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Monthly summary | Investment companies

August 2019

Economic & Political Roundup

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

Roundup

It was another good month for US assets, led by the dollar and equities. Sterling ended the month near post-referendum lows as the prospect of a 'no deal Brexit' loomed large, as Boris Johnson took over party leadership. It is also worth noting that government bond yields continue to fall.

Global

Easy money to continue while inflation remains in check

John Pattullo and Jenna Barnard, managers of Henderson Diversified Income, believe that uncertainty is increasing in the outlook for default rates; the default environment has been benign since 2009. F&C Investment's chairman, Simon Fraser, believes equity markets remain supported by reasonable valuations and fundamentals, with the more accommodative interest rate environment having a greater positive impact on company valuations than the increased risks that triggered the pivoting in rate policy. On the subject of how long the 'easy money' environment can continue, Ian Russell, chairman of Herald, says that from the perspective of a small cap technology fund, it will be until when tightness in the labour market feeds through to inflation.

UK

Valuation gap with the US continues to grow

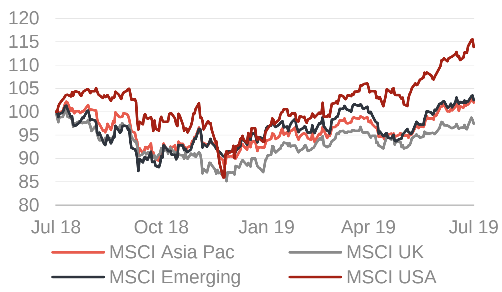
Gervais Williams and Martin Turner, managers of Miton UK Microcap, expect the major valuation gap between UK and US-listed companies, should narrow once the detail of Brexit is known. More takeovers of UK quoted companies would be expected too. Also, on the value theme, John Dodd and Kartik Kumar, managers of Artemis Alpha,…

Exchange Rate	31/07/19	Change on month %
GBP / USD	1.2159	(4.2)
USD / EUR	0.9028	+2.7
USD / JPY	108.78	+0.9
USD / CHF	0.994	+1.8
USD / CNY	6.8811	+0.2

Source: Bloomberg, Marten & Co

MSCI Indices rebased to 100

Time period 01/08/2018 to 31/07/2019



Source: Bloomberg, Marten & Co

	31/07/19	Change on month %
Oil (Brent)	65.17	(2.1)
Gold	1413.78	+0.3
US Tsy 10 yr yield	2.0144	+0.5
UK Gilt 10 yr yield	0.611	(26.7)
Bund 10 yr yield	-0.442	+34.3

Source: Bloomberg, Marten & Co

UK (continued)

…continue to believe that the uncertainty created by Brexit has excessively suppressed valuations. The manager of Aberforth Smaller Companies view the 'value' style's ongoing struggle as a function of financial conditions, specifically the extraordinary monetary policies deployed by many central banks. One means by which today's style headwinds might turn to tailwinds would be for an improvement in the outlook for real economic growth. While acknowledging that the UK equity market is likely to remain volatile until greater certainty emerges in both Brexit negotiations and trade relations between the US and China, Henderson High Income's chairman, Margaret Littlejohns, believes these circumstances also provide good opportunities to invest in financially sound companies for long-term investors looking for a high income stream.

Dan Whitestone, manager of BlackRock Throgmorton, also feels like the cycle has longer to run; he says that there are few signs that his team would expect to see at the beginning of a bear market or sustained period of GDP weakness, with low inflation and accommodative monetary policy provides support for equity markets.

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Europe

Accommodative rate policy helping but risks remain

Sam Cosh, manager of European Assets, says that while the efforts of central banks to support markets further (through 2019 so far) has led to a welcome recovery in asset prices, predictions cannot be made on exogenous events like Brexit or trade disputes, or on the direction of economic output, for that matter. Sam's focus remains on selecting stocks with characteristics that give the fund the best opportunity to deliver good returns through the market cycle.

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Global emerging markets

Preference for large-cap ETFs has weighed on return potential of active returns

Michael O'Brien, manager of Fundsmith Emerging Equities, says that there has been a tendency for investors targeting emerging market exposure to allocate capital to exchange traded funds (ETFs). ETFs typically invest in proportion to the weighting a stock has in the index, and thus concentrate buying on the largest stocks, having a disproportionate impact on their share prices. While this has held back some of the return potential of active funds, Michael says that, put simply, in developing markets growing populations are getting richer. He discusses several visible trends the team see every time they meet companies, or more pertinently, observe on the ground when they visit countries in which those companies operate.

Elsewhere, Carlos Hardenberg, Greg Konieczny and Mark Mobius, managers of Mobius Investment Trust, say that the macroeconomic outlook for the upcoming quarters across emerging markets is positively impacted by the successful revival of growth in China and further supported by a more dovish tone by the US Federal Reserve. In view of the upcoming 70th anniversary of the founding of the People's Republic of China in October, they assume ongoing constructive policy making by the national government. The managers go on to discuss themes around innovation, adding that they are seeing sweat shops turned into idea factories, producing a new level of competitiveness and reflecting a geographical shift from west to east. The tide of innovation is spilling over into the public sector too, where there is evidence that E-government is helping to address and improve tax collection while reducing corruption and leakage, leading to large scale debottlenecking overall.

Japan

Flat growth expected over the next year

Atlantis Japan Growth's manager expects corporate earnings in the coming financial year to be, at best, flat year-on-year with particular weakness in the initial six months. It is thought that monetary policy will remain exceptionally loose with a rate hike not likely to be considered for another 12 months. Over the medium-term, the manager sees annualised economic growth being in the 0-1% range, with risks to this view including a lengthy, comprehensive trade war between China and the United States (combined, both account for 40% of Japan's exports), tariffs and/or other hostile measures taken by the United States specifically against the Japanese automobile sector, a sudden JPY appreciation against the USD and increases in commodity prices.

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Flexible investment

Lack of trust in the stability of policy to weigh on companies' capital expenditure

The manager of Ruffer Investment tells us that they have been actively reducing exposure to the US dollar in recent months. Given the pivot by the Federal Reserve, narrowing interest rate differentials and the uncertainty of trade wars, it appears to them less obvious that the dollar will function as a safe haven. They have maintained a larger weighting in the yen. Peter Hewitt, manager of BMO Managed Portfolio Growth, says that although Brexit and its eventual outcome has saturation coverage in the media and would affect UK markets in the near term, over the longer run it tends to be the outlook for the fundamentals of the economy and the prospects for corporate profits and dividends that dictate the direction of markets. He adds that in a global context the tension that exists between the US and China manifest in widespread tariffs imposed by the US on Chinese imports which clearly has the potential to reduce overall global activity levels, particularly so in the Asia Pacific region.

Elsewhere, Scott Wolle, manager of Invesco Perpetual Select Trust - Balanced Risk Allocation Share Portfolio, provides his take on how uncertainty is affecting corporates around the world; he says that a lack of trust in the stability of policy along with evidence of weakening economic activity across the globe may have a stifling impact on companies' willingness to engage in capital expenditures until meaningful clarity returns.

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Biotech and healthcare

Expect profound change given the challenges that need addressing, despite political polemics

Paul Major and Brett Darke, managers of BB Healthcare, say that If one looks past the polemics, society still has huge structural issues to overcome with respect to the provision of healthcare. We simply cannot afford to carry on as is, lacking both the financial resources to scale up the system in its current form and the human capital to enable such an endeavour. The only certainty then is profound change and this, as ever, is a significant opportunity for the long-term investor. This fundamental positive, allied to inexorably positive demographic changes, argues for a positive investment outlook well into the future.

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Infrastructure

Greater returns from lending to sectors such as transport and power compared to availability-based PFI/PPP projects

We hear from Sequoia Economic Infrastructure Income, where the manager's report tells us that lending to sectors that include transportation, utility, power, telecommunication and renewables, is more attractive than lending into availability-based PFI/PPP projects, which are often hotly contested among lenders and therefore offer lower yields. Moreover, economic infrastructure projects usually have much more conservative capital structures than availability-based PFI/PPP projects, with equity cushions of typically 20-30% rather than 10%. We also hear from Gillian Nott OBE, chairman of Premier Global Infrastructure Trust – she tells us why the global infrastructure sector has been a popular investment destination over the first half of the year, and has been one of the main beneficiaries of the changed interest rate outlook.

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Other

We have also included comments on financials from Polar Capital Global Financials; liquidity from Invesco Perpetual Select Trust - Managed Liquidity Share Portfolio; technology and media from Polar Capital Technology; leasing from Amedeo Air Four Plus, Doric Nimrod Two and Doric Nimrod Three; renewables from Greencoat UK Wind; and the commodities and natural resources sector from BlackRock Energy and Resources Income.

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Contents

Global

(compare Global funds **here**)

John Pattullo and Jenna Barnard, managers of Henderson Diversified Income:

Background

The twelve months under review were exceptionally volatile for equity and credit markets with records tumbling in both a downward and upward direction. Most notable for bond investors was the dramatic shift in both the market and Central Bank views surrounding the outlook for inflation and future interest rate rises. It was a seminal shift in mind-set which culminated in the US Federal Reserve acknowledging that for the last ten years, there has been a continual undershooting of inflation relative to target.

It may seem obvious today but if one casts their mind back to mid-2018 there was an emotive tone to the debate surrounding the inflation outlook, US fiscal deficits and of course, the level to which long term bond yields could rise. The mind-set of observers, and their orthodox economic models, was squarely rooted in the upside risks to inflation and the end of the long term decline in bond yields. Luminaries such as Jamie Dimon, CEO of JPMorgan, fell into the trap of mis forecasting bond yields in an ever higher direction. Dimon settled upon a 5% US ten year bond yield in October, having earlier forecast 4%. In reality yields could not sustain a level over 3% for more than two months proving that even this threshold was not a sustainable equilibrium for the US economy. We disagreed with this consensus narrative, believing the experience of 2018 replicated and accentuated a pattern of over forecasting of bond yields which has been repeating for at least 26 years (based on our reading of the data). The failure in our view has always been the economic models.

Outlook

Our outlook for bond markets has long been driven by the structural and thematic factors which have served to shape our expectation of continued low inflation and low interest rates. Some may view this as complacent and reference the experience of the 1980s as a counterpoint to which we do not attach enough weight. We can assure you that this is not the case. Rather we have taken a longer term perspective and a more internationalist one than our critics would imply. The most common equilibrium in the long and broad sweep of bond market history is one of low yields and a low if not outright deflationary environment. The recent experiences of Japan and Europe also serve to highlight how difficult it is for Central Bankers to escape the curse of adaptive expectations and zero or negative interest rate policy. Even the US is beginning to exhibit the tell-tale signs of inflation expectations becoming unanchored to the downside i.e. the public incrementally reducing their expectation of future inflation year by year. This is a most unusual and foreboding development which should be close to a peak in the cyclical recovery juiced by fiscal spending.

The outlook for default rates is one which feels more uncertain to us. We have been firmly entrenched in a low default regime since 2009 in developed credit markets. One which was only briefly interrupted by commodity defaults in the US in 2015-16 when the oil price crashed. This feels less sustainable as markets turn down. We continue to favour lending to companies with proven defensive business models which still exhibit structural growth, an increased proportion of which are now situated in the United States. The benefits of buying these quality US dollar bonds comes of course with associated currency hedging costs, which are accounted via the capital account. Our style of credit investing with added diversification from longer dated investment grade bonds, should help us weather any coming storm as well as possible for a company whose target is income. As always, we remain focused on delivering a reliable, dependable and consistent dividend stream for shareholders.

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Simon Fraser, chairman of F&C Investment:

Markets and performance

Over the first half of the year the markets fully recovered from the sharp falls seen in the latter part of 2018. Despite signs that the global economy and earnings cycle were losing momentum and fluctuating sentiment on growth prospects, global equities were buoyed by rising expectations that central banks, led by the US Federal Reserve, would soon cut interest rates and suggestions the European Central Bank could restart quantitative easing. In addition, while concerns over trade continued to weigh periodically on markets some signs of progress between China and the US led investors to the conclusion that tariffs would be unlikely to materially dampen the overall outlook for the global economy and corporate earnings.

Investors in equities continued to look to bond markets for signs that the fragile growth backdrop may be tipping over into a more marked downturn. Interest rate expectations declined as the US Federal Reserve gave a dovish assessment and as inflationary pressures continued to prove elusive. Yields on longer dated bonds fell heavily, leading some to conclude that recession is likely in coming quarters. Historically the yield curve, representing the gap between long-term and short-term interest rates, is a reasonably accurate predictor of a future downturn. This warning sign, however, was largely viewed as a less reliable indicator in a world of low interest rates and investors chose to regard the backdrop as benign, with moderate growth and inflation and central bankers seemingly willing and able to continue to supply liquidity, supporting asset prices further.

Outlook

By most metrics the past decade has seen the longest uninterrupted economic expansion in US history and the longest bull market ever. Equity investors have enjoyed a period of extraordinary returns following the Global Financial Crisis.

Looking forward, equity markets remain supported by reasonable valuations and fundamentals. Policymakers have shifted to a more accommodative stance given still low inflation and rising risks to growth. Investors have so far viewed this move positively, considering the reduction of interest rates as warranting higher valuations on future earnings, despite the increased risks.

The political and economic backdrop can be expected to remain uncertain, particularly for the UK given the unclear outcome of the Brexit negotiations.

