It seems reasonable to assume some improvement in the business cycle in Asia; this will probably be

noticeable in the second half of 2019. However, there is still room for near term disappointment. The full effect of last year's interest rate rises may not have fully filtered through to the real economy and, importantly, the Fed is currently still shrinking its balance sheet, which could have uncomfortable ripple effects in asset markets.

At the same time, trade friction remains an unresolved issue. Until recently there was optimism that China and the US would achieve a workable compromise. While this hope has recently been dashed by implementation of increased 25% tariffs by the Trump administration over the whole range of Chinese exports to the USA, this may be a negotiating tactic, so a deal is still may be the most realistic outcome. However, there is a strong lobby in Washington which wants the USA to stand up to China as it is now perceived as a global threat to American interests and are reluctant to back down.

Outlook

At the time of writing, the earnings cycle in Asia appears to be bottoming after a torrid year of downgrades in which the mid-teens growth expectations of analysts were ultimately watered down to a modest year-on-year decline for 2018 and low single-digit growth for 2019. Given the increased chance of improved economic growth at some point in the second half of 2019, it is reasonable to assume that any further downside to Asian earnings will be limited from here. Catalysts for a stabilisation and improvement in earnings expectations include signs of supportive policy action, a softening of energy and raw material prices, the emergence of strong mandates to govern in the countries with national elections (particularly India and Indonesia), and a resolution to the trade dispute between China and the US. After a strong start to 2019, Asian stock market valuations were mixed although market weakness post our company's financial year end has seen valuations return to more attractive levels. As the market recovered in advance of earnings announcements, earnings-based valuation metrics are above 10-year averages although not at extreme levels. Asset value-based measures suggest valuations below 10-year averages, or even slightly below (for example, at the time of writing the price-to-book value based on the trailing 12-month book value is at 1.49x compared with the 10-year average of 1.63).

We believe the long-term secular growth opportunity in Asia remains substantial. Employment levels in the region are generally healthy and incomes are growing. As a result, the middle class continues to expand and the proportion of the population exposed to poverty is shrinking. Rising disposable income leads to changes in consumption patterns, with increased spending on leisure, travel, education, health care, discretionary consumer goods and housing. Rising financial inclusion also supports spending on bigger ticket items such as motor vehicles, as well as growth in demand for savings products and insurance. Population growth and, particularly, rising urbanisation creates rising demand for more and better infrastructure. Asia needs to invest trillions of dollars in infrastructure in the years ahead.

The Asian stock market offers many opportunities to access this growth. Your company is focused on finding businesses that can not only participate in that growth but also translate it into attractive returns for investors. This means finding companies capable of generating cash flows, after necessary maintenance capital spending, which can be re-employed back into their businesses to fund future growth or returned to shareholders. The changes to the portfolio highlighted above reflect that objective. We remain sensitive to valuation and will seek to move capital from businesses that become overvalued relative to their prospects into other, more attractively valued portfolio holdings or into new holdings.

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Manager's report for Schroder AsiaPacific: The net asset value per share of the company recorded a total return of +2.2% over the six months to end March 2019. This was modestly ahead of the performance of the benchmark, which was up +1.9% over the same period. (Source: Morningstar, net of fees).

Pacific ex Japan equities ended slightly up over the period as a whole, but this disguises a high level of volatility. Concerns over tightening global liquidity, a stronger dollar, slower growth across developed markets outside the United States, slowing data from China, rising trade tensions and weaker trade trends weighed on regional markets in the latter months of 2018.

Come the turn of the year, there was a sharp rebound despite little economic recovery being immediately evident and continued downward revisions in corporate earnings. However, valuations had fallen to historically attractive levels which under-pinned the case for modest recovery and a shift to a less hawkish stance by the US Federal Reserve undoubtedly helped sentiment. Other factors included some signs of a loosening in credit conditions in China along with other measures including tax cuts and targeted infrastructure spending.

Indonesia, the Philippines and Hong Kong have been the outstanding performers. In the former, growing confidence over the Presidential election (which the more market friendly Jokowi indeed won) and stability in the currency supported returns. The Philippines has proved a 'safe haven' amid global economic uncertainty, while a more dovish outlook for interest rates and liquidity aided the asset heavy Hong Kong market. Weak performances in Korea and Taiwan reflected their trade sensitivity and, more specifically, the downturn in the semiconductor cycle. A combination of political uncertainty and weak external balances undermined Pakistan.

Outlook and policy

As mentioned above, a shift in policy stance from the Fed and the Chinese authorities towards more accommodative positions have marked a significant reversal in sentiment coming into 2019. A more dovish Fed commentary has significantly lowered market expectations for future interest rate increases, and long bond yields have come down from their November highs. A flattening yield curve, with short interest rates close to long bond yields, points to slower global growth, but as the US dollar remains the key reserve currency it allows Asian monetary authorities scope to adjust their own policy stances given that inflationary pressures are uniformly subdued.

There has also been an important shift in China's policy stance in the last few months. Reserve requirement ratios have been cut and banks have been encouraged to lend more aggressively to small and medium-sized enterprises and the private sector. The sharp pick-up in total social financing in year-to-date data suggests that local financial institutions are responding to this top-down guidance. Fiscal spending also appears to be picking up to support growth, with lower taxes for consumers and SMEs being announced and an acceleration of some infrastructure spending coming through.

Having appeared to be progressing relatively smoothly, at the time of writing the trade negotiations have clearly hit something of an impasse. Conspiracy theories abound, and the one thing we can be sure of is that the various parties are putting the best spin possible to their own actions. It remains very unclear whether China has stepped back from what the US took to be firm promises, or whether strong domestic equity markets and economy emboldened Trump to seek more concessions. Irrespective of the causes, while regional markets do not look expensive severe trade disruption has the capacity to lead markets substantially lower, particularly as prospects for a reversal in negative earnings revisions recedes.

However, beyond the shorter-term shocks, both financial and economic, we remain confident in the underlying prospects for the region. Trade tension may well simply accelerate the longer-term trends on which regional prosperity will depend: the emergence of Asia (most specifically China and India) as massive domestic markets, with other lower cost economies round the region benefiting from relocation of manufacturing and rising fixed asset investment based on intra-regional competitive advantages. Furthermore, both national external balances and corporate cash generation and balance sheets are relatively strong. Given the portfolio's current net cash position, it is in a good position to take advantage of the potential volatility.

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David Shearer, chairman of Aberdeen New Dawn: Despite volatile conditions, equity markets in the Asia Pacific region ended the period under review (to 30 April 2019) in positive territory. Markets and investor appetite were impacted by a confluence of risks throughout 2018. These included higher interest rates and fears about shrinking global liquidity, worsening trade tensions and slowing global growth. However, sentiment improved in the New Year as receding trade and monetary policy worries fuelled a broad-based rebound.

The period was one of political significance for Asia, with key elections across several countries. In both India and Indonesia, reform-minded incumbents were re-elected with clear majorities, although in Thailand, the outcome remains inconclusive. On the whole, the results bode well for structural reforms and future economic growth across the region.

China was a key driver of sentiment during the period as trade friction with the US compounded fears about its slowing economy. While this had an impact on equities markets for most of 2018, there was a rebound from January 2019 on an apparent easing of trade tensions and fresh fiscal support from Beijing.

Despite the volatility, the company's exposure to China bolstered performance which was attributable to the quality of the portfolio's mainland holdings with a number making impressive contributions.

The company's exposure to Chinese stocks continued to increase during the year. While corporate governance is still a concern, the manager has seen signs of progress, with more companies adopting better practices. More broadly, China's longer-term potential remains bright given the expanding consumer class and massive domestic market. The manager introduced several more Chinese holdings that are well-placed to access the structural growth of sectors including health care, tourism and technology.

Apart from trade, monetary policy also swayed markets over the period. Initially, major central banks, led by the Federal Reserve, seemed set to end a decade of easy money policies. With the US Dollar also strengthening, most Asian central banks raised their own interest rates to combat inflation and defend their currencies. However, mounting signs of faltering growth in the US and Europe forced a re-think. Notably, the Federal Reserve turned dovish, though the supportive impact of looser monetary conditions may have been thwarted by the trade dispute with China. While the gloomier economic outlook weighed on banking stocks, Indonesia's Bank Central Asia (BCA) bucked the trend and was a notable outperformer. BCA had benefited from rising interest rates earlier in the year, but its consistently impressive financial performance was also rewarded by the market.

Meanwhile, technology stocks lagged the market after a sustained period of strength. Escalating trade tensions hurt consumer sentiment, with fears of slowing demand for chips and smartphones. This hampered the technology-heavy, export-oriented Korean market, along with sluggish economic growth and corporate earnings. Given the

portfolio's underweight exposure to South Korea, this was positive for performance. The manager also refined the portfolio's South Korean exposures, selling holdings that faced challenging prospects while adding to those with brighter prospects. Elsewhere, the manager also introduced some Australian holdings with the aim of providing more varied exposure to the portfolio in sectors with good growth prospects.

Outlook

It is clear that the direction of US-China trade talks will be crucial for sentiment in the Asia Pacific region. Markets could remain volatile for some time if the conflict continues. Already, companies seem to be becoming more cautious by delaying spending and investment. A full-blown trade war could significantly hurt regional economies and corporate earnings, although this remains the worst-case scenario amid continuing talks. In addition to this, there are other geopolitical worries, such as a rekindling of US tensions with both Iran and North Korea. However, amid this uncertainty, governments in the region are pragmatic. Most of them are ensuring that fiscal and monetary policies remain broadly supportive of growth and liquidity.

In this environment, the manager continues to focus on the fundamentals, with the portfolio invested in businesses with resilient sources of earnings that should protect them in tougher times. At the same time, recent changes to increase the portfolio's exposure to certain key growth sectors position the company to access Asia's huge potential where a growing and increasingly affluent middle class should bolster demand for a greater variety of products, services and technologies.

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Japan

(compare Japan funds [here](#))

Eiji Saito, Naohiro Ozawa and Michiko Sakai, managers of JPMorgan Japanese Smaller Companies: Valuations of Japanese companies are lower than historical averages and below those of most major markets. Many economies around the world have seen steady growth over recent years and we believe that the global economic backdrop remains broadly positive. Japanese companies are sensitive to economic cycles in overseas markets and, although we do not expect a recession, a failure to achieve a positive outcome for the current range of trade issues would pose a headwind.

The fundamental outlook for Japanese smaller companies remains positive, and we see no shortage of exciting investment opportunities. As symbolised by the new Imperial era named Reiwa (beautiful harmony) which began on 1st May Japan is seeking to achieve sustainable and broadly-based growth thanks to reforms to tackle threats such as the declining size of its population. Japan's key structural challenge presents significant opportunities, especially for smaller companies. The company maintains its focus on investing in businesses with strong growth potential, solid balance sheets and strong cash generation, across a diverse range of industries.