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Willis Towers Watson, managers, Alliance Trust

Our outlook for the rest of 2019 is set against a backdrop of increasingly difficult global economic conditions and political uncertainty. This uncertainty will, we believe, likely result in increased volatility in global equity markets in the coming years. This is an environment that, with a long-term investment horizon, can present good opportunities for talented stock pickers. This is particularly the case where investments are made through a concentrated, best ideas mandate.

Because economic policy and political uncertainty are elevated globally, it is increasingly difficult to predict economic outcomes. We expect growth in the major economies to steadily slow. This may be temporarily eased through further Central Bank support. However, we expect liquidity to fall and volatility to rise.

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Ian Russell, chairman of Herald:

In spite of the political turmoil in a number of places, the market background for both the stock market and the underlying trading in the portfolio companies in general has been benign. The economic upturn is now a decade long. Unquestionably the most recurrent issue in meetings with the portfolio companies is staff turnover and upward wage pressure - particularly in Northern California and to a lesser degree in London, but wage pressure has abated in China.

In addition, big markets such as mobile phones have seen softer demand, and the capacity shortages seen in semiconductors has passed, so prices have eased. There was a particular squeeze in capacitor supplies last year, and there are still significant lead times for these. The automotive industry has also been pressured by the sharp reduction in demand for diesel cars, while demand for electric cars has not yet arrived in volume. This has been exacerbated by political and media comments, which has also affected demand for certain capital equipment. These challenged markets are only marginally relevant to the portfolio, which in general has structural growth.

The US continues with an extremely loose fiscal policy, while Europe has free capital, so thus far consumer spending continues to be firm in most countries. The sixty-four-million-dollar question is how long easy money can continue. From the micro perspective of a small cap technology fund it is when the tightness in the labour market feeds through to inflation.

The biggest issue affecting the sector is the US/China trade war. The US seems to have softened its position on prohibiting sales to Huawei by US companies, but the broader trade conflict may continue in unexpected ways. Again, the portfolio has limited exposure to these challenges and the manager remains positive relative to other asset classes, with the caveat that the number of investable smaller quoted companies continues to shrink in the important markets of the UK and the US.

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Nick Mustoe, manager of Invesco Perpetual Select Trust - Global Equity Income Share Portfolio:

The global economic outlook is uncertain in our view. On the one hand central banks across the globe are maintaining a very pro-growth policy stance, and fiscal policy in many major economies is mildly expansionary. However, on the other, trade tensions between major trading blocks in Europe (the Brexit issue) and more importantly between the US and China, together with the ongoing secular trend of lower productivity improvements, are dragging on economic growth. Corporate earnings growth is therefore likely to be muted in the coming years. Our view is that major economies will continue to grow slowly, avoiding both recession and rising inflation, and that equity markets may grind higher over the next 12 months.

Whilst in our view not yet of bubble proportions, valuations in global equity markets are extremely bifurcated. Those stocks which seem to offer secular growth opportunities and low earnings volatility have risen sharply in price in recent years and have become increasingly expensive and offer low or no dividend yields, hence we do not own them. Meanwhile, companies with more obvious exposure to the economic cycle have, by and large, underperformed and are, in our view, trading at significant discounts to their intrinsic value. The gap in valuation terms between stocks exhibiting those differing characteristics is at record levels, whether you look at price/earnings ratios or measures related to asset values.

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United Kingdom

(compare UK funds **here**)

Harwood Capital LLP, manager of Oryx International Growth:

We continue to invest in existing holdings. Markets recovered dramatically at the start of 2019 after showing signs of a bear market in late 2018. While we are encouraged by this recovery, the macro environment remains uncertain as Brexit, US trade renegotiations and further political challenges in developed markets continue to generate volatility.

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Gervais Williams and Martin Turner, managers of Miton UK Microcap:

What if the UK economy is not especially successful in future?

Even though majors are defined by their giant scale, microcaps often have international market positions as well, albeit they often operate in certain niche sectors. Furthermore, given the well-developed nature of the UK AIM market, some overseas microcaps choose to list here. For both reasons, the principal drivers of the returns of UK listed microcaps are not especially related to the success or otherwise of the UK economy.

Even without globalisation, there would have been some periods of good economic growth over recent decades. However, the reduction of trade barriers has greatly boosted world growth and made it easier for all companies to grow. Hence, during the period of globalisation, when most larger companies were growing well, most investment strategies have become aligned with them. Meanwhile, interest in quoted microcaps has tended to die away. The UK is almost unique in retaining a vibrant stock exchange of listed microcaps over this period.

Why were the trust's returns so disappointing over the year to April 2019?

There are two reasons why the Trust's returns over the year to April 2019 were particularly disappointing.

- First, over the year under review, the date for Brexit has become increasingly imminent and, as the final details of Brexit remained unknown, it became harder to determine which UK stocks had the better prospects. Mainstream investors, for example, were able to participate in the general recovery of markets, via index instruments. However, index ETFs are not available for those investing in smallcaps. So, as the year has progressed, there has been an increasing absence of smallcap buyers, which weighed particularly heavily on microcap share prices. In the end, most drifted lower, even at a time when international markets were staging a recovery.
- Second, whilst stocks standing on undemanding valuations tend to outperform over the long term, there are periods when growth stocks have a period of catch-up. Over recent years there has been plenty of enthusiasm for growth stocks, and this was apparent again early in the year under review. Although markets fell back during the final quarter of 2018, growth stocks revived thereafter. Overall, this was a year when growth stocks strongly outperformed.

What should investors expect when the details of Brexit are concluded?

When the result of the EU referendum was first announced, the exchange rate of Sterling fell. And subsequently, many investors have been wary of allocating capital to the UK, so there has been less support for UK-listed stocks.

Most commentators assume that if the UK's departure from the EU is not chaotic, then prior trends will be reversed.

Sterling has weakened considerably since the referendum, but once Brexit is resolved, it may be that the exchange rate of Sterling rises. If this were the case, then the fact that a number of the larger quoted stocks in the UK pay their dividends in overseas currencies would be at a disadvantage. For this reason, it is anticipated that some mid-sized, small and microcap stocks might perform better over this period.

Over recent years, enthusiasm for US stocks has driven up the S&P 500 index in line with the growth of its surplus corporate cashflow, leaving the US stock market much unchanged on this valuation metric. In contrast, after the EU referendum, anxiety about the detail of the Brexit terms has held back investor enthusiasm, so the FTSE 100 index is now rather more attractive on this valuation metric that it was previously.

In short, a major valuation gap has opened up between UK and US-listed companies, which we expect to narrow once the detail of Brexit is known. In part, this may be due to renewed capital allocations to UK quoted companies. We also anticipate that there will be more takeovers of UK quoted companies. Therefore, we expect that the UK stock market at some point should begin to outperform others.

Prospects?

First, when the uncertainty over the detail of the UK's withdrawal from the EU is known, it is expected that investors will step up their allocation to UK-listed companies generally.

Second, anxiety ahead of Brexit has been especially acute for the share prices of UK microcap stocks, and hence their valuations have fallen well behind those of the mainstream UK-listed stocks. Therefore, we believe UK microcaps look inexpensive and may have more upside potential than the UK stock market overall.

Third, we look forward to the time when regular companies, standing on undemanding valuations, resume their prior long-term trend of outperformance.

We believe these trends will add to the ongoing long-term advantages of a microcap strategy. In recent years, the absence of productivity improvement and wage growth has led to a seismic change in the political and economic agenda. With the substantial change in the market environment, we believe that the agile and well-capitalised will generate disproportionate returns.

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John Dodd and Kartik Kumar, managers of Artemis Alpha:

We continue to believe that the uncertainty created by Brexit has excessively suppressed valuations.

In the UK market, the recent period has continued to be characterised by uncertainty because of Brexit, which has resulted in elevated volatility and certain sectors underperforming materially. We think that the premium being placed on good, predictable businesses that are seemingly insensitive to political outcomes is, on the whole, 'sky high'.

By contrast, the aversion to uncertainty means that businesses which are economically sensitive or perceived to be challenged are very lowly valued. In this environment we are aiming to adopt an approach that is both patient and rational. We are using the opportunity to invest as bargains are unlikely to remain once obscurities clear.

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Manager's report for Aberforth Smaller Companies:

While equities gyrated in response to macroeconomic developments, government bonds were consistently and unrelentingly strong since the growth concerns of 2018's fourth quarter. In the UK, the ten year gilt yield slipped back below 1%, while the German equivalent is once again negative. In the US, the ten year treasury yield fell from 3.2% in November to 2.1% at the end of June. This move took the US yield curve – longer term yields less shorter term yields – into negative territory on some definitions. With yield curve inversion a historically useful indicator of recession, such developments would seem to portend a gloomy outlook for the global economy. The UK meanwhile continues to contend with the additional complexity of Brexit. As deep uncertainty lingers and both ends of the political spectrum give cause for concern, sterling has weakened again. This has hampered the performance of the domestically oriented NSCI (XIC) in relation to the much more international large company indices. More fundamentally, the saga is also affecting economic activity: recent manufacturing surveys have been weak, which must reflect the unwinding of inventories that were built up in anticipation that the UK would leave the EU as planned on 29 March. Nevertheless, macroeconomic data, on balance, point to an economy that is making steady if unspectacular progress. This view is backed up by the results reported by small UK quoted companies.

In the first quarter of this year, 115 non resources companies that are tracked closely by the managers reported their final results to 31 December 2018. Sales and profits of these companies rose by roughly 6%, while the ratio of capital expenditure to depreciation – a measure of how actively businesses are investing – was 1.7x, a level that continues to suggest that companies are investing for future growth. The managers estimate that sales and profits will grow by 5% in 2019 and that the investment ratio will be a healthy 1.4x, though some of the capital will be deployed in companies' operations outside the UK. These estimates, which do assume that a "*hard Brexit*" is avoided, point to an acceptable outlook for a useful cross section of the universe of small quoted companies and belie depressed valuation ratios.

Outlook & Conclusion

The managers are inclined to view value's struggles as a function of financial conditions, specifically the extraordinary monetary policies deployed by many central banks. By extension, one means by which today's style headwinds might turn to tailwinds would be for an improvement in the outlook for real economic growth, in which context a resolution to the trade wars and Brexit would undoubtedly be helpful. Alternatively, a bit less complacency about inflation could also prove the catalyst.

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Jonathan Cartwright, chairman of Aberforth Split Level Income:

The last twelve months have demonstrated how volatile equity returns can be, not least from a portfolio of small UK quoted companies. This serves as a reminder of the long-term approach required for equity investment, particularly in small quoted companies, and of the advantages of investment companies' closed-ended structure.

The continued uncertainty of Brexit has brought the UK its third prime minister in just over three years and has heightened uncertainty for those considering investing in the UK. It is impossible to say when the clouds will lift, but evidence suggests that small

UK quoted companies offer attractive value for those prepared to take more than a short term view. The company has been in existence for only two years, but the managers run other funds that have histories extending back to 1990 and that have a significant overlap with the company's portfolio. The historical price earnings ratios of those funds' portfolios at 30 June 2019 had never been lower relative to the NSCI (XIC).

This cheapness comes with the company's investment strategy, which is based on the managers' commitment to a value investment philosophy. Value as an investment style will continue to influence portfolio returns but can be out of favour for prolonged periods, such as the decade since the financial crisis. However, it has provided superior returns compared with those of the NSCI (XIC) over the longer term. Consequently, in monitoring the company's progress, the board considers it important that the portfolio remains invested in accordance with the value style. This would seem particularly relevant today when so large a majority of small company investment trusts and open-ended funds follow the currently fashionable growth investment style. While acknowledging the challenge that currently accompanies the company's investment strategy, the board is also conscious that some of the most attractive opportunities in equity markets require a contrarian approach and so looks to the future with optimism.

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Margaret Littlejohns, chairman of Henderson High Income

UK equities rallied strongly in the first half of 2019, reversing the sharp decline experienced in the second half of last year, and the All-share index has almost returned to the same level it was 12 months ago.

Outlook

Twelve months ago, commentators were predicting relatively strong global growth and inflationary pressures that would lead to a gradual increase in interest rates by the US Federal Reserve and possibly the Bank of England. Views have now reversed with an expectation that growth may be slowing and that interest rates are likely to be cut. This has generally been positive news for both equities and bonds.

Thank goodness that I did not make any predictions on either the timing or the outcome of Brexit in my last statement. Since year-end the date of the UK's withdrawal from Europe has been postponed twice and is now set for the inauspicious date of Halloween! Against this backdrop UK equities remain out of favour, particularly with international investors. The UK equity market is likely to remain volatile until greater certainty emerges in both Brexit negotiations and trade relations between the US and China. However, for long term investors seeking a relatively high income stream, these circumstances also provide good opportunities to invest in financially sound companies with sustainable cash generative businesses that may be overlooked by others. The company will continue to build a well-diversified portfolio of such investments to create for its shareholders regular and reliable income with the potential for capital growth in the long term.

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James Henderson, manager of Law Debenture Corporation:

The valuation of the UK market is at an attractive level. The 10 year gilt is yielding around 0.7%, while the dividend yield on the UK FTSE 100 is around 4%. In the past, the yield on gilts has been higher than on equities. This was thought normal as dividends from companies were expected to grow over time. The current position would suggest that dividends in aggregate from UK companies were not going to grow and were likely to be reduced. The holdings overall in the portfolio are, however, expected to keep growing their dividends in coming years. Cash generation is strong from most of the larger holdings and dividend cover has been increasing. More generally the UK economy is growing, albeit slowly, in spite of the uncertainties over politics and Brexit. The UK companies held also earn on average around 65% of their revenues from outside the UK and the global economy is growing with the US and certain emerging markets surprising with their strength. It is therefore important for investors to focus on the fundamentals of how stocks are actually performing in their operations.