We remain mindful that the current economic cycle is maturing but believe that the global financial and business environment is healthy and not showing imminent signs of a broader slowdown. We also believe that by focusing on companies with leading market positions, strong balance sheets and healthy cash generation, the company is well positioned to benefit from the secular trends in Japan as well as weathering

potential short-term changes in sentiment driven by trade policies or other shorter-term economic indicators.

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Manager's report for CC Japan Income and Growth Trust: Equity markets worldwide have been impacted by geopolitical tensions and evidence of slowing economic trends which have had a significant influence on investor sentiment towards Japanese equities, individual stocks and sectors. The Topix index fell particularly sharply in the month of December 2018 as concerns intensified but, it has made a steady recovery in the first few months of 2019. The volatility in individual stocks has reflected this overall pattern with some of the weakest performers in the latter part of last year performing well year to date.

In the face of slowing economic data, Central Banks worldwide have made clear statements on monetary policy and this has impacted on expectations for global interest rates. The Bank of Japan downgraded its outlook for the economy in the near term, highlighting the impact of weakening exports. Monetary policy remains unchanged. The European Central Bank also cut its economic forecast for the year while the US Federal Reserve will now likely refrain from raising interest rates for the rest of the year, which represents a notable U-turn from previous expectations. This has resulted in clear performance trends for financial companies such as banks, whose ability to generate returns has been compromised by a flat yield curve and real estate investment trusts (REITs) which benefit from low interest rates.

The sharp rise in buybacks after two consecutive years of decline is confirmation of the 'flexible' approach to repurchasing shares detailed by most companies in their shareholder return policies. The equity market weakness during 2018 has provided the opportunity for management to acquire shares at substantially lower prices and clearly represents a prudent approach aimed at rewarding shareholders and also improving capital efficiency.

We believe that a more stable Japanese dividend environment than in the past, combined with the strong justification for managing buybacks on a flexible basis, will be beneficial for investors in Japan for the short and medium term.

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China

(compare China funds [here](#))

Nicholas Bull, chairman of Fidelity China Special Situations: In 2018/19 China displayed two of its enduring characteristics: volatility in the stock market and economic growth continuing at a rate in excess of 6% per annum. Following a strong performance, the previous year, the company's share price fell during the year and then recovered to finish close to where it had started. All of this demonstrates that, with China, patience is rewarded and an investment in the company should be viewed over the medium to long-term.

During 2018, the concerns about trade and policies put in place in China to restrict growth in credit clearly impacted business sentiment and growth and this contributed to the weaker stock market. Since the end of 2018, more stimulative policy, particularly for the private sector, has supported the economy and the stock market has performed markedly better in the opening months of 2019.

China's growth rate of 6.6% for 2018 continues to runaway in excess of developed market economies. Increasingly investors are seeing the benefit of having a portion of their overall portfolio dedicated to China and our company was designed, from the start, to fill that need.

The middle class in China continues to grow in size and in its spending power. The economy is increasingly driven by consumption and our approach from the start has been to build a diversified portfolio of stocks across the consumer sector.

We have avoided certain parts of the stock market, in particular the banks and the larger State-Owned Enterprises, many of which are components of our Benchmark Index, unless there is a compelling investment case for specific stocks.

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India

(compare India funds [here](#))

Hasan Askari, chairman of Aberdeen New India Investment Trust: The mandate handed to the BJP government should allow Prime Minister Modi to quicken the pace of his structural reforms. With infrastructure being a key agenda of the BJP's election manifesto, I would expect Mr Modi to continue with his capital expenditure programmes. This should provide some cushion from the impact of a tougher external environment, including escalating US-China trade tensions, resurgent oil prices and more challenging domestic conditions, such as weaker consumption and sluggish investment activity. Potentially, the BJP's larger majority could renew efforts to introduce the land acquisition bill, which would strengthen property rights, and update archaic labour laws that hold back productivity in the manufacturing sector. Nationwide and state-wide improvements in the ease of doing business, through a combination of digitalisation and better transparency, should also attract more foreign direct investment.

India remains a favoured market in Asia. Its young population and expanding middle class underpin the country's compelling growth prospects. Given the large domestic market, it is also less export dependent than many of its emerging market peers.

More importantly, the country is home to some of the best-quality companies across the region. It offers a diverse mix of well-managed domestic champions and offshoots of multinationals. This is supported by a culture of entrepreneurship and innovation. Your manager remains invested in companies with pricing power and solid fundamentals that continue to benefit from India's long-term consumption trends. The manager's preferred holdings also play to the strengths of what the country has to offer in IT services and engineering skills, given that it has the most engineering professionals in the world. This also feeds well into the digitalisation trend seen globally.

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Rukhshad Shroff and Raj Nair, managers of JPMorgan Indian Investment Trust: The Indian market just managed a double-digit return over the six months under review. Along the way it substantially outperformed the broader Asian region in the last calendar quarter of 2018, before underperforming it in the first three months of 2019.

Bolstered by a declining oil price, India was one of a minority of Asian markets which posted a positive US dollar return over the final months of 2018. This was achieved despite a somewhat soft third quarter GDP number of 7.1%, down from 8.2% in the

previous quarter, although the prior number had been flattered by a low base due to the earlier impact of the introduction of the Goods and Services Tax.

Following anticipated interest rate increases from the Reserve Bank of India (the 'RBI') in June and in August, contrary to consensus expectations it kept rates unchanged in October. This decision was followed by the surprise of the mid-term resignation of the RBI's governor, Urjit Patel. Although Mr Patel cited 'personal reasons' for his departure, there was speculation that he objected to government intervention in the workings of India's central bank.

The strong relative performance towards the close of 2018 was not sustained into the new year. In January 2019 India was the only Asian market to register losses in absolute terms. Some cyclical indicators suggested slower economic growth, with the corporate reporting season indicating that an overall recovery in earnings and profitability remains elusive. There was also some controversy over the accuracy of India's economic data.

A different facet of political risk manifested itself in February as military tension between India and Pakistan flared up. While the immediate threat of conflict was defused relatively quickly it acted as a reminder both of the risks in and around Kashmir and also of a tendency amongst some politicians to capitalise on the friction with an eye on the Hindu majority within India's electorate. Following the clash, PM Modi enjoyed an increase in popularity.

Against our expectations, in early February the RBI reduced interest rates by 25 basis points to 6.25%. It also changed the policy stance to neutral, citing the necessity of extending activity beyond government spending on infrastructure into higher private investment and consumption.

Given that the reduction took place in the run-up to the election, and as the current RBI governor is a career bureaucrat who was appointed after the surprise resignation of his predecessor, it raised some questions about political interference. That said, inflation is well within the RBI's target of 4% (CPI is 2% currently) and therefore real interest rates are high enough for the Monetary Policy Committee to ease monetary policy further in the near term.

Outlook

Prime Minister Modi's retention of power in the recent general election and the majority won by the BJP Party has led to a stronger mandate for the incumbent. However, while continuity of Prime Minister should be helpful, at no point was the prospect of a negative general election outcome priced in by markets. Moreover, in the longer run we see no particular correlation between which party is in power and the pace of GDP growth in India. What is more crucial is that over the past five years nominal GDP growth has not fed through to earnings growth: market earnings have been essentially flat for some time now. The key reason is that the banking sector has been through a negative earnings cycle on the back of non-performing loans. Provisioning for bad assets is now at more realistic levels and capital positions are being rebuilt. Normalisation of financial conditions should result in an earnings rebound. The path towards higher returns looks much clearer and more achievable.

We remain of the view that this is an early cycle economy. While valuations may not appear to be cheap relative to historic levels, with forward PE around the five-year average but above the ten-year average, we think that is partly because the corporate earnings cycle is depressed. An economic recovery and normalised earnings would make valuations appear cheaper and the long run growth prospects remain very compelling.

Russia

(compare Russia funds [here](#))

Oleg I. Biryulyov and Habib Saikaly, managers of JPMorgan Russian Securities:

Market review - and tentative signs of recovery

As we look back at the six-month period to 30th April 2019, it is apparent that global equity markets have surprised on the upside so far this year, recovering ground after a tricky end to 2018. Markets are seemingly less preoccupied by stagnant economic growth around the world and ongoing political uncertainty than they were in 2018 - even though both issues remain unresolved. Equity markets have risen this year, and global investors have become more upbeat, perhaps partly responding to central banks around the world pressing the 'pause' button on interest rate rises.

For Russia, the thorny topic of sanctions has not gone away and remains fluid but, a year on from the surprise US announcement of additional sanctions that hit the market with such force last April, the worst of the storm may already have been weathered. Moreover, the spotlight of attention has shifted to the ongoing trade wrangles between the USA and China so that Russian investment markets have been able to progress relatively unhindered. After all the negative sanctions noise directed at Russia in recent years, this vast country's economy appears to be showing tentative signs of recovery, with more recent stability in oil and currency prices both positive indicators. Dividend pay-outs from Russian companies have also maintained their positive trajectory.

Global politics remain an issue. Of all the simmering international challenges that could threaten to boil over into something more troublesome, the Russia-Ukraine stalemate is one that we continue to monitor closely. This story has taken a new turn following the landslide election of former comedian and novice politician Volodymyr Zelensky, who was inaugurated as President in May 2019. We are sceptical that this change in leadership will ease tensions between the two countries. Indeed, tensions grew towards the end of the review period as the Russian government made it easier for Ukrainian citizens to obtain a Russian passport.

Oil prices, so pivotal to the fortunes of the Russian economy, have seesawed over recent months. With the direction of travel for the global economy uncertain, oil price volatility is inevitable. That said, oil prices recovered over the period, providing support for the economy and we expect firmer prices throughout 2019. To temper our optimism, however, recent statistics have revealed sluggish economic growth of just 0.5% in the first quarter of 2019, which was much weaker than expected. An unpopular hike in VAT, which took effect from January, is likely to have been a key drag on growth, dampening consumer demand, albeit most likely a temporary stumbling block.

Against a rather more benign yet still uncertain backdrop, Russian markets have outperformed other emerging markets over the review period. Over the six months to 30th April 2019, the company's net asset value was up 9.5% on a total return basis, just ahead of the benchmark, the RTS Index, which rose by 9.4% on a net asset value total return basis.