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Dan Whitestone, manager of BlackRock Throgmorton:

Market review

Sharp declines in equity markets in the fourth quarter of 2018 have been erased by a strong rally through the start of 2019. Markets shrugged off a host of weak economic data, corporate earnings downgrades and political confusion in the UK. Meanwhile trade tensions continue to pose a risk to global growth and have been a catalyst for short term spikes in market volatility. The Federal Reserve tone became notably more dovish, which drove bond yields back to levels last seen at the beginning of 2018; the European Central Bank's stance also remained accommodative and Chinese policy was eased on both fiscal and monetary fronts. Brexit has continued to dominate the UK political landscape, culminating in Prime Minister Theresa May announcing her resignation, but the market reaction was relatively muted given the 'Brexit tax' that the UK market is already discounting.

Outlook

Equity markets globally have made a strong start to the year, in many cases shrugging off the ongoing geopolitical uncertainty, softening global economic data and increasing trade tensions. However, while the signs have been encouraging, we continue to recognise that at this point in the cycle, the market can be febrile and there is always potential for sudden spikes in volatility and large swings in sentiment. We will therefore continue to manage the net and gross exposure accordingly, happy to add risk as opportunities present themselves.

Despite these risks, we continue to believe that the cycle has room to run. While this has been a long cycle, there are few signs that we would expect to see at the beginning of a bear market or sustained period of GDP weakness. Low inflation and accommodative monetary policy provides support for equity markets, and importantly we continue to believe that there is sufficient growth for differentiated companies to prosper. To that end, we continue to highlight the importance of stock specifics in the current environment, and the greater dispersion in winners and losers that this market regime and political backdrop can generate.

Escalating trade tensions clearly present a risk to global growth and potentially to stock markets, but we feel well positioned to deliver a good investment outcome whatever happens next. Any global cyclical exposure in the long book has been moderated (despite many structural trends that benefit our long positions here regardless) and our long book is comprised of many advantaged business models with robust finances. The pace of industry change is not slowing and multi-year secular trends, like the need for corporates to invest in digital transformation, show no signs of slowing and benefit many of our holdings. On the flip side, we remain short financial leverage, and continue to identify lots of opportunities to short commoditised businesses with weakening demand, as well as structurally flawed businesses models, which we believe will be the first and real victims of any global slowdown.

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Douglas McDougall, chairman of Independent Investment Trust

Economic developments during the period have been rather overshadowed by political developments. Of particular note have been the belligerent tone adopted by the USA in its trade negotiations with China and Mexico, and the political chaos that has attended the apparently interminable Brexit process. The latter increases the possibility of Britain being subjected to an extreme left wing government, not an appetising prospect for investors. The most significant economic development of the period was the softening of central bank rhetoric on monetary policy. Markets have reacted favourably to this, but it can be argued that it should be a matter of concern that developed economies, many of which are operating close to capacity, are still not strong enough to cope with a normal interest rate environment.

Ever since the financial crisis we have struggled to develop any confidence in the outlook for economies or stockmarkets. The most important factor in the outlook is probably the future of monetary policy. The extraordinary laxity of the last decade has continued for far longer than we had thought possible and there is no sign of its coming to an end in the near future. However, the behaviour of stockmarkets in the final quarter of 2018, when many believed that we were entering a period of more restrictive monetary conditions, was a salutary reminder of how uncomfortable conditions may be for investors when policy finally is tightened. In these circumstances, it seems sensible to operate with higher cash balances than we have held in the recent past.

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James Goldstone, manager of Invesco Perpetual Select Trust - UK Equity Share Portfolio:

Once again, I find myself reflecting on a very difficult environment to be managing money, at least with a valuation focused philosophy and a portfolio so weighted to outright Value. There have been the odd rays of sunlight - AJ Bell, HomeServe, Future - all holdings in high growth companies that have performed very strongly and now trade on very high multiples of near term earnings. However, this performance has also served to underline the polarisation that now exists in the market between perceived winners and losers, between the value style on one hand and the growth and quality styles on the other.

Unfortunately, there are few signs of imminent relief. Geopolitics and the global economic picture look more uncertain by the day, most obviously as a result of the escalating US-China trade war which has seen lead indicators weaken globally and forced a reluctant Fed to back off tightening interest rates and contemplate monetary easing of one form or another.

Low growth and low interest rates therefore look set to persist and central banks appear as determined as ever to do "*whatever it takes*" to avoid a debt deflation. No sooner has unconventional monetary policy been reversed than it is once again being contemplated, such that the '*Japanification'* of other developed economies is now a regularly discussed theme. The UK picture is clouded further by Theresa May's resignation and the ensuing leadership contest which leaves a parliamentary stalemate and a no deal exit from the EU a possibility once again.

Companies with predictable revenues and earnings have always attracted a premium rating and those offering less visibility have always merited a discount. However, the current climate has produced a divergence in valuations between perceived winners and losers that is extreme, levels only seen twice in the last thirty years, at the height of the tech bubble in 1999 and immediately prior to the global financial crisis in 2008/9. At the top end, I believe stock markets are now at the limits of the rerating that has driven share price performance in recent years. The reciprocal of these high multiples is such low earnings yields that even if growth expectations are met, investing in these companies is unlikely to deliver an attractive total return. At the bottom end, earnings yields are so high that they alone offer a compelling total return. Should these companies grow earnings in the way I believe possible or ever be considered worthy of a rerating by the market, the total return from this point will be significant. This is not what the market expects. It is an increasingly contrarian approach that has seen underperformance in recent periods. Regardless, now is not the time to compromise on my conviction that valuation does matter.

I believe that a low valuation is the ultimate defensive attribute and a stretched valuation is a risk. The stock market seems instead to be interpreting a low valuation as evidence of a weak business and a high valuation to be the evidence of a company that can do no wrong.

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Europe

(compare European funds **here**)

Sam Cosh, manager of European Assets:

Market Review

European smaller companies have had a strong half, recovering the losses they endured in 2018. That weakness was driven by concerns, particularly in the final quarter, of the effects on global liquidity of a tightening cycle by the US Federal Reserve at the same time as the US trade dispute with China was dragging back global growth. These liquidity concerns have not only abated but completely reversed with expectations of further monetary support from central banks globally. The US Federal reserve is now expected to reduce rates, while the current president of the European Central Bank, Mario Draghi, has indicated further monetary stimulus if growth or inflation fall short of the Bank's expectations. While the trade tensions have not yet been resolved, a further dose of liquidity has been enough to fuel this recovery, extending this market cycle which has been characterised as much by the exceptionally low rate environment as economic growth.

Outlook

The monetary stimulus that has led to low interest rates has been the defining factor of the market cycle since the financial crisis, and the first half of the year continued this trend with central banks looking to support their economies further. This led to a welcome recovery in assets thus far this year. We cannot however make predictions on the decisions of central banks nor the outcome of political events such as trade disputes and Brexit, or the direction of economic output, for that matter. We can however select stocks with characteristics that give us the best opportunity to deliver good returns for our shareholders through the market cycle. We want to hold good companies, run by good managers, and we do not want to pay too much for these businesses.

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Global emerging markets

(compare emerging market funds **here**)

Michael O'Brien, manager of Fundsmith Emerging Equities:

While the performance of the index was volatile, most notably falling sharply in May before rebounding in June, sentiment towards the end of the period improved on the back of optimism that the US and China would reach a trade deal. Emerging markets were also positively impacted by a growing view that the US was unlikely to increase interest rates further.

Political developments also impacted several emerging markets, with Brazil benefiting from the proposed reforms of pro-business President Jair Bolsanaro, whilst the re-election of Prime Minister Modi in India and President 'Jokowi' in Indonesia also were well received by investors.

Over recent years, the inflow of investors money has been in the form of exchange traded funds which typically invest in proportion to the weighting a stock has in the index, and thus concentrate buying on the largest stocks, having a disproportionate impact on their share prices.

The opportunity

Long term trends driving the growth of the consumer in emerging markets.

Put simply, in developing markets growing populations are getting richer. Drilling down beneath this, there are several visible trends we see every time we meet companies, or more pertinently, observe on the ground when we visit countries in which those companies operate.

These trends encompass several components. Richer consumers ultimately purchase more expensive, higher margin products, which clearly benefits both the turnover and margin of those companies selling them. Before markets 'premiumise', however, there are a number of trends which we can benefit from 'on the way through'.

These include greater awareness of food provenance and quality, which leads to 'mom and pop' producers losing market share to established producers of branded products. This greater awareness of food quality leads to the development of modern retail formats such as supermarkets and convenience stores in the developing world. And as the economies of emerging markets develop, consumers become increasingly 'cash rich, time poor' which again leads to the growth of the consumption and economic development trends from which the portfolio looks to benefit.

Since just over five years ago, we have built up a not insignificant exposure to healthcare, primarily through medical diagnostics businesses, aided by people becoming more aware of illness and disease. This is driven by the increasing prevalence of lifestyle diseases in emerging markets such as cancer, heart disease and diabetes.

Beyond healthcare, we believe that there will be increasing opportunities to invest in technology companies providing products and, in particular, services to emerging market consumers and corporations given the competitive advantage provided by skilled labour availability.

This is a trend being driven by digitalisation which is increasing mobile phone penetration and the development of non-cash transaction platforms.

Carlos Hardenberg, Greg Konieczny and Mark Mobius, managers of Mobius Investment Trust:

Emerging and frontier market companies continue to act as a unique opportunity set for investors. A weight of evidence points to the healthy structural advantages present in these developing economies, which will drive robust returns for private sector companies over the coming decade. The current trade dissonance is causing ongoing volatility but will neither last nor derail the longer-term trajectory.

The macroeconomic outlook for the upcoming quarters is positively impacted by the successful revival of growth in China and further supported by a more dovish tone by the US Federal Reserve, pointing to room for further rate cuts in many markets. In view of the upcoming 70th anniversary of the founding of the People's Republic of China in October, we assume ongoing constructive policy making by the national government.

Two factors which are particularly important in emerging and frontier markets are reform and innovation. These are attributes not only reserved for companies in Asia, but increasingly apply to other regions in our investment universe. Particularly noteworthy are the reform efforts to the public pension system in Brazil, the wide-reaching changes in India ranging from tax to infrastructure, as well as the repair of public balance sheets across many emerging market economies. Fiscal prudence and robust public balance sheets will act as a general insurance policy, resulting in far lower risk spreads over the coming years.

Innovation is the most significant driver. E-commerce is gathering momentum and patent registration is reaching an all-time high. In 2017, 1.3m patents were filed in China, more than double the number in the US. 473 of these were related to Artificial Intelligence (AI), compared to 65 in the US and 2 in the UK. We are seeing sweat shops turned into idea factories, producing a new level of competitiveness and reflecting a geographical shift from West to East. This tide of innovation is not only impacting the private sector, but also spilling over to the public sector. E-Government is helping to address and improve tax collection while reducing corruption and leakage, leading to large scale debottlenecking overall.

Japan

(compare Japan funds **here**)

Manager’s report for Atlantis Japan Growth:

Market comment & Economic Outlook

The financial year ended 30 April 2019 was challenging for Japanese equity investors. Investor sentiment was negatively affected by geopolitical tensions in Asia, trade disputes and a sluggish Chinese economy. The Tokyo Stock Exchange short sell ratio hovered in the 45%-50% range for prolonged periods of time, a data point suggesting a lack of enthusiasm for Japan equities. The October-December quarter was particularly punishing as indices for large and smaller capitalised stocks declined by 15%-25% in local currency terms. Reassured by better economic data from China, and reported progress in trade negotiations, the Tokyo stock price index (TOPIX) rebounded in the final quarter of the company’s financial year. Despite this, during the financial year on a total return basis, TOPIX dropped by 6.8% in JPY (-2.9% in GBP terms).

The manager expects corporate earnings in the coming financial year to be, at best, flat year-on-year with particular weakness in the initial six months. Sluggish sales growth could negatively impact operating rates. Other profit headwinds include higher input labour costs owing to a) the tight labour market and b) personnel reforms intended to equalise compensation between full-time and part-time employees.

Japan reported a surprising 2.1% annualised growth spurt for January-March 2019. However this performance masked underlying weaknesses since the economy's principal components (consumption, private sector capex, and exports) declined. Owing to fiscal stimulus and anticipatory spending related to the forthcoming sales tax increase, Japan should remain on a growth path in the first two quarters of fiscal year March 2020, and then decline in the subsequent quarter. Real GDP growth in fiscal year March 2020 could be below its potential and in the 0.3% to 0.5% range.

Inflation is set to remain well below the Bank of Japan's 2% target for the foreseeable future. Consequently, monetary policy will remain exceptionally loose with a rate hike not likely to be considered for another 12 months.

In summary, the manager expects the Japanese economy over the medium term to generate annualised growth of approximately +0.5% to +1.0% supported by contributions from private sector capital expenditure, external demand and household consumption. The risks associated with this scenario include a lengthy, comprehensive trade war between China and the United States (combined, both account for 40% of Japan's exports), tariffs and/or other hostile measures taken by the United States specifically against the Japanese automobile sector, a sudden JPY appreciation against the USD and increases in commodity prices.

Biotech and healthcare

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

Paul Major and Brett Darke, managers of BB Healthcare:

Macro environment

Once again, we look back on a period where market commentary has been dominated by macro-political themes predominantly emanating from the United States, with the added spectre of nervousness regarding absolute valuations and market levels.

Over the last 20 years, global indices have seen a pattern of new highs being followed by market corrections (2000-2002, 2008-2009), with a gradual climb back to new highs over a five-to-six year period. However, the supposed highs of 2014-2016 saw only a minor correction (let's call it a pause) before the relentless march upward began anew.

Arguably then, we are in the longest bull market run in recent history and the wider market is struggling to hold, never mind break the highs of 2018. Meanwhile, economic data is mixed and not directionally clear. The US economy roars on, driven by a heady mix of productivity gains and tax policy, whereas Europe and China seem to be slowing. Geopolitics continues to throw us curve balls as various regional powers vie for hegemony.

How does one assimilate all this information? Is the past a good guide to the future? Does recent history matter at all in a world dominated by almost zero real interest rates and unconventional monetary policy? One thing we can all agree on is the air up here at market highs is thin and that makes people twitchy. Compound this febrile environment with someone who thinks Twitter is a policy tool and macro volatility becomes the new normal.

When macro dominates, the deviations in performance between stocks in a given sub-sector become less important; the wheat and the chaff do not separate. This heady mix is the active manager's worst scenario, as it becomes a struggle to outperform an index by virtue of a high active share.

In this environment, the beleaguered generalist fund manager, thus assailed by multitudinous external factors pulling attention in all directions, loses their appetite for risk as detailed analysis is sacrificed to the more basic task of staying on top of a rapidly evolving macro picture. For instance, late May 2019 saw President Trump threaten rapidly escalating tariffs on Mexican imports. By the time analysts had finished working out the potential impact a fortnight later, the tariffs were called off.

Turning back to healthcare, we saw this most acutely with the pronounced sell-off in Managed Care (US health insurance companies). Much like the wider market, the MSCI healthcare sub-index for providers (which includes the managed care companies) fell 18% in the December 2018 sell-off, but had recovered most of this by mid-February 2019 to sit only ~5% off its high from the previous year. Then, as had been widely telegraphed, various Democratic members of the US Congress submitted healthcare proposals to build on the Obama legacy and further enfranchise the role of government in ensuring access to affordable care. This led to a further 18% fall in the index by mid-March (leaving it 22% off the 2018 highs).

As detailed in our April 2019 factsheet, the proposals are not new and, as before, their major weakness is their financial infeasibility as currently proposed. Various broker surveys of healthcare fund managers put the probability of such legislation being passed in the low single digits, begging the question why the market reacted as it did.

Healthcare has long been a political football. It is one of those few policy areas in which interest spans the demographic and economic spectrum. Put simply, we all care. As such, it is reasonable to think the polemics continue and, whilst specialist investors may well appreciate the nuances of the policies, the over-stretched generalist is more likely to pack up and move on to less unfavourable climes.

We expect that the US political debate around healthcare will continue to focus on three issues: Firstly, populist measures to curb drug pricing/out of pocket expenses (likely limited in their actual consumer benefits or negative impact on the drug industry and its supply chain). Secondly, Democrat-led efforts to widen the availability of healthcare (assuming of course that lack of access to insurance is actually the reason why many Americans are uninsured or under-insured, rather than the high cost of services in the first place) and finally, the potential impact of further trade/tariff barriers on global customer and supply chain networks.

These vicissitudes are par for the course and one must always consider potential outlier risks when constructing a portfolio. We cannot say when the political rhetoric might die down, nor when the window for any adverse action might finally be behind us.

Outlook

As our chairman highlighted, the next eighteen months or so will be noisy. We have battled various political headwinds since our launch into a period of history that will probably be defined by the attempts of populous elements across the western world to redefine political and diplomatic norms. We can all hope for a return to a less disputatious discourse but for now, we are where we are and must accept truculent markets as the price we pay for a polarised democracy.

Political ideas ultimately must pass through a funnel of truth and, in the end, it becomes apparent what can or cannot ultimately be delivered. Whilst we can only hope such realpolitik comes to bear in the holdouts on the edges of each side of the Brexit debate, it must also come to pass on the Democratic side with respect to the future of the US healthcare system. It has been suggested the phrase "this too shall pass" is surely the most universal of truths and it feels that is very much the case here.

If one looks past the polemics, society still has huge structural issues to overcome with respect to the provision of healthcare. We simply cannot afford to carry on as is, lacking both the financial resources to scale up the system in its current form and the human capital to enable such an endeavour.

The only certainty then is profound change and this, as ever, is a significant opportunity for the long-term investor. This fundamental positive, allied to inexorably positive demographic changes, argues for a positive investment outlook well into the future.

Flexible investment

(compare flexible investment funds **here**)

Manager's report for Ruffer Investment:

Review

For most of 2018, for the first time in a few years, it seemed like central bankers might do as they had been saying they were going to do – raise rates in the near future. As the market came to price this in, US inflation linked bonds (TIPS) offered a rare positive real yield in arguably one of the safest assets in the world. We added 10% to these assets in November. As global bond yields dived lower in 2019, we took profits on this trade to reduce the portfolio's duration. The dominant currency remains sterling, it offers fundamental value on a long term basis. Among other currencies, we have been actively reducing exposure to the US dollar in recent months. Given the pivot by the Federal Reserve, narrowing interest rate differentials and the uncertainty of trade wars, it appears to us less obvious that the dollar will function as a safe haven.

Outlook

Jeremy Stein, a former Federal Reserve governor, astutely observed that monetary policy, while a blunt instrument, was the most effective policy tool because 'it gets in all the cracks'. What he meant by this was that interest rates are the fulcrum from which all economic and market activities take their lead. Because higher interest rates have a broad but blunt impact in tightening financial conditions and curbing risk-taking, policy makers don't necessarily need to have spotted the exact root cause of the next problem. Targeted, narrow macroprudential or fiscal policies often have a sort of whack-a-mole nature to them – you may squash one problem, but up pops another. The trouble is that after a decade of zero interest rates and five years of negative interest rates in Europe and Japan the economy and market are utterly incapable of tolerating higher interest rates. Twice in 2018 markets reacted badly to the prospect of higher rates before the pivot from Jerome Powell, chairman of the US Federal Reserve, caused expectations for interest rates globally to crash lower again. By the period end almost 20% of total debt outstanding globally stood at negative yields – at the latest estimate worth some US$13trn, as noted in the chairman's statement. Investors must never forget how extraordinary and unprecedented this backdrop is. Interest rates are the price of money and this price has been grotesquely distorted for a long period of time. This will have consequences, seen and unseen.

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Peter Hewitt, manager of BMO Managed Portfolio Growth:

Stockmarket Background

The past twelve months could be described as "*a year of two halves*" in terms of the fortunes of most major equity markets. The first part of the financial year was characterised by robust economic growth, particularly in the US as the tax cuts enacted at the start of 2018 took effect. This encouraged the Federal Reserve to continue its policy of steadily increasing interest rates. Most financial markets gave up ground over this period and as an illustration the All-Share index declined 7.7% (in total return terms) over the six months to 30 November 2018. Then toward the end of the calendar year signs of a slowdown became evident across most regions of the global economy and quite unexpectedly at its meeting just prior to Christmas the Federal Reserve paused the policy of "*normalisation*" of interest rates. As the New Year unfolded it became clear that the peak of the interest rate cycle had already been reached. Equity markets responded positively to this change of policy.

Although investors remained concerned as to the prospects for growth, equity markets experienced a sharp recovery. Conversely in the second half of the company's financial year the All-Share index rose by 4.9%.

Most markets declined over the year with the exception of Europe which managed a very modest gain and the US which once again led global market returns with a 9.6% gain from the S&P Composite index (sterling adjusted total return). Although the rate of growth in US corporate profits steadily slowed over the financial year it was from high levels, was well in advance of most other regions and was a key factor in the US market's positive returns. The escalating trade tensions between the US and China which resulted in tariffs being applied to a wide variety of Chinese goods imported into the US affected equity markets throughout the Asia Pacific region, including many Emerging Markets and Japan. Returns were depressed on fears that trade wars between the world's two largest economies would particularly impact companies in these regions.

The other important factor behind returns for a UK based investor was the level of sterling. For most of the period under review sterling was a volatile currency on foreign exchange markets. The machinations of the seemingly endless process of Brexit in the UK parliament were reflected directly on the value of the currency where sterling could be viewed as an instant barometer of progress or the lack of. Latterly in the final three months of the financial year, as the Brexit process appeared to reach stalemate, sterling experienced marked weakness against both the US dollar and the Euro.

Investment strategy and prospects

Uncertainty continues to characterise prospects for global financial markets. Although Brexit and its eventual outcome has saturation coverage in the media and would affect UK markets in the near term, over the longer run it tends to be the outlook for the fundamentals of the economy and the prospects for corporate profits and dividends that dictate the direction of markets. In a global context the tension that exists between the US and China manifest in widespread tariffs imposed by the US on Chinese imports which clearly has the potential to reduce overall global activity levels, particularly so in the Asia Pacific region. Again, predicting the outcome is difficult, however it is an issue that has the potential to impact financial markets everywhere adversely.

The reason the Federal Reserve paused its policy of "normalising" interest rates and indeed may consider a cut in interest rates later this year is evidence that growth is slowing. Both the US and China are experiencing slowing growth rates whilst in Europe and Japan growth is still positive but at very modest levels. Inflation, despite record low unemployment in the US and UK and a definite pick up in real wage growth, remains stubbornly low across all developed economies. A move to higher levels which would require interest rates to be increased is some way off. Bond markets are very cautious as to prospects with the yield curve in the US close to being inverted which often is viewed as a precursor to recession. That may happen in the medium term and meantime must be watched closely, however the next twelve months seems set for positive growth. Indeed there are indications that the activity levels are stabilising both in the US and Europe.

In terms of corporate profits, growth rates have slowed materially, especially in the US when the substantial cut in business tax rates in 2018 fuelled very strong growth. That said both in the US and Europe they remain positive but lower levels of profits and dividend growth appear likely over the next twelve months against a background of buoyant levels of employment and strong consumer expenditure. Looking to the medium term, the risks of recession have begun to rise which would be exacerbated if the ongoing tensions between China and the US were to worsen.

The above is a moderately positive backdrop for equity markets. Valuations outside the US are below long-term averages whilst in the US the forward P/E ratio of the S&P Composite index at 16x is about the same as a year ago which is slightly above the long-term average.

This reflects superior corporate earnings growth from US companies over a prolonged period. This better relative earnings performance from US companies when compared to European counterparts is likely to continue. In broad terms the environment remains constructive for moderate progress in equity markets however the risk of further bouts of volatility, similar to that experienced last Autumn, which can be both sharp and uncomfortable for investors has increased. In particular, the sensitivity of investors to the interest rate policy of the Federal Reserve is a key factor in determining the direction of global equity markets. For the UK the uncertainty of Brexit can be added to the mix. Eventually, should that be resolved, there is considerable scope for strong performance from UK equities as valuations are well below long term averages.

In terms of long-term investment strategy, the case for exposure to sectors which offer secular growth characteristics remains in place. When inflation is subdued, interest rates low and growth moderate then investment companies focussed on sectors such as technology, healthcare and biotechnology should prosper. That may change in the future but for the current financial year trusts with these attributes are well placed.

Though there are risks, which have increased over the last year, on balance prospects for equity market returns remain positive.

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Scott Wolle, manager of Invesco Perpetual Select Trust - Balanced Risk Allocation Share Portfolio:

The ongoing trade tensions ratcheted higher in May as the US-China talks broke down and the Trump administration threatened Mexico with a new schedule of tariffs. Additionally, it seems that other countries are in the administration's crosshairs. While seeming unpredictable in business or personal negotiations may be a viable tactic, unpredictability around national policy and the great potential for disrupting trust between nations and carefully structured business plans is most unwelcome. The surprise decision on Mexican tariffs – that seems to have been made unilaterally by the president without the support of or even foreknowledge by his party – could present several issues. First, Congress potentially could fail to support the measure against Mexico and wrest the tariff-levying power from the president. This would weaken Trump's stance in the eyes of his adversaries. Secondly, China may dig in its heels, recognising the US administration's inner-party turmoil and seeing that the president has opened a multi-front war on himself. The other major issue is a lack of confidence from US businesses. Companies have spent many years crafting intricate supply chains and manufacturing capabilities across borders that may now be upended through these tariff actions. A lack of trust in the stability of policy along with evidence of weakening economic activity across the globe may have a stifling impact on companies' willingness to engage in capital expenditures until meaningful clarity returns. Given the level of uncertainty at present, we believe a focus on economic diversification is a reasonable approach.

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Financials

(compare financial funds **here**)

Nick Brind and John Yakas, managers of Polar Capital Global Financials:

Investment Review

Financial markets suffered a brutal sell-off in December with the S&P 500 index falling by nearly 15.0% at the worst point on Christmas Eve before staging a partial recovery in the last few days of the year. The fall was sparked by hawkish commentary on the outlook for US interest rates by Jerome Powell, the chairman of the Federal Reserve, and in particular a statement around the downsizing of the Federal Reserve's balance sheet which he said was on "automatic pilot".