Outlook

It is easy to forget that Russia's economy only returned to economic growth in 2017 after suffering two years of recession. 2018 may have been a surprisingly positive year overall for Russian equities, but there was a wide dispersion in returns achieved across the market which plays to our strengths as stock pickers. Our investment approach, and our focus on identifying long-term growth opportunities from individual stocks, has

delivered robust returns to shareholders over recent reporting periods, even though the underlying economic and geopolitical landscape has been challenging and changeable.

Our current thinking has not shifted materially since our January 2019 report. On a short-term view, the economic picture is undeniably mixed, with sluggish global growth likely to weigh heavily on the outlook for Russia. Domestically, the economy has not been improving as we would have hoped and, as things stand, we do not expect domestic consumption to be the main driver of returns in the next 12 months. We will therefore remain cautiously underweight domestic stories and will concentrate our attention on export-focused businesses.

Looking further out, we are confident that economic recovery in Russia remains on track and we passionately believe that Russian equities provide a long-term investment opportunity. We expect to see:

- Firmer oil prices, driven by production cuts and politics, which will be positive for the earnings of Russian companies.
- Interest rates to fall by 1 to 1.5% over the next 18 months, an expectation made more likely by the most recent set of statistics that showed lacklustre economic growth.
- Rising dividend payments and dividend yields expected to remain strong, highlighting the attractive valuations available. With local Russian investors becoming bigger participants in the equity market, we expect the search for yield to become more prevalent.
- The rouble continuing to be volatile, but with the possibility of less intervention from the Central Bank who had been aiming to keep the currency relatively weak but is now under less pressure to build reserves.
- The environment around sanctions remaining fluid, and we will continue to monitor the situation. However, there is every possibility that relationships with the West will thaw rather than worsen.
- Likelihood of capital flows to the Russian economy - and to investment markets - as a result of government reforms and its privatisation programme, i.e. selling off state-owned enterprises that would trigger higher dividends.

Naturally, investing in Russia is not without its challenges but investing in any single country brings with it a series of specific risks. For those investors prepared to accept these risks, we believe the fundamentals for investing in Russia remain compelling and our ability and resources to uncover well-managed companies with robust balance sheets is both proven and remains strong.

We are very selective about the companies we invest in. We still believe the market is attractively valued, with particular value to be found in certain sectors. We will continue to base our investment decisions on relatively strong and improving fundamentals, which we believe will reassert themselves as the primary drivers of returns over time. For now, however, we will stick to our investment process and look beyond short-term volatility, spurred on by the reasonable company valuations we are seeing and in anticipation of sentiment towards Russia becoming more positive.

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Biotech and healthcare

(compare biotech and healthcare funds [here](#))

Sven H. Borho and Trevor M. Polischuk, managers of Worldwide Healthcare Trust:

Global Pharmaceuticals

Global large capitalisation pharmaceutical stocks were somewhat of an enigma in the financial year. Perhaps no sector better exemplified the unique dynamics of healthcare equities and the macroeconomic influences that dictated share price performance in the period. In our view, the large rotation into pharmaceutical stocks and outsized outperformance was due solely to these macro factors: a defensive rotation given fears of rising interest rates, market volatility, and a slowing global economy. Fundamentals, such as earnings, clinical catalysts, or political risk had much less or even no effect on stocks through the year.

The start of the year was unremarkable, with shares moving mostly sideways through to the beginning of July. Revenue and earnings performance were typical for large capitalisation pharmaceuticals: low to mid-single digit top line growth and mid to high-single digit earnings per share growth. Moreover, there remained some investor angst over drug pricing in the U.S. and what the Trump administration may or may not have planned from a legislative perspective. The collective lack of notable share price moves was reflective of the fundamentals at that time: minimal catalysts, financials as expected, and in-line valuations.

However, as the second quarter earnings approached, the defensive nature of large capitalisation pharmaceutical stocks played a major role. The entire sub-sector started to move higher as the calendar turned to 1 July. Why- Not because expectations rose for earnings results. Not due to an uptick in M&A. Certainly not due to diminished political risk. Perhaps there was a valuation argument to be made. But rather, as discussed above, it was because of a broad market rotation into value from growth stocks commenced in the middle of the calendar year. The result- A near record performance for drug stocks in the quarter: almost 15% higher (total return in sterling) as measured by the NYSE Arca Pharmaceutical Index, the second largest quarterly move for the index this century. Pharmaceutical stocks were defensive, indeed.

This was quickly followed by some downward moves for the group, again due almost entirely to macro rather than fundamental factors. Volatility clearly began with comments from the Chairman of the U.S. Federal Reserve in October 2018 who cautioned that interest rates would move higher in the near term. Fears of a slowing economy and continued U.S.-China trade wars exacerbated a suddenly bad market environment. Investor mentality switched from “value” to “risk-off” and carnage ensued. Despite some whipsaw in November, the resulting sell-off in December removed only some of the gains of the DRG by year’s end, and it significantly outperformed the healthcare benchmark by over 7% (in sterling terms).

Finally, the start of 2019 again brought some renewed optimism to the market. When the U.S. Federal Reserve subsequently backed down on interest rate rises for 2019, market momentum was reignited. Pharmaceutical stocks also moved higher, but now underperformed the benchmark. Overall, the DRG rose 26.5% (in sterling terms on a total return basis) and 17.3% (in U.S. dollar terms on a total return basis) in the financial year, with some notable moves both up and down in between. What a ride.

But what about the fundamentals of the large capitalisation pharmaceutical sector. They remain mixed. First, some positives. It is without question that innovation is at or near an all-time high in the therapeutics space. The genomic revolution at the turn of the century is now ripe enough to be producing more curable targets than ever before. Drug development is more sophisticated and resulting in less attrition in later stages than previously seen. Also, when the pipelines appear thin, business development takes over and acquisition of the small, small/mid-capitalisation biotechnology stocks helps fill the coffers.

Perhaps this is a question of the chicken versus the egg, but the FDA has just had another record year for new drug approvals. 2018 marks the second consecutive year in which it has approved a record number of new molecular (or biological) entities, with 59, smashing the 2017 record of 46. Also, of note, the FDA approved a record number of generic drugs in 2018, eclipsing the record set in 2017. Whilst the resignation of Commissioner Scott Gottlieb in early 2019 was disappointing, the FDA has established unprecedented levels of efficiency, modernisation, and collaboration and has never been more aligned with industry to get new drugs approved. We expect the career staffers to carry on this current culture of achievement, regardless of who may become the next commissioner. Speaking of such, Health and Human Services has named Ned Sharpless, head of the National Cancer Institute, as the acting Commissioner. Already an appointee of President Trump and vetted by Congress, we believe Dr. Sharpless is the leading candidate to become the next head of the FDA.

Conversely, there remain some negative headwinds for this group. Whilst more drugs are getting approved, it has become increasingly difficult getting these drugs to patients as market access has become much tighter over the past two decades. In Europe, country regulators have never been more stringent on price negotiations. In the U.S., managed care payers are more aggressive than ever, using a variety of tools such as “prior authorisations” and “step edits” to limit utilisation. Rising usage of formularies and tiered access are also the norm. Finally, the practice of some payers who engage in “exclusive” contracts with certain manufacturers eliminates competition altogether.

Of course, one issue that persists in therapeutics is the dreaded “patent cliff”, when a drug’s exclusivity expires and generic substitution erodes sales. Whilst not at its worst currently, the looming issue is biosimilars. The situation in Europe has been reasonably well chronicled: branded biologics are forced to reduce price from single-country payers (between 20% to 80%) and volumes are eroded by roughly 30% per annum. However, in the U.S., the outlook remains less certain as there has only been one antibody of import that has faced a biosimilar thus far (infliximab from Johnson & Johnson). However, companies on the precipice of U.S. biosimilar competition are many, including Abbvie, Roche, and Johnson & Johnson. Overall, we expect U.S.\$100 billion worth of branded sales to be at risk to generic competition to 2027 (source: Wolfe Research).

Of course, the spectre of drug pricing fears also remains into 2019. First, drug price increases, if not completely gone, are at the very least a diminishing tailwind. In 2017 and again in 2018, net drug price increases were below that of inflation at less than 2% (source: PhRMA). Most companies now report that drug prices are a net negative contributor to sales, not a positive. We expect this trend to continue, if not accelerate.

On the legislative front for drug pricing in the U.S., we expect action to be taken in 2019 or 2020 by the Trump administration. There has been a plethora of proposals from both the Republicans and Democrats over the past two years, some with merit, some without. We believe that three policies that are most worth watching are (1) the move from a rebate to discount system, (2) the institution of foreign price references, and (3) switching Medicare Part B covered drugs to Part D coverage.

First, a move from a rebate to discount system may actually cause net drug prices to go up (at least temporarily). As rebates are a closely guarded industry secret between manufacturers and payers, there is no way to know if a disclosed price discount was above or below the rebate being paid. Nevertheless, this would reduce out-of-pocket expenses for patients (1) with no insurance or drug benefit plan and (2) who pay a co-pay that is a percent of the list price. Overall, this could be a win-win solution: pharmaceutical companies maintain status quo of net pricing (or better) and President Trump can announce significant discounts on drug prices.

Second, the institution of foreign price references to establish a price for U.S.-sold drugs, on the face of it, could be negative for the industry. President Trump has proposed the “International Pricing Index” or the IPI. This plan would peg the price of drugs sold in the U.S. to the average price in 16 other countries (in which the current administration believes that prices are on average 44% lower). Thus far, details on the IPI are sparse but we would note that this remains a document only (not a bill), cannot be passed by executive action alone, will need support by Congress, would not take effect until 2020 (at earliest), and the peak effect would not be until 2025 (at best). Importantly, the IPI is not a proposal for a direct purchasing of drugs. Finally, we note that the IPI was first proposed by President Trump just ahead of the November 2018 mid-term federal elections, thus perhaps, more of a shrewd political move by the President rather than a real policy risk for the industry.

Third, the switching of Medicare Part B covered drugs to Part D coverage has been one of the first and most consistent proposals by this Administration. It has full support of the Centers for Medicare and Medicaid Services and therefore we think something could materialise from this proposal. The premise is that current drugs in Medicare Part B (in-office administered drugs) are not subject to any rebates or restrictions whereas they are in Part D. We view this risk as mixed as the numbers of companies to be adversely affected could be limited.

With 2019 well under way, it is not too early to think about 2020 and with it, another U.S. Presidential election. With that, Democratic candidate Bernie Sanders, the U.S. Senator of Vermont, has attracted the attention of voters and investors alike with his “Medicare for All” proposal. While not a new idea, an April 2019 “town hall” meeting and subsequent tweets from Mr Sanders himself elicited an egregious sell-off in healthcare. His proposed single payer system in the U.S. of course would be very concerning and would adversely affect basically all healthcare players, from managed care (which would conceivably go away) to significant pricing pressure on manufacturers. An epic sea change, indeed. This has panicked the generalist investor and hence the recent observed sell off.