The severity of the falls was not seen as justified and equity markets rallied strongly in January with the momentum of this carrying through to the end of April. The rally was given further impetus by less hawkish commentary from the Federal Reserve about the outlook for interest rates and the pace at which it would shrink its balance sheet. Solid fourth-quarter results also helped underpin the positive turn in sentiment.

However, concern around the escalation of trade tensions between the US and China and a fall in leading indicators resulted in interest rate expectations falling gradually over the period, with the next move by the Federal Reserve being expected to be a cut in interest rates. Not surprisingly, this acted as a headwind for bank stocks, which are beneficiaries of rising interest rates. US regional banks were particularly weak as they are more sensitive to movements in interest rates.

European politics, particularly around the UK and Italy, have also acted as a headwind for sentiment with the latter getting into a dispute around its budget deficit with the European Commission at the end of the period. As a consequence, Italian bonds fell, putting pressure on Italian banking stocks which had until then performed well. There was some expectation that the ECB would also consider a tiered-deposit scheme to offset the impact of negative interest rates, albeit that subsided after a paper was published by the ECB arguing that negative interest rates had not had a detrimental impact on the banking sector.

Money laundering allegations weighed on sentiment towards Swedish banks. Danske Bank, Denmark's largest bank, had come under significant criticism in 2018 over alleged flows through its Estonian branch. While initially Danske was seen as an exception, other Swedish banks came under suspicion over their money laundering controls, in particular Swedbank, which suffered a sharp fall in its share price and resulted in its CEO and chairman both being forced to step down.

UK financials rallied on the expectation of a "softer" Brexit as the UK government was forced to concede to the date when the UK could leave the EU being pushed back. However, the rally proved short-lived as the political impasse worsened, leading to the resignation of Prime Minister Theresa May, following the collapse in support for the Conservatives, but also the Labour party and a surge in support for the newly founded Brexit party and pro-remain parties at the European elections.

Merger & acquisition activity picked up during the period with Deutsche Bank and Commerzbank admitting to talks, which fell through, with other banks also linked to discussions with the latter. In the US, SunTrust and BB&T announced a merger to create the sixth largest bank in the country with one of the reasons given being a need to increase spending on technology to compete against their larger peers. In the UK, Charter Court Financial Services and One Savings Bank, both buy-to-let focused lenders and both holdings in the Trust, also announced a merger.

In May, as trade tensions appeared to ratchet up with the US threatening to impose tariffs on Mexico, bond yields fell further and the market priced in three interest rate cuts by the end of 2020. German 10-year government bond yields fell to -0.2%, levels last seen in 2016. While bank shares fell on the back of this, non-life insurance and REITs saw further share price gains.

Outlook

The brief bounce we witnessed in the sector in April was lost as financial markets switched to a risk-off mode in May despite more positive macro data in the US and Europe over the month. Sentiment towards the sector remains poor as evidenced by recent conferences where attendance is down sharply and anecdotal observations from sell-side analysts suggest a complete lack of interest from generalist investors.

While Brexit also continues to weigh on sentiment it will have an impact on performance if it reaches some form of resolution. We have felt for a while that the sell-off in financials and fall in bond yields is at odds with the buoyancy in wider equity markets and either the sector is overly discounting a downturn that will be short and shallow at worse, and will see the sector subsequently bounce or that it is correctly forecasting a much sharper slowdown and equity markets have further to fall.

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

Research put out by the research firm Autonomous highlighted the correlation between implied loan losses and the credit to GDP gap i.e. the degree to which loan growth has exceeded nominal GDP in relation to its long-term trend. Not surprisingly the correlation is very high as strong loan growth relative to GDP correlates highly with higher loan losses in a downturn and vice versa reflecting the exuberance or caution to which banks extend new loans. The credit to GDP gap over the last few years has been negative for most developed countries i.e. loan growth has been slower than nominal GDP growth. If the correlation stands then this would suggest there will be very limited pick-up in loan losses if a recession were to occur in the next year. Adding the improvements in underwriting standards, pre and post the financial crisis, think so-called liar loans versus the much more stringent underwriting standards today, a marked deterioration in asset quality would be surprising.

Another area where banks lost significant money during the financial crisis was in trading assets, for example, leveraged loans. There has been understandable concern recently around both the sharp increase in leveraged loan issuance but also the fall in underwriting standards. The banking sector's exposure to leveraged loans has fallen significantly since 2007 and on some estimates, it is around US$80bn, down from close to US$500bn prior to the financial crisis.

Berkshire Hathaway released its results and Warren Buffet's annual letter to shareholders at the end of February. While we do not own Berkshire Hathaway currently, it is instructive that in the second-half of 2018 he increased their exposure to US banks by $15bn, starting two new holdings in JP Morgan and PNC Financial and has carried on adding to both in 2019, while highlighting how difficult it is to find attractive investments in any other sector.

In a CNBC interview when talking about his holdings in US banks he stated: "They're very good investments at sensible prices, based on my thinking. And they're cheaper than other businesses that are also good businesses by some margin." We would agree. The sector continues to return significant capital to shareholders reflecting their very strong balance sheets and we remain constructive on the outlook despite it remaining out of favour.

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Liquidity

(compare liquidity funds **here**)

Manager's report for Invesco Perpetual Select Trust - Managed Liquidity Share Portfolio:

The PIMCO Sterling Short Maturity Source UCITS ETF is actively managed by PIMCO and has the flexibility to navigate changes in the macroeconomic outlook. PIMCO's baseline outlook includes a shallow recession in the next three to five years, which means that inflation is likely to remain low and central banks are likely to maintain base rates below historic averages. However, this relatively benign baseline is only one of several realistic scenarios and the probability distribution of economic outcomes is wider and less certain than usual.

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Technology and media

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

Ben Rogoff, manager of Polar Capital Technology:

In contrast with hopes for more synchronised growth, 2018 proved anything but as the US economy (2.9% v 2.7% estimated) surprised to the upside while most other major economies were negatively impacted by trade tensions, tariffs and other political uncertainty. The combination of slower and more uneven growth is expected to persist in 2019 with growth in advanced economies expected to slow to 1.8% (2018: 2.2%)

with the US still forecast to grow at circa 2.3%, almost three times faster than Germany. While domestic demand is expected to remain robust (courtesy of tight labour markets and cycle-low unemployment), US growth is expected to moderate due to tighter monetary conditions, unwinding fiscal stimulus and some trade-related weakness. Weakening external demand (largely China) is expected to have a greater impact in Europe, particularly in export-heavy Germany with one-offs such as revised auto emission standards and industrial action further weighing on the growth forecast at just 1.3% (2018: 1.8%). Despite the expiry of the March Brexit deadline, there remains considerable risk to current expectations of 1.2% growth in the UK. Japan should grow c1% this year (2018: 0.8%) with the government pledging to use 'every measure possible' to mitigate the impact of a planned consumption tax increase scheduled for October. After a more challenging year, developing economies are expected to downtick modestly in 2019 with growth pegged at 4.4% (2018: 4.5% estimated) supported by another year of more than 7% growth in India (2018: 7.1%). In contrast, growth in China (2018: 6.6% estimated) is expected to slow further to 6.3% due to the combination of trade tensions/tariffs and financial regulatory tightening (aimed at shadow banking) offset by fiscal stimulus necessary to sustain growth above 6%.

The more challenging economic backdrop has taken its toll on earnings expectations with EPS growth contracting to between 4-9% for most major markets in 2019. In the US, estimates have been revised sharply lower with forecasts for 2019 operating earnings almost halving from where they stood in October. According to Factset, revenues and earnings are now expected to increase 4.7% and 3.4% respectively this calendar year. Estimates also remain significantly back-end loaded with earnings forecast to contract in Q2 before improving through the rest of the year. However, at the time of writing, this (Q1) earnings season has proved better than feared with blended revenue growth of 5.2% with 76% of companies beating earnings by 5.6%, above the five-year average. As in previous years, margins and buybacks remain key determinants of earnings progress this year. Buybacks have formed a key part of the US earnings story and, together with corporate net buying, have accounted for 20% of earnings growth since 2012. This looks set to continue in 2019 with buybacks likely to remain an important source of bottom-line growth this year as companies trade cheap debt and plentiful cashflow for equity. However, record levels of repurchases last year ($1trn) were buoyed by repatriation incentives which will be a tough act to follow.

The combination of rebounding equity markets and negative earnings revisions has seen the forward PE on US stocks recover to circa 16.8x (2018: 16.5x) having reached a high of 17.9x in October and sub-14x in late December. This valuation metric is modestly above five and 10-year averages of 16.4x and 14.7x respectively. As in previous years, international markets appear better value, but less so on a sector-adjusted basis, with the exception of the UK which remains a cheap outlier following record Brexit/Corbyn-related outflows. The recent recovery in equity markets has been offset by lower US treasury yields and subdued measures of inflation so that the relative valuation gap between stocks and bonds remains relatively unchanged from last year. While the Fed Model (which compares earnings and bond yields) continues to suggest that equities remain substantially undervalued versus both treasuries and corporate bonds, the so-called Rule of 20 (where the fair value PE is equivalent to 20 - CPI) suggests that equities are only modestly undervalued today having traded at fair value briefly last year. Although equity valuations remain appropriate for the current environment, we do not expect them to expand easily from here given political/trade uncertainty and the potential for further negative earnings revisions. Given our expectations that a trade deal will be concluded, we suspect downside risk to valuations should prove modest absent deflation or inflation, the two primary causes of sharply lower PEs. Rather, we expect a return of volatility, which largely explains the current elevated level of cash in the portfolio that reflects heightened macroeconomic uncertainty and the magnitude of the recent bounce.

While there are myriad risks to this relatively sanguine view, the odds of a melt-up - the idea that bull markets tend to go out with a bang not a whimper - have lengthened this year with many measures of excess having moderated over the past 12 months. At that time there was plentiful evidence of investment fads (bitcoin, marijuana stocks), while investor sentiment was ebullient. In addition, long-term risk-free rates were threatening levels incompatible with an accommodative investment backdrop. In addition, fund manager positioning has completely reversed, with last year's confidence and cycle-low cash being replaced with consternation and in January, the highest levels of institutional cash held since the financial crisis.

Risks

As ever, there are myriad risks that could challenge our view. The most significant of these relates to the slowdown in the global economy and associated recession risk. While markets have rebounded strongly on trade deal/recovery hopes, the global economy continues to lose momentum with the IMF recently cutting its 2019 global growth forecast to 3.3% from 3.5%, its third downward revision in six months. More ominously, the JP Morgan global manufacturing PMI is at post-2016 lows and at just 50.6 in March was flirting with contraction. Uncertainty looks largely to blame, unsurprising given trade war, Brexit and other political concerns all looming large. In addition, Europe has been negatively impacted by a number of specific issues including tougher emissions regulations that brought German car production to a temporary halt, and the Gilets Jaunes protests that cost France 0.2% of Q4 GDP. In January, the German IFO index fell to a three-year low, Italy slipped into recession for the third time in a decade while in March, the German government sold 10-year bunds with a negative yield for the first time since 2016. China has already cut the RRR twice while introducing fiscal measures in order to ameliorate its slowdown. Although US momentum has moderated as fiscal stimulus fades, there appears to still be plenty of residual strength too - non-farm payrolls jumped by 263,000 in March and US hourly earnings grew 3.4% y/y. This resilience is a good reminder of how closed the world's largest economy is with just 27% of S&P 500 sales coming from overseas. As such, odds of a US recession this year appear low and as outlined in previous reports, we remain focused on a number of indicators such as market breadth, credit spreads and yield curve inversion to help us navigate choppier waters.

However, it is also abundantly clear that clarity on trade is essential to restore confidence and return the global economy to firmer footing. As such, another significant risk to our base case is the failure of the US and China to conclude a trade deal. While we believe a deal will be done, the February summit in Hanoi (where negotiations with North Korea ended without agreement) was a good reminder that President Trump believes that 'sometimes you just have to walk away'. At the same time as pursuing a deal, the US is also continuing to act unilaterally to address trade or IP violations. This twin track approach has seen US lawmakers propose banning the sale of US semiconductors to ZTE, charge Huawei with violation of US sanctions on Iran and stealing technology, and trying to persuade its allies to shut Huawei out of 5G network builds on security concerns. This twin approach also speaks to the bigger issue of whether a grand bargain is even possible. The trade war began with an imbalance between the two superpowers that accounted for nearly half of the US's $375bn overall trade deficit which could have been resolved by the Chinese agreeing to purchase more US goods and promising to improve market access and IP rights. However, a bellicose speech given by Vice President Michael Pence in October positioned China as America's rival and accused Beijing of 'employing a whole-of-government approach' in order to carry out a 'litany of economic, political misdeeds'. This hardening of rhetoric reflected China's rapid ascent and years of missed opportunities to narrow differences between the two countries. While resolution may ultimately require the US to 'share economic and strategic power with a rising China', the US - hardly a stranger to the use of a big stick - will not surrender its economic, technological and what it perceives to b) moral leadership without a fight.