But what is the reality? First, April share price sentiment traded as if Mr Sanders had already won the U.S. Presidency, which is obviously not the case. Rather, former Senator and Vice President Joe Biden is the assumed front runner on the long list of Democratic candidates for that party’s presidential nominee. Mr Biden is a supporter of the Affordable Care Act, or “Obamacare”, which he helped in put into law when he was part of the Obama administration. It would be inconceivable for Mr Biden to support legislation that would be in opposition to Obamacare.

Second, could “Medicare for All” even become a reality? It would require a Democratic sweep of the President, House, and Senate. Of course, this requires Mr Sanders to win both the Democratic nomination and the Presidential election. The House probably remains Democratic but for the Senate to move from Republican would require three (or four) seats to flip at the next election in 2020, which we view as highly unlikely.

Third, how is “Healthcare for All” paid for? Early estimates easily eclipse U.S.\$30 trillion. The increase in taxes will be severe and pervasive across constituents (citizens, states,

businesses). While stumping for this policy change may resonate with voters early on, the staggering price tag, when that finally comes into focus for voters, may diminish support.

Fourth, many are drawing analogies today between Hillary Clinton in 1993/1994 and 2015/2016 to Mr Sanders today. The one key difference is that Ms Clinton (or her husband) was the undisputed front runner and major policy changes seemed inevitable at those times. As mentioned, Mr Sanders is not currently the front runner of the Democratic party nor is he expected to be.

Overall, we view the fundamentals of the global pharmaceutical companies as positive, albeit partially fragmented. Valuations remain undemanding with price to earnings ratios towards the low end of the historical range for the group post the April 2019 sell off. Innovation remains strong with a number of data read outs and new drug launches expected in 2019. Earnings growth rates, however, are disparate from company to company, ranging from low single digits to high teens as patent expirations, pipelines, and new product flow can be dissimilar across the industry.

Biotechnology

When the broader market experienced historic volatility and a drastic downturn in the second half of 2018, it weighed on both the biotechnology sector and the portfolio. Whereas large capitalisation companies are historically thought of as lower-risk and more defensive, the market sell-off in 2018 was largely indiscriminate and affected both large capitalisation and emerging biotechnology companies.

While biotechnology and the broader market began a recovery in 2019, we believe investor appetite for emerging capitalisation biotechnology was particularly reinvigorated by increased M&A activity in early 2019, including the acquisitions of Celgene (by Bristol-Myers Squibb), Loxo (by Eli Lilly), and Spark (by Roche). Clearly, M&A continues to be a core strategy for large capitalisation companies to bolster their existing portfolios and pipelines, many of which suffer from overhangs. While large capitalisation companies remain at historically low valuations, we see emerging biotechnology companies as more attractive investments.

Innovation remains high in biotechnology, with cell therapy and gene therapy as some of the “hot” new spaces now being commercialised. We continue to see companies with strong platform technology as attractive investments and see technical know-how as an increasingly valuable asset. With the emergence of newer treatment modalities such as cell therapy, gene therapy and gene editing, we believe manufacturing and technical expertise has become a critical aspect of generating and maintaining value.

As a record number of gene therapy programs are poised to enter the clinic in 2019, infrastructure and manufacturing capacity has struggled to grow proportionally to support these trials, and thus has become a valuable commodity in the space. We see value in companies with differentiated expertise in platform technology, which we see as relatively scarce in a growing field.

We believe recent transactions in gene therapy reflect the valuable nature of internal technical expertise, with the acquisition of portfolio company Spark Therapeutics by Roche being a prime example. With the first marketed in vivo gene therapy in the United States and multiple late-stage gene therapy candidates, Spark has been a clear pioneer in manufacturing, clinical development, regulatory and commercial execution in the space. We also highlight portfolio company MeiraGTx as a gene therapy company with strong technical expertise, which we believe is also reflected by Janssen’s licensing and collaboration deal with the company in inherited retinal diseases. Portfolio company Sarepta has also shown a strong commitment to manufacturing and has become one of the leaders in the space.

Following the striking clinical and commercial success of the first wave of immuno-oncology drugs including Keytruda and Opdivo, many biotechnology companies have focused their efforts on identifying the next immuno-oncology target. Disappointingly, several high-profile immuno-oncology targets, such as IDO1, have failed to produce meaningful clinical benefit in large clinical trials. Whilst the search for the next immuno-oncology target continues albeit with markedly less enthusiasm, we see targeted therapies as re-emerging as the class of choice in oncology.

First-generation tyrosine kinase inhibitors (TKIs) such as Gleevec were a revolution in their time and produced impressive clinical results across a variety of tumour types but were plagued by safety and tolerability concerns. However, with improved genetic sequencing capability, companies have developed inhibitors of specific genetic mutations driving specific tumour types, leading to unprecedented response rates and substantially more tolerable side effects. We see the targeted therapy approach as a clear success for precision medicine and believe innovation will continue in the space.

Portfolio company Exelixis has pioneered the development of next-generation targeted therapies with the commercial success of its drug Cabometyx/Cometriq in various tumor types including renal cell carcinoma and hepatocellular carcinoma. We also see portfolio company Deciphera as an important player in TKIs, with their drug ripretinib showing strong efficacy in KIT-mutant gastrointestinal stromal tumours with a meaningfully improved safety and tolerability profile over first-generation KIT inhibitors which had substantial off-target activity.

With the approval of Eli Lilly/Loxo's Viktrakvi in NTRK-mutant tumours and the continued development of targeted therapies, we believe genetic sequencing will increasingly become a key aspect of early diagnosis in oncology. We therefore see portfolio company Illumina as a clear beneficiary in the resurgence in targeted therapies, as we expect increasing use of their sequencing technology to support further drug development and commercial uptake of targeted therapies.

Specialty Pharmaceuticals

In the U.S., although the focus on drug pricing remains high, investors' worries have moderated resulting in improved sentiment for specialty pharmaceutical stocks. The U.S. government and regulatory directives aimed at reducing drug expenditures have been incessant and a power shift within Congress has produced a fresh wave of legislative initiatives targeting drug pricing. Despite continued uncertainties, investors have apparently grown more comfortable with the array of potential outcomes from these varied approaches to contain drug spending, with worst case scenarios now heavily discounted. We continue to monitor these dynamics closely.

Improved operating performance for many specialty pharmaceutical companies and a combination of new product launch cycles and favourable clinical data disclosures have revived interest in the group. We continue to believe that a select group of stocks within this sector could outperform in the near and intermediate term. Relatively low valuations create favourable risk-reward profiles, especially ahead of a multitude of impactful pipeline catalysts.

In Europe, the outlook remains bright for companies with durable product franchises, established sales and marketing infrastructure, and rich proprietary pipelines. Lesser diversified U.S. and Asia-based players continue to actively seek product/corporate acquisitions and partnerships to gain access to attractive European markets, setting the stage for significant business development and M&A. We expect an uptick in activity over the next 12 months.

Generic Pharmaceuticals

The systemic, multi-year, price erosion cycle affecting companies participating in the U.S. generic market has finally run its course, with senior management teams from multiple generic manufacturers highlighting the pricing stability observed over the last few quarters. Several factors are behind the improved pricing environment in the U.S.

To start, generic operators have scaled back their marketed product portfolios and have halted production of products with marginal profitability. In several cases, this has resulted in product shortages. Many manufacturers have also withdrawn generic drug applications currently pending FDA approval due to unfavourable market conditions and reduced profit expectations. This has reduced incremental competition in some markets. We still anticipate significant consolidation of the U.S. generic market, which could provide further pricing stabilisation, however this could take considerable time since sector leverage remains elevated.

Although investor concerns about U.S. pricing dynamics have subsided, worries about legal risk have escalated which has stifled the performance of the large generic companies. Litigation involving the marketing of opioids along with litigation involving potential pricing collusion for a broad basket of drugs have caused generic drug stocks to underperform, pushing valuations to the lower end of historical ranges. Although we find the current sector valuations quite attractive, we acknowledge that these legal overhangs could persist. We continue to employ a selective approach with this sector.

Although geographically diversified players have benefited from exposure to markets outside of the U.S., we have seen some growth moderation in certain E.U. markets. Asia remains a high growth area, with utilisation driven by continued economic expansion, favourable demographics, supportive government policies, and other contributing factors.

Biosimilar launches are gaining traction and we anticipate steady uptake in all markets. In Europe, where a significant number of biosimilars have been introduced, we have seen accelerating rates of market penetration. In the U.S., there have been fewer biosimilar launches and less rapid product uptake due primarily to third-party payer obstacles (i.e., branded product rebates). We anticipate additional U.S. biosimilar launches in the 2019-2021-time frame with a steady acceleration in market penetration rates.

Medical Devices

End market growth rates in the medical devices space remain strong, with accelerating organic growth rates and well-fortified pipelines that should drive a continuation of this trend. The key factors underpinning the growth are strong consumer confidence and low unemployment rates in the United States, elevated levels of research and development (R&D) spending across the industry, a large number of new product approvals by the FDA, and further penetration of key international markets, especially emerging economies.

On the negative side, valuations remain high and there has been some investor consternation about “Medicare For All” rhetoric from select Democratic primary candidates in the United States. However, we believe valuations are warranted given the high single digit organic sales growth and mid-teens earning per share growth profile of many large-capitalisation companies in the sector, and while a shift to “Medicare For All” would certainly have a negative impact on device companies over the long term, we still think the likelihood of a meaningful shift toward a single payer system in the United States remains low, with any impact to device companies far in the future.

Turning to stock selection, we continue to prefer (1) cardiology – where innovation remains industry leading, (2) surgical robotics – where technology advances have been

and will continue to be disruptive to historical surgical paradigms, (3) diabetes – given the sheer market size and potential for several new product cycles to drive elevated growth rates for manufacturers, and (4) extremities implants/biologics – which remain at the early stages of the adoption curve.

Healthcare Services

Performance in healthcare services has been very divergent in this financial year. Fundamentally, managed care companies generally performed strongly this year due to a multitude of factors: stable cost trends, tax reform benefits, and the repeal of the health insurer fee for 2019 allowed companies to invest for significant growth. However, the beginnings of fears about U.S. healthcare reform in early 2019 erased positive performance, and companies such as CVS (a pharmacy benefits manager and retail pharmacy) and Cigna (managed care provider) that engaged in major vertical consolidation were punished for doing so.

Otherwise, on the “providers” side of the healthcare services spectrum, companies had a stronger 2018 after a weak 2017, with stabilising volume and increasing acuity contributing to growth. The supply chain struggled, as generic deflation pressured distributors, intensifying competition and regulatory scrutiny pressured pharmacy benefit managers, and reimbursement and retail headwinds pressured pharmacies.