In addition, loss of policymaker support remains a key risk to our base case, although the recent Fed reversal has allayed policy error fears. The alignment of policymakers and shareholders that has underpinned risk assets since 2009 depends on central banks fearing deflation more than inflation which still holds today. Much rests on wage inflation (the driver of c60% of inflation) and inflation expectations, both of which have remained contained in part thanks to technology. However, there is no guarantee that this will persist, particularly given how tight the US labour market is. The Fed could also resume its rate-tightening path once external conditions improve and reflexivity risk has passed. Returning to 1998-99 as a guide, a low 1.4% core PCE did not prevent the Fed from raising interest rates three times during 1999 once the emerging market crisis had passed and in response to a re-acceleration of global growth and a sharply higher equity market. In other words, data dependency ,and the neutral rate, are open to considerable interpretation - should the US economy once again show signs of 'remarkable dynamism', 2020 could easily follow the path of 1999. Other reasons interest rates could surprise to the upside include policy error, higher oil prices that feed into inflation expectations, a record US budget deficit and rising government debt:GDP ratio.

With Brexit looking less certain and President Trump limited by gridlock in Congress, populism appears a less potent risk this year. The chastening experience of Brexit (not a subject I intend to dwell on) and the prospect of a potential second referendum 'would be an even starker retreat from peak populism'. In addition, Italy's populist governing coalition, having said they would not *'backtrack by a millimetre'*, ended up backtracking by nearly 0.4% of GDP following a prolonged standoff with the EU over the size of its budget deficit. However, the underlying causes of the discontent that has manifested as populism have not dissipated and, as the Gilets Jaunes protests demonstrated, can resurface at any moment. In Germany, populism has left Angela Merkel a lame duck following regional elections which saw both mainstream parties (CDU and SPD) cede circa 10% share each while the AfD captured 12%. Populist right-wing governments remain in control in a number of the Visegrad countries (Czech Republic, Hungary, Poland and Slovakia) while Jair Bolsonoro, the recently elected president of Brazil, has adopted some of the rhetorical themes of Trumpism. Other political risks relate to Iran (Trump renounced the nuclear deal signed by Obama and sent an aircraft carrier to the Persian Gulf), North Korea and a more belligerent Russia.

In addition to those outlined above, there are a number of additional risks that investors should consider. China represents a key risk to the global economy and financial markets. Following the slowest official GDP growth in 28 years (6.6%) and the first negative year for auto sales since 1992, avoidance of a hard landing in China remains imperative. However, benign inflation should allow the government sufficient monetary and fiscal firepower to deliver GDP growth in line with the official target of 6-6.5% set in March despite trade war uncertainty and tariffs. Debt, or more specifically the systemic risk posed by its magnitude is another risk that needs monitoring given non-financial credit as a share of GDP hit a near-record 46.4% in Q3 2018, surpassing the previous high of 45.2% recorded during the financial crisis. Although actual credit risk is unlikely to materialise until the cycle turns, high levels of corporate leverage ($2.7trn worth of corporate debt is outstanding) may prolong any downturn while the positive correlation between US equities and investment grade spreads could leave stocks at the mercy of a relatively illiquid corporate bond market. Other risks include the ongoing challenge to nation states posed by terrorism and unintended consequences of dollar strength and policy divergence, particularly in emerging markets.

Technology Outlook

Worldwide IT spending is expected to reach $3.76trn in 2019 representing 3.2% y/y growth. This represents a modest deceleration from last year (2018: 3.9%) and is likely due to the weaker macroeconomic backdrop as well as difficult comparisons (as we anniversary tax cuts that acted as a tailwind for business spending). Stronger than expected 2018 growth, together with a more uncertain macroeconomic backdrop and negative y/y growth at Apple and a number of more cyclical stocks has left 2019 expectations for both revenues and earnings at a moribund 2% y/y, However, these numbers are misleading because internet and computer gaming stocks were reclassified as communication services and consumer discretionary respectively during the year. In addition, while sector growth is expected to recover in 2020 (revenues and EPS forecast to rebound by 6% and 11% respectively) there is likely upside to 2019 forecasts given that 89% of technology companies beat earnings in 1Q19, the highest proportion of any sector.

Buybacks are also likely to remain supportive with the technology sector accounting for 36% of total buybacks during the first nine months of 2018, up from 22% a year earlier.

The combination of superior growth and marked outperformance saw the technology sector enjoy a well-deserved rerating over the past year leaving it trading on a forward PE of 18.9x as compared to 18x at the previous prior year end. However, this minor change belies a remarkable range of valuations experienced during the past year or so with the sector making a post-2008 high in January 2018 at circa 19.5x and troughing at c14.5x in December 2018. The recent market recovery combined with negative earnings revisions has led to the sharpest rerating of stocks since the financial crisis which leaves them exposed should a trade deal and/or a second half earnings recovery fail to materialise. The sector's relative rating represents a circa 8% premium to the broader market, ignoring the sector's relative balance sheet strength. While this is a little elevated versus recent history, we do not expect the sector to materially de-rate over the coming year given its growth and balance sheet profile. As in previous years, the technology sector is the only one which boasts net cash. According to our own estimates, this is equivalent to 8% of current market capitalisation which, at face value, reduces cash-adjusted valuations to circa 17.3x enterprise value/earnings.

Although cyclical names have performed strongly since January on trade deal hopes, our own excitement remains underpinned by a new cycle/cloud thesis that appears to be gathering strength with every earnings season. We expect the Nifty Fifty-type market to persist as investors gravitate towards growth stocks against a backdrop of an uneven, sub-par global economy and limited upside to PE multiples. As previously discussed, we have many of the necessary ingredients for a Nifty Fifty-type market with the added bonus this year of lower risk-free rates (helpful for longer-duration names like Netflix) and negative earnings revisions in the broader market helping to create even greater distinction between winners and losers from technology-driven disruption. Continuation of a thinner market is consistent with the idea that leadership rarely changes during a late-stage bull market while the flat yield curve should be supportive of technology outperformance versus financials. In addition, a raft of high profile IPOs (potentially including Airbnb, Palantir, Slack and Stripe) support the idea of a 1998-99 rerun.

Thematic update

As we have previously articulated, internet platforms remain some of the greatest beneficiaries of smartphone ubiquity, the cloud and plentiful bandwidth with more than 4.3 bn people accessing the internet, circa 57% of the world's population. Despite a disappointing year for internet stocks, we remain upbeat about their medium-term prospects although we expect regulatory headwinds to persist, while slowing global growth represents (hopefully) a more transitory risk. With GDPR being implemented in May 2018, the risk associated with data privacy appears to have been absorbed well. While GDPR-type legislation is gaining traction globally, we expect the leading platforms to be relatively strengthened in a world where compliance costs and the value of first-party data are rising. Likewise, we are relatively sanguine about antitrust concerns, epitomised by Senator Warren calling for the break-up of Amazon, Facebook and Google. While this scenario remains a tail-risk, greater levels of scrutiny may see the internet giants tread more carefully. Growing political pressure may also manifest as higher tax rates as the EU and others explore so-called digital taxes based on revenue, rather than profits. Although we expect worst case scenarios to be avoided (overhauling the global taxation system for the digital age will take time), internet companies may look to mitigate this risk by moving to country-based taxation as Facebook will this year.

While the headlines continued to be dominated by regulatory risk, the internet economy continues to capture a disproportionate share of global growth while user engagement is healthy. The outlook for online advertising remains positive (up 18% in 2018) driven by mobile. Alphabet and Facebook continue to dominate the market and deliver significant ROI advantages for advertisers. However, Amazon is a significant new entrant leveraging its vast purchase history data, attracting direct mail and trade spend budgets to its advertising platform. Social media continues to grow its share of advertising dollars; Facebook remains the undisputed leader with over 2.7 bn monthly active users (MAU) across its family of apps and an astonishing two billion daily active users. In China, Tencent's WeChat boasts c1.1bn MAU.

The growth in e-commerce continues apace and is set to increase from $2.9trn in 2018 to $4.9trn by 2022 representing a CAGR of 20%. Mobile commerce (m-commerce) continues to outgrow the overall market and in 2018 represented c40% of total US eCommerce but only 4% of overall retail spending. Omnichannel is likely to remain a focus with Paypal announcing the acquisition of iZettle to boost its offline strategy.

Internet-driven disruption is also being increasingly felt in media content as time continues to migrate away from linear TV. In the US, eMarketer calculates time spent viewing digital video exceeded 82 minutes per day last year, an 18-fold increase while time spent watching linear TV has been declining since 2012 and is expected to contract by a further 4% in 2019. Demographics play a large part in this trend, a parliamentary committee revealing that conventional TV viewing by under-25s has halved in the UK since 2010. Streaming video and music services remain a key media battleground with YouTube (almost two billion monthly logged-in users) and Netflix (139m paid users) dominating the former, and Spotify (207m MAU) and Apple (56m paid subscribers) leading the latter. However, the remarkable experience of Fortnite - an online game with 200m registered users - demonstrates that TV and music are having to increasingly compete with gaming for consumer screen time. No doubt with this in mind, Alphabet (aka Google) announced Stadia, an online streaming gaming service expected to launch later this year.

Our belief that the smartphone market was mature was borne out in 2018 as worldwide sales of smartphones fell by 5% y/y with units shipped falling to 1.4 billion from 1.5bn in the previous year. Slowing innovation, economic headwinds and price increases led to elongated replacement cycles. This, together with weak Chinese demand led to the smartphone industry experiencing its first ever annual decline while both Apple and Samsung ceded market share to the four Chinese vendors. With smartphone penetration at 70-80% in most advanced markets, unit growth is likely to be modest at best going forwards with IDC forecasting a return to low, single-digit growth through 2022. This upbeat assessment reflects hopes that less uncertainty in 2019 together with new-form factors and/or 5G can return the market to growth. However, replacement cycles have continued to extend, reaching 2.8 years in the US in 2018. For now, we cannot know where replacement cycles will end up but the PC experience is sobering; despite a plethora of would-be drivers such as laptops, two-in-ones, chromebooks and OS upgrades, units have declined every year since peaking in 2011 while sales are now circa 30% lower than where they stood then.

Our long-held view has been that Apple is best understood as a mass affluent/luxury consumer goods company with an exceptional brand/customer base and ecosystem. If anything, this view was strengthened a year ago by the shift towards price rather than unit-driven growth. Likewise, we were genuinely excited about services that were growing in the mix. However, a year later and the investment case for Apple has changed again. Having decided to stop disclosing units and ASPs, Apple went on to negatively preannounce results for the first time since 2002 with iPhone units down 15% y/y in Q1 and the company laying the blame squarely on China's macro-related weakness. With an installed base of 1.4bn people including more than 900m all-important active iPhone users, the core of the Apple story seems unchanged. The company appears to still have pricing power as iPhone ASPs have increased from $686 in 2017 to $755 in 2018. Services remain healthy too, accounting for 13% of total sales and growing a respectable 19% y/y. While overall market share slipped during 2018, Apple continues to dominate premium smartphone markets such as the US where c40% of devices run iOS (versus circa 14% globally) and even as replacement cycles extend, Apple remains remarkably good at selling iPhone-related products into its mass-affluent base.

Unfortunately, the premium smartphone market is now fully penetrated and replacement cycles are extending. We remain sceptical that an ageing installed base is ripe for an upgrade because a large portion of the 900m+ iPhones are second-hand/hand-me-downs. We are also less sure that pricing is as healthy as it seems with recent actions (price cuts in China, adjusting for the strong dollar in certain markets, promoting trade-ins) tactical rather than strategic answers to the issue of price elasticity. This is particularly true in emerging markets where Apple's premium offering and App Store have less resonance, like in India where the Apple X is priced at 10x the cost of the average handset. As the largest smartphone market and 16% of sales, Apple will need to solve China. Better unit growth progress in Q1 was likely helped by cheaper/old models which will weigh on ASPs and service attach rates and - in time - could threaten Apple's luxury good status which depends on high residual values.

Apple has also enjoyed limited success in the connected home where its premium priced offerings have faced intense competition from both Amazon and Google. What is striking is that the further one moves away from the iPhone, the less relevance Apple seems to have, which talks to the importance of inertia (people are loath to switch platforms) and value of the App Store. The latter represents the crown jewel of Apple's services business and the source of Apple's *'walled garden*.' However, app stores have become more contentious recently, due to the apparent data advantage enjoyed by Apple (and others) which means they should 'either run the platform or…play in the store'. Spotify has made the same point in its recent complaint to the EU about the (30%) 'Apple tax' which Apple's own Music service does not have to suffer. Potential risk to the App Store comes at a time when the Apple proposition is more reliant on services growth than ever before.

For now, Apple remains one of the best businesses in the world and one of the most important investments we have ever made. Its ability to create multiple new product categories - iPods, iPhones, iPads, Apple Watch and an ecosystem that both enables and sustains them - is unprecedented. This has left the company with $113bn of net cash on the balance sheet together with a baseline of c$50bn of annual cashflow which can be used to sustain EPS growth until replacement cycles have fully extended or augment services growth via large-scale M&A. There is also optionality associated with products that either enrich (or revive) the smartphone franchise. For these reasons we are likely to retain a large but underweight Apple position. However, the product-driven growth story that we fell in love with has morphed into a cashflow/financial engineering alternative with most of the bottom-line growth currently modelled coming from future buybacks. This is fine as long as it is funded from the P&L (not the balance sheet) but a marked shift in cashflow generation, product pricing or M&A strategy would telegraph that this unique company was beginning to suffer from the weight of its incumbency.

Weak smartphone demand, together with trade war concerns during the second half of 2018 took the shine off another strong year for the semiconductor industry, although rampant DRAM pricing (+20% on a full-year basis) accounted for two-thirds of overall revenue growth. Having been particularly weak into the market lows, the sector has recently led the upward charge on prospects for a trade deal and a second-half recovery. Recent datapoints in both smartphones and datacentres, where cloud capex growth is slowing after a remarkable 2018, suggest that expectations of a second-half recovery are likely at risk. As such we are cautious near-term on inventory digestion as a result of weaker demand in both servers and smartphones and the unwind of the buffer built during the early days of the trade dispute. However, we remain excited about the opportunities brought by AI-infused data processing power growth and consider semiconductors one of the cheapest and most levered ways of gaining exposure to the so-called data economy. In addition, new emerging applications such as streaming gaming will help replace smartphone-related revenue while 5G should enable a number of new applications based on machine-to-machine and machine-to-human communication. In contrast, we remain cautious on smartphone-related plays (with the odd exception) and on Intel following an eventful year for the world's largest semiconductor company which saw it cede leadership at the leading manufacturing nodes to TSMC.

The robotics market was also negatively impacted by smartphone trends as well as weaker Chinese demand and trade/macroeconomic uncertainty. This resulted in growth slowing to c10%, from circa 30% in 2017, with much of the deceleration due to a pause in capacity expansion of organic light-emitting diodes (OLED). In addition, sharply lower subsidies for Chinese factory owners to modernise production lines impacted demand, while plunging EV battery manufacturing utilisation rates weighed heavily on lithium battery-related demand. That said, demand should remain robust in automotive (adoption of light/mixed materials), logistics (automated warehousing, guided vehicles) and medical (robotic-assisted surgery) sectors. Although we remain positive on the secular opportunities, we are mindful of weakening macroeconomic trends as well as the ongoing US/China trade dispute. In addition, both autos and smartphones - the two biggest end markets for industrial robots - are still experiencing weak demand and inventory digestion. We will look to take advantage of any share price volatility in order to rebuild our exposure having materially reduced it early last year.

While other would-be secular themes that were buffeted by cyclical headwinds, the software sector enjoyed a remarkable year as valuations expanded further alongside fundamental strength. Disruption - the zeitgeist of this cycle - continued to create an appropriate sense of urgency on the part of incumbents across myriad industries to reinvent themselves via digital transformations to avoid disintermediation, obsolescence and/or irrelevance. This allowed next-generation software companies to deliver strong growth, aided by limited exposure to China (responsible for just c1% of software revenues) and, by extension, trade worries. Sector valuations also likely benefited from improved profitability and elevated M&A activity. In addition to the landmark IBM/Red Hat deal, software M&A highlights included SAP's acquisitions of Qualtrics and Callidus, Microsoft's purchase of GitHub while private equity swallowed up a number of secondliners. Although we do not anticipate much further valuation upside from here, growth is likely to remain robust. While the economy and uncertainty might pose a threat to deal timelines, the business transformations under way are existential and software increasingly drives critical systems and revenues. We have taken some profits after a strong run, though the sector remains well supported by much improved profitability, the emergence of next-generation winners and the likelihood of further M&A.

In contrast, computer gaming stocks experienced a challenging year following disappointing results from bellwethers Electronic Arts and Activision, which were impacted by a combination of poor execution, a fierce competitive environment and regulatory headwinds. Not only was the holiday season overcrowded, but competition for time and wallet share was taken to another level by Fortnite, a free-to-play (FTP) Battle Royale game which went viral, growing from zero to 200m registered players and 80m monthly players in 16 months. This saw it generate $2.4bn in revenue during 2018 - 'the most annual revenue of any game in history' - solely through back-end monetisation. In addition, growth in China (the largest video games market globally) decelerated to just 6.1% amid a regulatory body reshuffle and hiatus in the approval of new game monetisation. Despite this perfect storm, we still like the gaming market, which is expected to be worth $148bn this year (+11% y/y).

However, the success of Fortnite (and EA's competitive response Apex Legends which reached 50m players in just one month) may have opened Pandora's Box in terms of monetisation, although the success of Take Two's Red Dead Redemption 2 was a shot in the arm for premium content. New consoles expected in 2020 and streaming services could significantly increase the addressable market but new distribution models in video and music have not been unequivocal positives for incumbent content. As such, we are likely to remain more modestly positioned until the FTP / streaming dust settles.

In addition, there are a number of other themes that we remain excited about including payments where change is happening at an accelerated pace. While healthy consumer confidence and tax cuts played a part in stronger volume growth at Visa and Mastercard last year, the secular trend towards digital payments remains compelling. Drivers include eCommerce growth and contactless payments which has been accelerating the cash-to-card transition by one percentage point a year. In addition, we are excited about the business to business (B2B) opportunity which Mastercard estimates is almost three times larger in volume terms than consumer spend and, being largely cheque-based, appears ripe for disruption. The peer-to-peer (P2P) market represents another attractive growth vector, with US mobile P2P volume estimated at $167bn in 2018 forecast to more than double by 2022. We have exposure to two of the three leading P2P assets via our positions in PayPal (Venmo) and Square (Square Cash). As with software, we believe payments remains one of the best ways to gain exposure to disruption, demographics and changing user behaviour/expectations. However, the competitive landscape remains intense (reflecting the size of the prize) while the recent fall from grace of next-generation highflyer Metro Bank is a good reminder that technology is no substitute for balance sheet when it comes to banking.

The last word is reserved for artificial intelligence (AI) following a year when companies across myriad industries embraced AI-infused automation. Investors followed suit, pouring more than $18bn into AI companies, a 24% y/y increase. Adoption is being primarily driven by a step function improvement and cost of ML due to both silicon and system level innovation. While artificial general intelligence (AGI) remains a long-term goal, significant progress has been made in specific task solving, so-called narrow AI. As such, healthcare/digital health look more attractive potential areas with Amazon's acquisition of PillPack reigniting the debate about potential disruption to healthcare, an industry expected to produce data at 48% CAGR through 2020. Early-stage drug discovery is another key AI application designed to reduce the risk of failure and minimise costs - the average cost of bringing a drug to market is said to be $2.2bn. In the field of radiology, AI may offer a solution to the problem faced by the average radiologist that needs to interpret an image every three or four seconds for eight hours a day resulting in an error rate said to be as high as 30% even if only images that show pathological changes are considered in the error analysis. Only time will tell whether a 169-layer convolutional neural network (CNN) can diagnose pneumonia from chest X-rays better than radiologists.

Regulators have been very supportive so far, with the FDA fast-tracking approvals of AI-driven clinical imaging and diagnostics. while making the regulatory framework more flexible to accommodate rapid AI improvement. AI enablers are likely to continue to benefit from the deployment of AI infrastructure so expect Alphabet, Microsoft and Alibaba to derive meaningful revenue from 'AI as a service'. However, we also remain focused on trying to find companies where AI can have a significant impact on the business model in time. During the past year we initiated a position in Shimadzu, a Japanese analytical instrument supplier which is working with Fujitsu to incorporate AI into its latest mass spectrometer. By applying deep learning to more than 30,000 images, the equipment can automate the peak picking process with the same accuracy as an operator with over 10 years' experience but shrink detection time from two hours to several seconds. Thankfully neither Shimadzu nor Fujitsu appear to have any immediate plans to enter the fund management industry.

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Leasing

(compare leasing funds **here**)

Robin Hallam, chairman of Amedeo Air Four Plus:

The key development during the period was the announcement on 14 February 2019 that Airbus will close production of the A380 in 2021. This development means that the total production run for the aircraft will be around 250 units, almost half of which will be operated by Emirates (with whom the company has six A380s on fixed-term leases). The A380 remains a unique double-decker aircraft in that it has the capability to carry over 500 passengers on two decks and this can help facilitate growth at slot-constrained airports around the world. The announcement by Airbus has no direct impact on the company's leases nor its ability to pay targeted distributions. The company's first lease expiry does not fall due until 2026. While the A380 forms approximately two-thirds of the group's portfolio by appraised value, the portfolio is complemented and diversified by two additional aircraft models, namely the B777-300ER and A350-900. The company's share price fell sharply on the day of the Airbus announcement, having demonstrated little volatility since launch in 2015 and currently resides at 91.25 pence at the time of writing. However, during the year the company has continued to declare quarterly dividends of 2.0625 pence per share, representing a yearly distribution of 8.25 pence per share and your board is hopeful of continuing to pay such dividends for the foreseeable future.

With respect to new transactions the landscape remains much as I described in my statement accompanying the most recent half-yearly report. It is pleasing to consider that aircraft investment is gaining traction with investors as a more traditional asset class, but the challenge of securing high-quality transactions that will maintain the company's existing sterling denominated dividend target and double digit total return target mean your board has not been able to recommend any new transactions for shareholders to consider. Having discussed the recent pace of growth with shareholders and the company's advisors I continue to believe that we should be patient and exercise discipline with regard to future growth. I continue to encourage Amedeo to source potential future transactions and to work with Nimrod in evaluating their suitability for shareholders. During the period each of our lessees has continued to meet its obligations and so dividends have been maintained at the targeted level.

IATA economic analysis

Annual growth in industry-wide revenue passenger kilometres (RPKs) started 2019 positively, rising by 6.5% y-o-y in January, its fastest pace over the past six months. The seasonally adjusted upward trend in RPKs accelerated in January but it is too soon to think that this represents a change in trend.

Available Seat Kilometres (ASK) grew by 6.4% y-o-y in January, very similar to the RPK growth pace. Load factors remained at 79.8% from last year. The Latin American region recorded the highest passenger load factors during January (82.5%), followed by Asia Pacific (81.0%).

European airlines showed the fastest growth in International passenger demand in January: 7.7% y-o-y. European RPKs show a slower pace than in previous months due to the uncertainty of its economic growth caused by Brexit. Asia Pacific airlines follow closely, showing a 7.1% y-o-y increase in January for international RPKs, a considerable improvement from 5.0% in December 2018. The region's upward trend slowed down over the third quarter of 2018 mainly due to natural disasters that had an impact on air traffic. However, demand recovered rapidly. The characteristic strong demand in the region has been backed by the recent increase in connecting airport pairs and the rise in household income across the middle class.

Middle-East RPK growth became positive again in January, as carriers based in the region flew 1.5% more international RPKs than a year ago, recovering from flat growth seen during the end of 2018.

IATA shows cautious optimism for 2019 due to lower oil prices and a solid but slower economic growth. IATA forecasts that 2019 will be the tenth consecutive year of profit and the fifth year that airlines deliver a return on capital that exceeds the industry's cost of capital, creating value for its investors.

Doric GmbH, manager of Doric Nimrod Two:

Market Overview

Following a moderation over the second half of 2018, industry-wide passenger traffic, measured in global revenue passenger kilometres (RPKs), ended the calendar year with an average growth rate of 6.6%. According to the International Air Transport Association (IATA), the slowdown in RPK growth corresponds to ongoing concerns about future global economic expansion. However, RPKs in January grew by the fastest pace since mid-2018 (6.5%). This result lies between the average RPK growth rate seen over the past decade (6.1%) and five-year historical average (7.1%). IATA states that recent developments remain consistent with its forecast passenger growth rate of 6.0% for 2019. Industry-wide capacity, measured in available seat kilometres (ASKs), increased by 6.1% in 2018. This resulted in a 0.3 percentage point increase in worldwide passenger load factors (PLFs) to 81.9%. With the PLF at 79.6% in January, the load factor was essentially unchanged from the same month the year before.

Passenger traffic in the Middle East grew by 4.0% in 2018. This was outpaced by a 4.9% increase in capacity, leading to a 0.6 percentage point decrease in PLF to 74.8%. However, following the adverse impact of a number of policy measures and geopolitical tensions in recent years, IATA notes that a healthy recovery in RPK growth commenced early in 2019 with passenger traffic up 1.5% in January compared to the same month in the year before, after flat growth was observed toward the end of 2018.

Asia/Pacific-based operators remained the top performers in overall market demand in 2018 as RPKs increased by 8.6% compared to the previous year. Europe ranked second with 6.7% followed by Latin America with 6.2%. North America saw an increase of 5.0% while Africa had the slowest growth

Lessee - Emirates Key Financials

The 2018/19 financial year, ending on 31 March 2019, marked the 31st consecutive year of profit for the airline. With a net profit of AED 871m (USD 237m), the bottom line was down by 69% compared to the previous financial year. This decline in net profit came despite an increase of 6% in revenue to AED 97.9bn (USD 26.7bn). Due to a combination of high fuel prices, intensified competition in the lessee's key markets, and an unfavourable currency impact, the airline saw its profit margin decrease to 0.9%, down from 3.0% in the previous year. The past financial year "has been tough, and our performance was not as strong as we would have liked", said His Highness Sheikh Ahmed bin Saeed Al Maktoum, chairman and chief executive of Emirates Airline, commenting on the latest results. He further noted that Emirates' regional competitors "one-point business plan" was "*to always undercut Emirates' fares at all cost*s". The lessee tried to avoid engaging in price wars and was focused "*to improve yield, even if it meant conceding market share*".

Emirates' overall passenger number remained flat during the 2018/19 financial year with the airline carrying 58.6m passengers, with a share of 41% flying on an A380. Passenger traffic, measured in RPKs, increased by 2.7%, while capacity, measured in ASKs, grew by 3.6%. This resulted in a passenger load factor of 76.8% compared to last year's 77.5%. The high seat factor on the A380 fleet continues to demonstrate the customer preference for the A380, according to the annual report.