Looking ahead, the outlook for healthcare services is turbulent. Democratic presidential candidates touting “Medicare for All” proposals pose existential risk to managed care. While rhetoric will eventually moderate to more realistic proposals following the election in November 2020, negative headlines could persist and intensify for the entirety of the presidential campaign. Further, the Trump administration is moving forward with several reforms on drug pricing reform, including an International Price Index model for certain drugs in Medicare Part B, and mandating pharmaceutical rebates be paid to consumers at the point of sale.

Whilst the fundamental outlook for managed care remains strong, we expect the political environment for managed care to be difficult. We believe the current fundamental outlook for providers is stable but see greater risk to providers in most outcomes for healthcare reform, as Medicare generally reimburses providers at lower rates than commercial insurance.

Finally, the supply chain will face significant headwinds, as reimbursement challenges and drug pricing reform make it difficult for the space to grow. In this environment, we prefer quality names with strong fundamental outlooks that stand to be unharmed or benefit from plausible realistic outcomes of healthcare reform that may incrementally expand Medicare.

Life Science Tools / Diagnostics

The life science tools sector continued to reach new highs in the reported period, as a convergence of strength across most major end markets and geographies, as well as insulation from political headwinds, resulted in healthy performance. Growth across the sector was led by biopharma end markets, which have benefited from the rapid uptake of new technologies in bioproduction. Geographically, macroeconomic indicators moderated across the world, especially in Europe and somewhat in China, though company performance remained strong. M&A activity increased among the industry consolidators with a notable slant toward biopharma businesses, with Danaher acquiring GE’s Bioprocessing business and Thermo Fisher Scientific’s acquiring Gatan, Becton Dickinson’s Advanced Bioprocessing business, and Brammer Bio.

Our view remains that the fundamental outlook for the tools sector is very positive. Companies have favourably shifted mix towards higher-margin, recurring consumable

revenue, as well as towards faster growing, higher-margin biopharma end markets via acquisitions, hence they are poised to grow organically at sustainably higher rates. The macro environment remains healthy, though we are watchful of Europe and industrial end markets. The ever-present overhang of China and its associated macro/trade concerns represent downside risk, though we do not expect a significant negative outcome from trade negotiations. Despite elevated valuations, we remain positive on the sector, and expect the group to compound strong returns for the foreseeable future. We prefer companies with outsized biopharma end market exposure, scale, and balance sheet capacity to consolidate the industry and enhance returns.

Emerging Markets

Equity markets in China were not immune from volatility during the financial year. Headwinds included the unpredictable policy changes in hospital drug procurement and the negative macro environment of U.S.-China trade tension. Meanwhile, on the positive front, we saw acceleration in innovative drug approvals, and improved transparency in healthcare products registration pathways.

In the incoming year, we remain cautious on policy risks in the drug price regulations, and therefore prefer healthcare service companies over large pharmaceutical companies, especially those exposed to discretionary or premium healthcare services paid out-of-pocket. We are excited about the fundamentals of the emerging Chinese biotechnology sector but believe some of the companies are currently overvalued. Our participation in certain pre-revenue biotechnology IPOs in Hong Kong is very selective and concentrated.

In India, we seek investments in specialty and generic pharmaceutical companies with a global diversified presence, strong compliance track record, cost effective manufacturing capabilities and differentiated pipeline focus. The Indian pharmaceutical industry grew at circa 10% during the reported period led by prescription volume growth. We anticipate continued volume growth driven by strong underlying secular demand which will more than offset pricing erosion stemming from government initiatives to contain drug costs.

Additionally, Indian pharmaceutical companies continue to benefit from the high double-digit growth rates registered in emerging markets such as South East Asia, Middle East, Africa, and Eastern Europe. The U.S. generic market, which accounts for more than 40% of the revenues for Indian pharma companies, has experienced more favourable dynamics with multiple signs of pricing stability observed over the last 12 months. This bodes well for near and intermediate term operating performance for many Indian players.

We also look to invest in domestic healthcare companies within India with scalable and profitable business models, including hospitals. We are closely monitoring the roll out of Ayushman Bharat, a National Health Protection Scheme (NHPS), which is a government funded healthcare programme launched in September 2018 aimed at expanding health insurance coverage. We continue to keep a keen eye on changing pricing dynamics, cost efficiencies, and leverage and are intensely focused on the cash generating abilities of our portfolio companies.

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Martin Murphy, manager of Syncona: The Third Wave of advanced therapies, in particular cell and gene therapies, have continued to gain significant momentum this year. We remain very encouraged by the strong regulatory support and positive overall market setting for these undoubtedly transformational medicines. It is our view that we are still in the early days of the Third Wave, which has the potential to drive decades of

innovation in healthcare as personalised, tailored medicines come to the fore powered by advances in genomic understanding.

Syncona is a global leader in this area, and our portfolio companies are very well placed to compete in a fast-growing space. We have an early mover advantage and have made significant strategic investments in areas like manufacturing and delivery, which puts us in a strong position to enable the commercial success of these emerging therapies.

We continue to have one of the world's leading gene therapy platforms across multiple companies addressing the key tissue compartments where gene therapy has delivered proof of concept, namely the eye, the central nervous system and the liver. This includes Gyroscope, our second retinal gene therapy company which is seeking to be at the forefront of moving gene therapy from the smaller monogenic diseases, like Choroideremia into more genetically complex and more prevalent diseases.

In the year, we also further expanded our cell therapy franchise through the creation of our new company, Quell Therapeutics, focused on engineered T-Regulatory cells.

We continue to see exciting new opportunities for investment both within the Third Wave and beyond, where new technological advances are being applied to First and Second Wave modalities such as small molecule drugs and biologics. We are focused on founding companies in areas where the Syncona model can be applied to our advantage as we seek to build a portfolio of 15-20 globally competitive companies, adding new companies at a rate of approximately 2-3 companies a year.

Our portfolio companies are scaling rapidly, and we believe they are well-placed to continue to execute on strategy in line with their development plans. Many of our companies are now conducting clinical trials, where the data generated will be the core driver of fundamental value. This process is never without risk, but we believe our companies are positioned to navigate these processes as they seek to deliver transformational treatments to patients.

Long term, we continue to focus on building a selective portfolio companies and delivering 15 per cent IRR through the cycle. We believe that our differentiated business model and leading multi-disciplinary team, supported by our strategic pool of capital, will enable us to capture superior risk-adjusted returns for shareholders as we seek to build the next generation of healthcare companies.

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Private equity

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

Manager's report for Reconstruction Capital II: Both the Romanian and Bulgarian economies continued to report increases in GDP during 2018 of 4.1% (2017: +7.0%) and 3.1% (2017: +3.6%), respectively, and are expected to continue to grow during 2019. Romania's 2018 GDP growth, which was the highest in the EU for the second year running, continued to be mainly driven by increased private consumption. The IMF is forecasting a slowdown in GDP growth to 3.4% in 2019 due to the effect of inflation on disposable incomes.

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Manager's report for Standard Life Private Equity:

Primary investment market review

The European and North American private equity markets remain particularly buoyant, with high levels of activity in fundraising, new investments and exits, an ongoing trend since the financial crisis of 2007-8. Many institutional investors have increased their allocations to private equity on the back of strong performance, and the expectation is that this will continue relative to a more muted public market outlook. The high levels of investment activity, tied to increased private equity allocations, continues to prompt managers to come back to the fundraising market earlier and seek to raise ever-larger funds.

In Europe and North America, 2018 buyout activity of \$139 billion and \$274 billion respectively represents increases of 26% and 34% over 2017. As such, buyout activity in Europe is at its highest level since 2007, and in North America 2018 was broadly in line with 2015 which had the highest activity since 2007.

With respect to fundraising, the best small, mid and large cap managers are raising new funds rapidly (and being frequently oversubscribed), notwithstanding significant fund size increases in many cases. The increasing allocation to private equity by large institutional investors means that many second tier and new managers are also finding success in reaching fundraising targets. 2018 was another record year for buyout fundraising in Europe with \$74.9 billion raised in the period, which was marginally up on the prior year at \$74.6 billion. Conversely, North American fund raising was less successful with only \$136.7 billion raised in 2018, down 31% on prior year.

Notwithstanding the softer fund raising in 2018 in North America, since 2013 buyout fundraising globally has continued to outstrip new investment activity over the same period. As a result, record levels of dry powder (raised capital not yet invested) are being witnessed across the globe, with North America accounting for approximately 60% of the aggregate amount. The growth in dry powder has not been uniform across the different fund size segments, however. In the mega buyout space, dry powder has seen a rapid increase. However, in the mid-market space, where the company typically invests, dry powder growth has been relatively steady. The capital raised for European and North American private equity now represents around 3.9 years and 4.8 years of investment capacity respectively, up from 2.8 years and 3.3 years at December 2015.

Valuations within the European buyout market have coalesced around 9.0x-10.0x EBITDA since 2008, albeit with some notable fluctuations due to specific large deals in highly or lowly related sectors. In 2018, the average purchase price multiple surpassed 10.0x EBITDA. Total debt multiples have shown a gradual increase since 2009, levelling to just over 5.0x EBITDA from mid-2014 but have increased again in the last 18 months. Valuations within North America have crept upwards in recent years, with 2018 averaging at 10.6x EBITDA, albeit Q4 2018 was lower at 10.3x EBITDA. Increasing debt availability has contributed to higher valuations in North America - average debt of 5.8x EBITDA is now at its highest level since 2007. Notwithstanding the higher debt levels, covenants have tended to loosen over the past few years, as the debt funding market for buyouts has grown increasingly competitive.

Overall, the company has seen a steady pace of activity over the past few years and it is expected that the levels of new investment and realisation activity will remain robust over 2019 and into 2020. This is driven, in part, by Europe and North America having a large population of privately-owned businesses and a substantial number of corporates looking to divest non-core divisions, providing significant opportunity for private equity managers. European and North American private equity firms account

for the significant majority of all private equity firms globally. Given the attractive dynamics in these markets, they will continue to be the focus of the company.

Secondary transaction market review

2018 was a record year for the secondary market in terms of deal volume, with \$74 billion of transactions completed. This represents a 28% increase on volumes transacted in 2017. The key reason for this growth continues to be a combination of strong pricing and innovation, which have together unlocked an increasing number of larger deals. Transactions over \$500 million in size accounted for nearly 60% of the overall deal volume and as a result a high proportion of the market (around 70%) is concentrated in buyers managing vehicles with capital greater than \$4 billion.