During the 2018/19 financial year, Emirates added 13 new aircraft to its fleet: seven Airbus A380s and six Boeing 777-300ERs, including its last of the 777-300ER type before the first Boeing 777X is scheduled to arrive in 2020. Only one of the aircraft, which joined the fleet, was on an operating lease. The carrier also withdrew 11 aircraft from its fleet, leaving the fleet count (including 12 freighters) at 270 as of 31 March 2019. This fleet roll-over resulted in an average fleet age of 6.1 years, an increase of five months compared to the end of the previous financial year.

Aircraft - A380

As of mid-March 2019, the global A380 fleet consisted of 230 commercially operated planes in service. The fourteen operators are Emirates (109), Singapore Airlines (19), Deutsche Lufthansa (14), Qantas (12), British Airways (12), Korean Air Lines (10), Etihad Airways (10), Air France (10), Qatar Airways (10), Malaysia Airlines (6), Thai Airways (6), Asiana Airlines (6), China Southern Airlines (5) and Hi Fly (1). Another two are listed as in storage. In addition, two A380s are earmarked for part-out after the owners of the aircraft voted for such a solution.

In February 2019, Airbus announced that it will discontinue its A380 programme in 2021, following a revised agreement with Emirates under which the airline is cutting its A380 order total from 162 to 123 aircraft - leaving just 14 to be delivered to the airline. Another two aircraft will be delivered to All Nippon Airways (ANA) with the airline having taken delivery of its first A380 on 21 March. Therefore, a total of 251 A380s will now ever be manufactured. According to its departing CEO Tom Enders, Airbus no longer has a "*substantial A380 backlog and hence no basis to sustain production*". Enders added that - notwithstanding the upcoming production end - Airbus will "*continue to fully support the A380 operators*".

Qantas has stated that it remains committed to the 12 superjumbos already in its fleet over the long-term with cabin refurbishments scheduled to commence mid-year.

Air France intends to return three A380s upon expiry of their leases in 2020-2021 and is currently reviewing the status of another two leased A380s. The move comes as part of a fleet optimisation programme and will reduce the number of Airbus A380s from the 10 it currently operates. The remaining A380s will begin retrofitting from 2020 onwards.

Qatar Airways CEO Akbar al-Baker announced that the airline intends to phase out its A380 fleet from 2024. The start of the phase-out coincides with the 10-year anniversary of the A380 at Qatar Airways, which received its first superjumbo in 2014.

Lufthansa disclosed that it will sell six of its 14 A380 jets back to Airbus in 2022 and 2023. The buyback is reportedly part of an agreement between Airbus and Lufthansa group to order another 20 Airbus A350-900s.

It remains undisputed that the Airbus A380 is a niche asset in a class of its own from its inception. Due to the young age of the fleet the secondary market is yet to develop with the first second-hand A380 making its way to a new operator only a year ago. At this early stage and with only one transaction fully completed, the secondary market is still in its infancy. Whether or not all of the announced A380 returns from Air France, Lufthansa and Qatar will materialize, remains to be seen. In the meantime, potential operators have the chance to test the A380 via a wet lease arrangement over a limited period of time and without making any long-term commitments. This opportunity allows airlines interested in the A380 to explore the full potential of the aircraft and can create additional demand for second-hand equipment, once it becomes available

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Charles Wilkinson, chairman of Doric Nimrod Three:

The key development during the period was the announcement on 14 February 2019 that Airbus will close production of the A380 in 2021. This development means that the total production run for the aircraft will be around 250 units, almost half of which will be operated by Emirates. The A380 remains a unique double-decker aircraft in that it has the capability to carry over 500 passengers on two floors and this can help facilitate growth at slot-constrained airports around the world. It remains the case that a secondary market for the A380 has yet to develop and uncertainty over future residual values remain. Notwithstanding this, at the time of the announcement by Airbus, His Highness Sheikh Ahmed bin Saeed Al Maktoum, chairman and Chief Executive, Emirates Airline and group stated, "*For us, the A380 is a wonderful aircraft loved by our customers and our crew. It is a differentiator for Emirates. The A380 will remain a pillar of our fleet well into the 2030s*." More recently, the Emirates Annual Financial Report highlighted: "*We are strong believers in the A380 programme, despite Airbus' decision to stop production in 2021*." The announcement by Airbus has no direct impact on the group's leases nor its ability to pay targeted distributions. The group's lease expiries do not begin to fall due until August 2025. Furthermore, the group's debt structure is such that all debt liabilities will be fully paid off at the end of the ultimate lease (subject only to the continued solvency of Emirates) at which point the aircraft will be unencumbered.

Nonetheless, the directors note that following the 14 February 2019 announcement by Airbus regarding the cessation of the A380 programme in 2021, there has been a broadening of opinion between the group's three independent appraisers with regard to the asset appraisal values as they each continue to assess the consequences, positive and negative, of the Airbus decision.

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Infrastructure

(compare infrastructure funds **here**)

Manager's report for Sequoia Economic Infrastructure Income:

The company's focus is in economic infrastructure, which includes transportation, utility, power, telecommunication, renewable and other related sectors that exhibit infrastructure characteristics and typically have demand exposure. Sequoia believes that lending into these sectors is more attractive than lending into availability-based PFI/PPP projects, which are often hotly contested among lenders and therefore offer lower yields. Moreover, economic infrastructure projects usually have much more conservative capital structures than availability-based PFI/PPP projects, with equity cushions of typically 20-30% rather than 10%, and in Sequoia's opinion this compensates for the potentially higher revenue risk. Lending into the economic infrastructure sector has delivered an investment portfolio with equity-like returns but with the protections of debt, including lower volatility and less downside risk than equity. None of the loans or bonds acquired has defaulted and were selected, in part, based on their prospects for high recovery in the event of a default. Each loan and bond in the portfolio is to a borrower with an adequate equity cushion which helps to protect the company from credit losses. Sequoia believes that diversification is an important risk management tool for an infrastructure debt portfolio, since a large component of credit risk in infrastructure is idiosyncratic or project-specific risk and is typically not highly correlated to exogenous factors such as the broader economy. As such, a properly diversified portfolio ought to have a more stable performance than one which is concentrated in one jurisdiction or sector, e.g. a debt portfolio that was largely focused on financing UK renewable projects might be highly exposed to specific risks such as regulatory changes.

Outlook

Sequoia has developed a very strong pipeline of mostly private debt infrastructure lending opportunities, which are expected to become executable mostly over the next three to nine months. Pricing on these opportunities is consistent with the company generating a gross return in excess of 8%. The potential investments are widely spread across a range of sectors and jurisdictions. Sequoia is especially excited about potential investments in the renewables, accommodation and TMT (Telecommunications, Media and Technology) sectors where the current portfolio is arguably underweight, lending opportunities are often attractive and additional investments into these sectors would be desirable.

Sequoia expects project finance senior lending margins, especially in the UK and Europe and for "core" infrastructure projects and availability-based PFI/PPP projects to remain tight, driven by sustained commercial bank appetite for these types of assets and by increasing demand from institutional investors such as continental European insurance companies. However, spreads in the mezzanine market, and for senior debt in the US and some asset classes in the UK and Europe, are expected to remain more attractive.

Overall, the opportunity for the company in economic infrastructure debt is strong and the asset class remains under-invested and attractive.

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Gillian Nott OBE, chairman of Premier Global Infrastructure Trust:

Overview of the period

The global infrastructure sector has been a popular investment destination over the first half of the year, and has been one of the main beneficiaries of the changed interest rate outlook. As I note above, this has stretched valuations further. At the start of the year, the FTSE global core infrastructure 50/50 total return index traded on a price / earnings (P/E) multiple of 17.7x. By the end of June, this had expanded to 22.2x, so in essence the index performance can be put down to market movements rather than investment fundamentals.

The managers categorise the portfolio into three sectors: yield equities, growth equities, and yieldcos & investment companies. The first and third categories have gained along with markets, however the growth equities element, which contains most of the company's emerging market positions, has under-performed, and this has accounted like last year for the portfolio's underperformance against markets.

The growth equities sector has continued to see very strong earnings and dividend growth, yet trades on a deeply discounted rating. The managers remain committed to this sector and intend to maintain these holdings both for diversification and for the long term value opportunity they represent. It must however be recognised that these holdings, predominantly in emerging markets, can have volatile share prices, often not reflecting underlying performance.

Finally, the long term saga that is Brexit drags on. The managers, in response to the deteriorating sentiment around the UK situation, removed all currency hedges in early April, which has enabled the portfolio to benefit from the decline in sterling over the second quarter of the year. The absolute exposure to GBP-denominated companies was also reduced, although this was partly in response to heightened perceived political risks resulting from talk of potential renationalisation of UK infrastructure assets.

Outlook

As I discussed in my 2018 statement, on a fundamental basis, the board believes that Brexit is of relatively low importance to the company. However a satisfactory resolution could lead to an appreciation in sterling which would have a negative valuation impact on the portfolio. At the time of writing, however, the outlook is unclear and a solution appears far off.

There are a number of potentially destabilising forces at work in the global economy. Tensions in the Middle East, particularly relations between the US, UK and Iran, are increasing, although somewhat surprisingly, to date this has had a limited effect on commodities markets. Meanwhile the direction of travel in the standoff between the US and China remains unclear. However if the relationship improves between these two countries there is the potential for a beneficial effect on markets globally.

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Renewables

(compare renewables funds **here**)

Tim Ingram, chairman of Greencoat UK Wind:

Outlook

There are currently 22GW of operating UK wind farms (14GW onshore plus 8GW offshore). In monetary terms, the secondary market for operating UK wind farms is approximately £60bn. The group currently has a market share of approximately 4 per cent. The average age of the portfolio is 4.8 years, compared with 4.9 years at listing in March 2013.

In June, the UK parliament adopted a net zero emissions target for 2050, going further than previous legislation, which mandated 80 per cent emission reductions by 2050. decarbonisation of the electricity sector, primarily through renewable generation, will be critical to achieving this. The target is for 30GW of offshore wind capacity by 2030, supported by the CFD regime. We are also now seeing the development and construction of onshore wind farms on a subsidy free basis. We do not expect any material change to the company's business as a result of the UK exiting the European Union.

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

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Environmental

(compare environmental funds **here**)

Michael Naylor, chairman of Jupiter Green Investment:

Outlook

Over the last 12 months, we have seen a powerful confluence of health, environmental and public cost concerns. Concerns over waste and plastics, in particular, have taken centre stage. Many Asian countries have followed China's lead in closing their doors to waste coming from overseas, ostensibly to be recycled. The UK's new waste strategy is set to tackle how materials are designed, produced and used, as well as recycled. Similar initiatives are underway across developed and emerging countries, creating opportunities from sustainable packaging through to recycling technologies. For investors, this means a growth in opportunities to allocate capital to businesses at the forefront of the "circular economy", a theme that has been pursued for many years within the company.

Air pollution has also hit the headlines: a lancet countdown report indicated that pollution levels of 71% of the 2,971 cities studied exceeded World Health Organisation guidelines. For investors, the drive to tackle air pollution is creating a breadth of opportunities including: the suppliers of parts and technology to the makers of electric vehicles (EVs) and businesses that employ new technologies to reduce emission levels or enable greater fuel efficiencies.

Against this backdrop, it is no surprise that interest in sustainable forms of investing - environmental, social and governance (ESG) investing - has been expanding rapidly as younger generations demand more responsible corporate behaviour. Some of the world's biggest institutional investors continue to lead the way by allocating more of their funds in companies that score well on ESG criteria. Sapling vehicles for ESG investment also continue to grow, including climate bonds (or green bonds), whose proceeds are earmarked for use on assets or projects that help in the fight against climate change.

In keeping with this, the company continues to invest in businesses tackling some of the world's most urgent challenges including the quest for more sustainable consumption, energy-efficient transport, better pollutions control and testing, and more efficient water infrastructure. Many investee companies are at the forefront of evolving trends, such as in waste recycling and the development of circular economies.

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Commodities and natural resources

(compare commodity and natural resource funds **here**)

Ed Warner, chairman of BlackRock Energy and Resources Income:

Market overview

The first half of 2019 saw markets recover following the falls at the end of 2018, but returns from energy and resources stocks were mixed. The mining sector performed particularly well, with the EMIX global mining index returning +12.2%, in contrast to market falls in a pressurised energy sector. The MSCI world energy index fell by 3.7% over the six months under review. A 50/50 reference index (being an equal split of both the EMIX Global Mining index and the MSCI world energy index) returned +4.3% compared to a 2.6% return from the MSCI world all country index.

In the mining sector, outperformance was driven by credit stimulus in China which bolstered demand, combined with the Vale tailings dam collapse in Brazil which curtailed supply. The dam tragedy resulted in more than 5% of global iron ore supply being removed from the market and the iron ore price increasing by over 40%. In the energy sector, poor performance was triggered by the significant correction in the oil price towards the end of 2018. Although the price of oil rose in the first half of 2019, this did not translate into positive performance for energy equities; the exploration and production (E&P) sector fell by almost 20% over the period despite a degree of M&A activity.

Outlook

Market concerns over global economic growth and escalating trade tensions have created a challenging backdrop for the energy and mining sectors. Yet despite this, many mining and energy companies (particularly the larger capitalisation companies) represent a compelling investment opportunity, with high free cash flow yields and strong and well financed balance sheets. In the mining sector, the significant decline in capital expenditure in recent years has led to restricted supply which in turn has helped to push up prices and boost performance.

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QuotedData

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