Average pricing in secondary transactions in 2018 declined modestly from 93% of NAV in 2017 to around 92%. This reflects the continued supply of 2008 and older vintage funds, which generally have limited upside and therefore trade at higher discounts to NAV. There was also an increase in emerging market assets which tend to be dilutive to overall pricing levels. Stock market volatility in the fourth quarter of 2018 may also have had an impact.

The trend in average pricing masks the fact that better quality buyout funds and newer vintages, which are typically the ones targeted by the company, often trade at material premia to NAV and so require the buyer to hold the investment below cost for a period of time.

Another key factor behind the market growth trend has been the ability of secondary buyers to raise capital, both through their own fundraising efforts and with the availability of more leverage. With many of the bigger secondary managers actively raising capital in 2019 and targeting ever larger fund sizes, it is estimated that over \$150 billion will be available to invest in secondary transactions over the near term.

On the innovation side, General Partner-led transactions have continued to gain traction and to be adopted across a wider range of transaction types, size segments and assets classes. This category of secondary deal grew significantly in 2018 and accounted for \$24 billion of volume, equivalent to 32% of the total market volume. Many of the best-known private equity managers have used the secondary market to offer liquidity to their investors. Often these deals allow the existing manager more time to develop and sell key assets, sometimes with additional capital and sometimes with adapted incentives.

The level of complexity of some of these GP-led deals has been challenging for managers, their advisers, secondary buyers and the existing investors in the funds being restructured. This has led to the Institutional Limited Partners Association publishing a set of guidelines on these deals in April 2019. The key recommendations in this report focus on the need for proper engagement between GPs and Limited Partners and appropriate levels of disclosure to ensure fair treatment.

The manager has remained focused on targeting secondary interests in high quality private equity funds that would fit well alongside the company's existing portfolio of funds, co-investments and managers. The manager continues to originate and analyse a variety of secondary opportunities on behalf of the company, but over the course of the last year a number of transactions were declined due to high price levels. The manager remains highly selective in its secondary strategy for the company given the current macro and secondary pricing environment.

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Debt

(compare debt funds [here](#))

Paul Read, Paul Causer and Rhys Davies, managers of Invesco Enhanced Income: The six months to the 31 March 2019 can be split into two distinct periods. During the last three months of 2018, financial markets came under pressure before then rallying in the first three months of 2019. The key catalyst for the change in sentiment was a shift in central bank policy.

Between October and December rising tensions over trade between the US and China, disagreement between the European Union and Italy over the Italian budget deficit, Brexit, some deterioration in economic data and the prospect of higher US interest rates all weighed on sentiment. The high yield sector came under particular pressure at this time with the market punishing companies that were showing signs of weakness. Adding to concerns for the BB part of the high yield market was the end of the European Central Bank's Corporate Sector Purchase Programme.

Sentiment turned following the US Federal Reserve's decision to pivot away from hiking interest rates. The Fed announced that it recognised that economic and financial conditions had changed. Therefore, it was prepared to alter the composition of its balance sheet if economic conditions warranted. This was a significant move by the Fed that saw expectations about the timing of future interest rate hikes pushed out. The Fed re-affirmed this policy shift in subsequent meetings. At its March meeting, the median forecast of members of the Federal Open Market Committee (the body responsible for setting US interest rates), known as the dot-plot, had been revised lower. Having expected three hikes this year as recently as November 2018, the dot-plot now suggested that the Fed would not hike interest rates at all during 2019.

In March, the European Central Bank joined the Fed in pivoting toward more accommodative policy. The ECB announced plans for new Targeted Long-Term Refinancing Operations. The programme is designed to help stimulate the eurozone economy by offering low cost loans to banks over a two-year period. The ECB also updated its forward guidance to state that it did not intend to hike interest rates this year.

Against this backdrop, issuance levels have fallen with Barclays reporting European high yield issuance 39% lower compared to the same period in 2018. While supply has fallen, demand for high yield has been strong providing a supportive technical backdrop for the market. European currency high yield credit spreads (the premium over government bonds that companies need to pay to borrow) began the period at 361bps. They then widened to a peak of 538bps in November 2018 before narrowing to end the period at 416bps.

Areas of the high yield market that experienced significant re-pricing in the latter half of 2018 included the retail, energy and auto sectors. Subordinated financials also came under pressure.

A high-profile example of the re-pricing was Debenhams, which reported significant losses. The company's 2021 bond fell from a price of £78 in November to £42 in late March 2019. Although not held in the portfolio, the price move is illustrative of the volatility within the sector and serves as a reminder of the potential for material losses in the high yield market.

Year-to-date, the trend reversed with many parts of the market rallying strongly. Indeed, the European currency high yield bond market has had its strongest start to the year

since 2012. However, this recovery has not been universal with the dispersion in returns creating some investment opportunities.

Outlook

Despite the rally year-to-date, the premium over government bonds that high yield companies need to pay to borrow remains higher than it was a year ago. Moreover, the more dovish backdrop has re-ignited the search for yield and investor demand for new issues is very strong. That said, the overall level of yield has fallen back towards recent averages and so we must expect the strong gains we enjoyed in the first quarter of 2019 to moderate from this point.

Since the end of the review period, high yield markets initially continued to rally, with European currency high yield spreads touching a low of 366bps. A number of factors helped drive this: improving relations between the US and China; stronger economic data; record highs for the US stock market and a continued dovish sentiment from central banks. However, sentiment reversed in May following a re-emergence and escalation of trade tensions between the US and China; additional tariffs aimed at Mexico; souring Italy – EU relations and weaker economic data. Risk assets, including high yield suffered and spreads widened back out to 446bps. Government bond yields fell sharply as markets started to price in the chance of US interest rate cuts, a far cry from market expectation of just six months ago. Companies that reported weaker than anticipated results saw quite significant repricing. With yields and volatility increasing in recent weeks we have found a number of opportunities to add some bonds to the portfolio at more attractive levels.

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Manager's report for Alcentra European Floating Rate Income Fund: Credit markets performed strongly in the first quarter of 2019 as prices rebounded from the Q4 2018 weakness. The more volatile credit markets performed particularly well after trading lower in Q4 2018, with US loans up 3.78% and Euro HY up 5.18%, while the Credit Suisse Western European Leveraged Loan Index (hedged to EUR) returned 2.01%⁴ for the same period.

We continue to expect issuance of €70bn to €80bn for the full year, lower than the €96bn level seen in 2018. Issuance is expected to remain robust given private equity sponsors still have excess capital to put to work, however we do not expect as many jumbo deals as were seen in 2018.

On the demand side we expect appetite for European loans to remain solid. We expect the CLO market, a large part of the European investor base, to see slower issuance over the full year as the cost of leverage has risen (particularly AAA spreads). A recovery in this market would help further support demand for European Loans.

We continue to expect low default rates and we would anticipate 1.5%-2% for 2019. There remains some scope for volatility with Brexit, more European elections, QE and Trump all likely to feature in the headlines.

However, we would still expect the core European Loan market to continue to be relatively well insulated in comparison to other asset classes. New CLOs, unlevered loan funds and to a lesser extent banks, will all continue to drive demand and the underlying, senior secured borrowers are more resilient to the macro factors mentioned above.

For 2019 we would expect a coupon return year, with the potential for some capital upside if market conditions remain positive.

Manager's report for Chenavari Toro Income Fund:

Market Overview

The data flow in Europe showed weakening economic conditions in Q4 with contraction of industrial production in Germany, Italy and the UK and continued to disappoint in Q1 driven by a weaker than expected composite PMI, consistent with protracted manufacturing weakness mainly due to a worsening external demand (The Markit Eurozone manufacturing PMI declined to 47.5).

As the world economy has slowed, the major central banks have taken a decidedly dovish turn. The ECB officially ruled out the possibility of a rate hike in 2019 and announced a new round TLTRO while also studying tiered deposit rate to alleviate banks with excess reserves and potentially lower interest rates further. Germany 10Y nominal rates have fallen back to sub 0% level while implied vols and credit indices hover around all-time lows. As central banks are back to spur a slowing growth, we believe the global expansion should continue for the foreseeable future (absent any exogenous shocks) but the advanced cycle, limited fiscal stimulus and already low unemployment rate should limit any decent pick up in developed markets.

This somewhat "goldilocks" weak economic growth background coupled with the U-turn in monetary policy should be supportive for European credit and especially structured credit where the default picture remains benign for now (the 12m trailing default rate on the European Leveraged Loans Index officially touched zero in January). We expect tiering amongst managers and vintages to remain pronounced across the capital structure and the better vintage positions held in Taurus may continue to deliver above average equity payments.

As the CLO arbitrage remains quite challenged, we continue to expect a slowdown in European CLO new formation while gross issuance is already down 30% year-on-year due to the sharp reduction of reset and refi transactions (€0.8bn in Q1 2019 vs €4.7bn in Q1 2018). CLO BB and B rated tranches offer an attractive risk reward investment and are trading at a record premium to the broader credit markets.

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Property - UK

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

Manager's report for Civitas Social Housing: The supported housing sector continues to experience strong growth, and this is predicted to increase significantly into the future. The sector has recently enjoyed the most significant growth in investment (CAGR 7.8%) of all parts of adult specialist care in the UK.

Investors of various types have responded to the strong demand for the provision of long-term supported housing and have been encouraged in this by the clear statements of support made by the Government. In August 2018, the Government made the following announcement:

"Ministers recognise that supported housing is a vital service for some of the most vulnerable people in our communities, and last year consulted on possible alternative funding options. Having listened to views from providers, stakeholders and councils, the Government has decided housing benefit will remain in place to fund this accommodation"

Whilst there was no suggestion that state funding would not be available to meet both care and accommodation costs of vulnerable adults, the fact that the current system of provision from central Government, in the form of Housing Benefit, has been reaffirmed, was taken very positively by the sector. It is also worth noting that no political party dissented from this view and there does not appear to be any difference of opinion amongst the mainstream political parties on the principle that vulnerable people who cannot work should receive full state support for their care and accommodation.

Against this positive macro background, smaller specialist Housing Associations are becoming further engaged in the sector as registered providers and lessees, with a number passing the 1,000-unit milestone that brings about increased scrutiny from the Regulator of Social Housing (RSH).

We welcome this scrutiny as evidence of the increasingly important role our sector plays in housing provision in England and Wales. We interact very regularly with the RSH and are pleased to report that we have a highly positive and productive working relationship with them. We know the RSH is actively working through the various issues that it has raised, and we are contributing via our Housing Association partners to that work where that is appropriate. We believe that the RSH is supportive of the initiatives we are undertaking to strengthen and professionalise the sector in which we operate.

During a panel discussion at the Social Housing Finance Conference in London, which Civitas co-hosted, the RSH acknowledged the industry's "growing pains" and areas for improvement, whilst noting that there was "nothing inherently wrong" with the industry model. We are actively involved in working with all our RP counterparties to help them grow and improve, providing, for example, advice on governance structures and adding operational skills.

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James Agar, manager of Ground Rents Income Fund: Residential ground rent transactional volumes remain low and this is thought to be at least in part due to continuing uncertainty relating to leasehold reform. The current government proposals under consultation are not retrospective, but there is a stated desire from policymakers to make leasehold enfranchisement and extensions simpler, fairer and cheaper.

In the company's view, any reform of legislation impacting value would need to strike a fair balance and would require sufficient compensation to be paid to landlords, to be compliant with Article 1 of the First Protocol to the European Convention on Human Rights, as previously asserted in its submission to the government's consultation on this topic.

In contrast, commercial ground rents have become increasingly popular over the past 12-24 months, experiencing strong demand from institutional investors seeking long-dated, inflation-proof income streams. In this environment, the average net initial yield for commercial ground rents was 2.6% in 2018, 20 basis points lower than in 2017.

The annual retail prices index (RPI) slowed to 3.0% in April 2019 from a peak of 4.1% at the end of 2017. Most of the deceleration has been due to the fading impact of sterling's depreciation in 2016, which followed the UK's vote to leave the EU.

There are a number of potential factors that will influence inflation, including commodity prices, trade wars, Brexit and currency fluctuations. The company remains well hedged to inflation with approximately 70% of the portfolio ground rent reviews being index-linked. It is also worth noting that inflation-linked gilt yields fell from -1.7% to -2.2% over the period², increasing the yield premium offered by the company's underlying portfolio.

Outlook

Despite headwinds relating to regulatory reform, we believe the underlying portfolio offers well-secured, long term, inflation-linked income that should remain attractive to investors in a low interest rate environment.

The change of manager provides an opportunity to undertake a review of the strategy and portfolio with the board to determine the best course to maximise sustainable shareholder total returns. The results of this review will be announced in due course.

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Property - Europe

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

Manager's report for Schroder European Real Estate: Economic growth forecasts have been revised down over the last 3-6 months and Schroders forecasts now that Eurozone economic growth will slow from 1.8% in 2018 to 1.25-1.5% p.a. through 2019-2020. While short-term growth was impacted by political turmoil and uncertainty over the new Italian government, Brexit and the protests in France, the main weak spot is manufacturing, reflecting slower growth in China and the US. Particularly Germany, with its big exposure to manufacturing, has seen forecasts revised down sharply. By contrast, consumer spending remains stable, supported by very healthy labour markets, higher pay awards, low inflation of around 1.5% p.a. and some softening in austerity measures combined with higher public sector spending. The benign outlook for inflation means that the European Central Bank is likely to wait until 2020 before raising the refinancing interest rate. The main upside risk is that consumer spending is stronger than forecast. The main downside risks are continued lack of clarity on Brexit, an escalation of the US-China trade dispute and the threat of US-imposed tariffs on EU exports.

Outlook

GDP growth has slowed in Europe over the last six months, impacted by economic and political uncertainty. The majority of the major real estate markets continue to perform well. Occupational demand in leading European cities such as Paris, Berlin, Hamburg, Frankfurt and Amsterdam remains strong. In conjunction with this, the supply side remains balanced with disciplined bank lending reducing speculative development. These are all characteristics for positive rental growth and investment demand.

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Property - debt

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

Manager's report for Real Estate Credit Investments:

European Real Estate Markets

European real estate markets continue to be polarised, with a marked difference in demand between core long-term income assets and those which need asset

management or development. The opportunity to bridge the gap between creating value and core income is significant.

Debt markets demonstrate a similar polarisation, with lending appetite (both banks and alternative lenders) focused on long-term core income lending and eschewing value-additive or development lending. We feel that the aversion to value-additive asset lending in favour of core income lending is misplaced. The risk and return profile in the latter significantly outweighs the former, albeit for a lender that has a deep capability of understanding and executing on value-add or development asset strategies itself.

UK real estate markets have seen significant value declines since the Brexit vote in 2016. This is especially acute in certain sectors such as retail, but we cannot see a single asset class that has not suffered from Brexit. On the other hand, we continue to note increased liquidity and buying interest at these lower clearing levels. In the main, the negative consequences of Brexit on the economy, the UK consumer and on the UK real estate asset class are, in our view, largely priced in.

The same applies to lending markets in the UK, which continue to see foreign banks remaining on the sidelines.

European real estate and lending markets differ across the continent. We believe that the German and Spanish lending markets demonstrate the greatest depth of competition and hence represent a weak risk adjusted investment proposition, with France representing the better proposition for lending.

Brexit uncertainty is, in our view, presenting the UK real estate market as the destination for opportunistic capital, much like the opportunity presented in the Southern European real estate markets during the 2008 and 2011 crises.

What is apparent on the ground in the UK is that lenders such as Cheyne still see significant volume from opportunistic borrowers and sponsors requesting funding for new projects, albeit at valuation levels which take into consideration the uncertainty generated by Brexit. Away from direct lending to new deals, we also see the continuation of substantial compelling opportunities from the valuation stress that Brexit has caused to otherwise good projects. Our preferred model here is to support capable sponsors with robust assets demonstrating a clear path to value creation, but which are in stress due to value declines or adverse incumbent creditor behaviour.

During the year, seven of our loans (across various real estate asset classes including logistics, office, hospitality, mixed-use and residential) have been re-paid or re-financed suggesting that market liquidity (at the lower valuations) is holding up at this most uncertain of times.

We continue to look for the most compelling lending opportunities in Europe as well as the UK. At the end of 2018 we closed a senior loan deal in Lisbon, Portugal with the largest global institutional real estate investor. The first quarter of 2019 has seen us finalising transactions in France and Italy, and we are continuing to evaluate further opportunities in Ireland, the Netherlands and Germany.

Outlook

2018 was an extremely challenging year for global capital markets. Most asset classes suffered negative returns in 2018 as key macroeconomic concerns took centre stage including a deepening global trade war, Brexit and a new European sovereign crisis. Cheyne remains cautious in its investment approach, to reflect these conditions, and maintains a strong investment pipeline continuing our revised focus on senior loans and bonds at the expense of deeply subordinated mezzanine positions.

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Technology and media

(compare technology and media funds [here](#))

Neil England, chairman of Augmentum Fintech: London has developed into a major global centre for fintech companies, a position built from its importance in established financial services and a supportive regulatory environment. Your company has already participated in some exciting deals and our manager will continue to focus on selecting businesses with strong prospects in both the UK and Continental Europe. We have developed a significant pipeline of potential investment opportunities which is showing no sign of slowing.

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Renewables

(compare renewables funds [here](#))

Manager's report for Gore Street Energy Storage:

Market Update:

Electricity network charges

The regulator for electricity and gas in GB, Ofgem, has been reviewing electricity charging arrangements to ensure that they are fit for purpose. In recent years, it had identified certain charging methodologies as being distortive to markets because they acted as subsidies to the costs of producing power, which disrupts competition. In response, it committed to conducting two reviews.

The first, the Targeted Charging Review ("TCR") addressed the issue of charging for residual costs, which are the sunk network costs that network operators are entitled to collect over the lifetime of their assets. The current charging methodologies for recovering the residual in transmission charges, and balancing charges for distribution-connected sites allows for them to avoid these costs, which are significant in the case of transmission charges. Similarly, some distribution charges recover the residual through a variable component that commonly takes the form of a payment to the site for running at certain times of the day.

In November 2018, Ofgem published its draft decision to change these charging methodologies. In principle, the proposals aim to reduce avoidance of residual costs by using fixed charges, or metering of gross demand on the distribution system (not net demand, which nets off the output from distribution-connected sites). Ofgem has proposed to implement its decisions between April 2020 and April 2021.

These changes will have the impact of reducing the "embedded benefit" to sites that are distribution connected. While the company's portfolio of sites is distribution-connected, the company has been tracking the review from the outset and has reflected the direction of travel on transmission and distribution charges in its investment decisions since First Admission.

In parallel, Ofgem has also been considering how to most efficiently allocate capacity on the network, and how to signal the costs and benefits that different users create from their usage patterns under its Network Access and Forward-Looking Charging Review. Ofgem initiated this review in December 2018, and confirmed that a significant focus would be distribution charging, including both the aforementioned variable component, but also including a review of whether connection charges could change to become "shallower" (e.g. less of an upfront cost to the connecting site, but more of an ongoing commitment in development timescales). This review is due to publish working papers in summer 2019 and reach a draft decision in spring 2020. Ofgem expects implementation to take place between April 2022 and April 2023.

The impact of the Network Access and Forward-Looking Charging review is not yet clear, as the decision could range from reducing distribution charges from levels seen today, through to creating new charging mechanisms that benefit flexible generation at different times of the day. As such, the company is closely monitoring and contributing to the consultative phase of the review.

Capacity market

The UK capacity market is a policy mechanism that provides a long-term revenue stream to the company's sites, based in a £/kW/year payment which is derated according to the level of storage installed at the site. As the company reported in November 2018, the capacity market was suspended on 15 November 2018, following a European Court of Justice decision to rule in favour of an objection against the original decision for State Aid not following due process.

Since this decision, the capacity market has entered a standstill period which prevents further auctions being held or making any further payments under auctions already conducted, until the State Aid clearance situation is resolved.

The UK Government is working towards reinstating the capacity market, and the industry has received regular updates from both the UK Government and National Grid during the standstill period. In December 2018, the UK Government stated that it is exploring with the European Commission the most rapid and effective path to conduct a formal investigation (i.e. the due process that was omitted from the original State Aid decision). It confirmed that it had asked the delivery organisations to continue to operate the capacity market scheme short of making payments and confirmed that it would hold a "top-up" auction later in summer 2019, for delivery in winter 2019/20. Any agreements that are allocated in that auction would be conditional on the European Commission's formal investigation. On 3 January 2019, the UK Government responded to the Business, Energy, and Industrial Strategy Committee, stating that it expects that in the event of a positive decision, past payments would be honoured, and it would expect to make deferred payments from the standstill period. It also said that it was considering ways to continue to collect payments from electricity suppliers (who fund the capacity market through collecting levies in consumer bills).

As such, it is the manager's view that the capacity market will be restored, and any deferred payments collected in line with the UK Government's steer. In the interim, the company has prudentially considered the impact of the absence of the capacity market in the short term, which has had a negative impact on asset values.

Brexit and the impact on the electricity industry

The UK Government, Ofgem, and Irish regulators have published guidance to the markets recently to provide a steer on the potential outcome of a "no deal" Brexit, which is considered to be the most disruptive to electricity markets.

In such a scenario, the electricity interconnectors between GB and the continent, and GB and Ireland, may not be able to continue operating in the market coupling mechanism that operates between wholesale markets at the day-ahead stage. This may result in different wholesale market prices in GB and its connected markets than would otherwise be the case. Depending on the outturn of those prices, the arbitrage value for storage assets could be affected positively or negatively.

Outside of the impact on interconnector flows, Ofgem has identified that some industry licences and codes may need to change during the implementation period (if a withdrawal agreement is agreed), or sooner in a no deal scenario, as these currently reflect EU legislation. Similarly, the monitoring of energy market trades and protection against insider trading will need to transition to GB either at the end of the implementation period, or from the date of no deal.

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Richard Morse, chairman of John Laing Environmental Assets: As the board considers the acquisition outlook for the company, the main impression is of competitive pressure in asset markets. This competitive pressure is felt more acutely in market sectors that investors are now comfortable with, such as wind and solar, but is present now across the spectrum of environmental infrastructure. Indeed, the board has noted increasing competition in sectors as diverse as energy-from-waste, biomass, flexible generation and hydro.

This competition is also being felt in the listed sector, as evidenced by higher premiums to NAV and new entrants coming to market with focused geographical and technological propositions and target dividend yields that are below those currently on offer from the established funds such as JLEN.

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Kevin Lyon, chairman of NextEnergy Solar Fund: We expect to continue taking advantage of the new-build opportunities we have secured in the subsidy-free solar sector in the UK. Having identified this opportunity early, we have been able to secure development opportunities at attractive valuations. This will facilitate the construction of new plants with satisfactory financial returns. We are targeting a total of between 100 and 150 MW in subsidy-free solar plants. We shall seek to achieve attractive risk-adjusted returns from these activities via corporate power purchase agreements (PPAs) or direct-wire agreements with off-takers.

Any opportunity to acquire operating solar PV assets in the UK will be closely scrutinised by our manager but we expect to have limited growth from those opportunities due to our financial discipline in acquisitions.

Our teams will continue to work on achieving technical improvements, cost reductions, financing efficiencies and the implementation of new technology across the portfolio. Achieving these objectives should contribute to posting increased cash dividend cover results. An area of particular focus will continue to be the life extension of individual assets across the portfolio.

In addition, we will continue to expand our biodiversity programme to include an increasing number of our solar PV assets. This work is just one of our contributions to ensuring a better environment for this and future generations.

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Manager's report for SDCL Energy Efficiency Income: The energy efficiency asset class is becoming an important component of energy supply and demand management.

Market Risks

Electricity prices remain high in resource-constrained markets such as the UK and North-East USA, in combination with depressed natural gas prices, this continues to present an attractive incentive for alternative sourcing of lower cost and lower carbon energy through energy efficient or distributed generation solutions.

The market for both operational energy efficiency and distributed generation projects remains strong with a significant number of pipeline opportunities being seen since the IPO in December 2018.

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Commodities and natural resources

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

Robert Crayford and Keith Watson, managers of Geiger Counter: The interim period has been one of consolidation for the uranium sector. Following the strong 35% rise in the prior year to end-September 2018 the spot uranium price has declined from its recent high of nearly US\$30/lb in December 2018, closing the half year around 9% lower and has since slipped a further 4%. Equity performance has largely mirrored this with a 10% decline in the Fund's NAV to end-March and a further 7% since.

Price declines have largely occurred following commentary from Kazakhstan's state-run producer Kazatomprom, that it expects uranium production volumes from the country to increase by 5% in 2019. Though in-line with its guidance outlined at the time of its IPO in November 2018, against the backdrop of the US 232 investigation which has understandably stymied utility purchasing particularly in the United States, the world's largest consumer, the news has had a disproportionate impact on sentiment. A subsequent update from Cameco that it intended to purchase approximately 7-9Mlbs U3O8 in the spot market to meet calendar 2019 sales commitments, slightly less than previous guidance of 10Mlbs similarly contributed to the recent softness. Cameco has subsequently reversed this decision with guidance now steering towards purchases of up to 12Mlbs this year, though the group has yet to meaningfully buy material. Despite such variation in its guidance for 2019, we believe Cameco's spot market purchasing will provide support over the medium term as, without the necessary incentive price to restart operations, a reduction in buying this year will effectively only defer purchases into future years. Indicative of current market paralysis, Cameco has indicated that it only received commitments for approximately one third of its attempted purchases this year at spot prices.

Despite short term disruption caused by the 232 Petition, we believe revised policy to address US energy security presents opportunity within the sector. Most importantly, given the US drive to maintain energy independence individual state policy has already shifted to encourage extension of the operating lives of the country's existing reactor fleet to sustain nuclear generating capacity. In this regard New York, Illinois and latterly Ohio, have implemented schemes rewarding nuclear's carbon free status and maintaining nuclear power output.

Consistent with this viewpoint, the US Energy Information Administration provided a sector update highlighting that despite the growth of renewables generating capacity, carbon emissions continued to grow, reaffirming its stance to extend nuclear plant operating lives to safeguard the long-term contribution of nuclear power. The EIA statement that "without reactor life extensions stable, carbon free baseload power will

continue to reduce markedly" are at the heart of the nuclear power debate. The Paris based IEA stated that renewables investment would have to grow fivefold the next two decades in order to offset the scheduled retirement of nuclear reactors, but that this would not only be hugely expensive, but would also face public resistance and require major power grid investment. We note that variable renewable power on its own does not offer a base load power solution.

Backed-up by commentary from the pro-nuclear US Energy Secretary on the industries green credentials, we expect nuclear power to retain a significant share of US generating capacity having contributed a record 807 TWh in 2018, around a 20% share of the market. Clarity on the country's policy, which may reduce the US dependence on material imported from Russia and Kazakhstan for nearly 50% of its needs, may unlock pent up utility demand when the 232 investigation concludes, currently scheduled mid-July. This could help the uranium price recover in the latter half of 2019 following lacklustre interest in the year-to-date.

The impact of US trade policies on global trade and by extension electricity demand, has weighed more broadly on power generation fuels. However, set against fossil fuel price declines uranium has held up relatively well, as shown below. We believe this reflects the less cyclical nature of underlying uranium demand and also a recognition of its key attribute as a carbon free source of base load power, particularly in regions such as China and increasingly, India. Of note, India was specifically referenced by Kazatomprom as the primary recipient of the country's increased uranium production, testament to India's desire to expand its nuclear power capacity and combat air pollution.

Importantly we believe some modest downwards shift in underfeeding volumes by enrichers has begun to take effect which will, in part, counter the increase in Kazakh production during 2019. We look for this helpful dynamic to continue as enrichment contracts begin to roll off, in similar fashion to the long-term uranium purchase contracts with miners such as Cameco.

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Royalties

(compare royalty funds [here](#))

Merck Mercuriadis, founder of Hipgnosis Songs:

Market Conditions

The financial period to 31 March 2019 has been another positive period for the music industry, with increasing take up of paid subscription services driving streaming revenues. Streaming became the majority of global recorded music income in 2018 (56 percent) and industry experts continue to forecast further strong growth.

Streaming

At the end of the first quarter of 2019, Spotify confirmed that it had 100 million premium (paying) subscribers, which was up 32 percent (+25 million) year-on-year. Spotify's total MAU (including paying and advertisement funded customers) in Q1 grew 26 percent year-on-year to 217 million and the company confirmed that it now has more than 2 million users in India. Spotify's main competitor, Apple Music, passed 50 million paying subscribers in Q1 2019, up from 40 million in April 2018.

Streaming made up 56 percent of total U.S. music revenues in 2018 compared to 9 percent in 2011. In the U.S. - the largest music market - paid streaming subscriptions grew 42 percent in 2018:

In 2019, JP Morgan forecast that U.S. music subscription revenues are expected to grow at a compound annual growth rate of 27 percent from 2017 to 2022 and that royalty revenues will triple in that time. JP Morgan are predicting that there will be 2 billion paid subscribers to subscriptions services worldwide by 2030.

Apple recently announced the closure of iTunes, reflecting the migration of consumers from download to streaming services. iTunes will be rolled into the new Apple Music app where consumers will be able to choose whether to download or stream music under one roof.

The International Federation of the Phonographic Industry ('IFPI') also recently announced that global recorded music revenues grew by nearly 10 percent last year to \$17.3bn, with nearly half of income now coming from streamed music, reversing an industry decline since 2001 that hit a trough in 2014.

The most recent global publishing data from the International Confederation of Societies of Authors and Composers ('CISAC') (relating to 2017) shows global growth of 6 percent, with Germany (+7.2 percent), Netherlands (+5.1 percent), Australia (+18 percent) and Brazil (+36 percent) performing strongly. More recently, the American Society of Composers, Authors and Publishers ('ASCAP') reported 7 percent revenue growth in 2018, and UK society PRS for Music (2018 financials, reported April 2019) showed 4.4 percent income growth.

When looking at music publishing holistically (including revenues that do not come from these collecting societies, such as synchronisation), Will Page, Chief Economist at Spotify estimated that publishing had grown 6 percent year-on-year, for the most recent available data (2017 value, published in 2019). Goldman Sachs predict that, on average, publishing revenue will grow at a compound 4 percent per annum to 2030.

Synchronisation

Global market data on synchronisation is difficult to collate, since private transactions are completed on a deal by deal basis. IFPI publish a global figure for record labels, which grew 5 percent year-on-year to 2018 and gives an indication of trend. However, the relational nature of these deals presents a significant opportunity for us to claim a larger share of these revenues through pursuing the right kinds of transactions.

Outlook

All of these positive market indicators and the impact that they will have on the value of our assets are best illustrated by the increased valuation of the Universal Music Group, where its corporate owners, Vivendi SA, and subsequently the market have valued Universal at something approaching \$50 billion. This is a company that was valued at \$6 billion less than 3 years ago.

We are continuing to see increased interest from songwriters who want to sell their Catalogue to a company such as ours that understands the cultural importance of their work and which will hold their professional legacy in the highest regard. We therefore remain confident that there are increasing opportunities for us to continue to make excellent acquisitions.

We are currently in exclusivity and performing due diligence on a significant number of new Catalogue acquisitions. The company has acquired, or entered into exclusivity agreements to acquire, Catalogues with a value of £146 million and therefore we expect

to fully invest our remaining capital, excluding any leverage, by the end of July 2019. We now have a pipeline of catalogues with an aggregate value in excess of £1bn. The music industry is performing well, with experts forecasting continued growth in paid subscription services.

QuotedData

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