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Monthly summary | Investment companies

February 2020

Economic & Political Roundup

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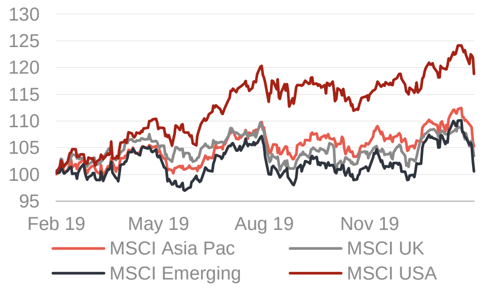
A collation of recent insights on markets and economies taken from the comments made by chairmen and investment managers of investment companies – have a read and make your own minds up. Please remember that nothing in this note is designed to encourage you to buy or sell any of the companies mentioned.

Exchange Rate	31/01/20	Change on month %
GBP / USD	1.3206	+0.7
USD / EUR	0.9015	+1.0
USD / JPY	108.35	(0.5)
USD / CHF	0.9634	(0.6)
USD / CNY*	6.9109	(1.0)

Source: Bloomberg, Marten & Co. *Note: USD / CNY rate as of 24/01/20 as a result of the Chinese lunar new year holidays.

MSCI Indices rebased to 100

Time period 01/02/2019 to 31/01/2020



Source: Bloomberg, Marten & Co

	31/01/20	Change on month %
Oil (Brent)	58.16	(15.0)
Gold	1589.16	+4.9
US Tsy 10 yr yield	1.5068	(19.8)
UK Gilt 10 yr yield	0.524	(39.6)
Bund 10 yr yield	(0.436)	+131.9

Source: Bloomberg, Marten & Co

Roundup

Global stocks began the year positively, carrying over momentum from the end of 2019, before waning following the coronavirus outbreak. The scale and impact of the virus remains unclear at this time and we note that most of the commentary from the chairs and managers enclosed was drafted before the outbreak.

Global

Global recession likelihood has been pushed out

Bankers's manager, Alex Crooke, says that while the outlook for the year ahead has improved in recent months much of this is priced into shares. He goes on to say that the supply of new equity remains low by historical standards and the wall of money that is committed by private equity investors must surely start to be deployed taking listed companies private. Elsewhere, Colin S McGill, chairman of BMO Managed Portfolio Growth/Income, says that action taken by central banks globally have had the desired effect and as a result, prospects for growth in 2020 have modestly improved such that the economic cycle appears likely to be extended and the chances of a recession pushed out until 2021 at the earliest.

UK

UK asset rally pauses as hard Brexit remains possible

The managers of Aberforth Smaller Companies and Aberforth Split Level Income say that expectations that the general election outcome would provide Boris Johnson with the parliamentary backing to cultivate a softer form of Brexit were thwarted after the government sought to make it legally impossible to prolong the transition period beyond December 2020. This has left a 'hard Brexit' on the table, giving sterling and UK equities pause for thought. Elsewhere,…

UK (continued)

…Neil Hermon, manager of Henderson Smaller Companies, says the UK economy has been flirting with recession. The political and Brexit uncertainty has weighed on consumer and business confidence, delaying and postponing investment and purchasing decisions, and dampening economic growth. While the exact nature of the future trading relationship with Europe is yet to be determined, Neil says it is hoped that now some of the uncertainty has cleared, the UK economy will strengthen, helped also by potential tax cuts and boosts to public spending.

Douglas McDougall, chairman of Independent, says that while there are plenty of other things to worry about, principally the terms of the UK's withdrawal, the non-election of Corbyn and a clear Conservative victory justifies a less cautious stance.

River and Mercantile UK Micro Cap's manager, George Ensor, believes that UK micro caps remain a fantastic opportunity and that the election outcome should provide encouragement for global investors to return to the market following a prolonged period of underperformance.

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North America

Over the next decade, technology will become ubiquitous and extend into all parts of society

The manager of Baillie Gifford US Growth looks forward to the next decade, focusing on technology, where innovation is the new normal. We are moving from the exploration age into the deployment age where new markets and business models that were created in the past decade will grow and become the new normal. Technology will become ubiquitous and extend into all parts of society. The manager says we will no longer talk about "internet-enabled" businesses, no more than we talk about "electricity-enabled" businesses.

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Asia Pacific

Many Chinese internet companies have been expanding into non-core areas, creating uncertainty over future returns

Commentary by Invesco Asia's manager, Ian Hargreaves, was released before the coronavirus outbreak. He notes that global growth has decelerated over the past eighteen months, with particular weakness in the manufacturing sector. There are several reasons for this: the lagged effect of China's earlier policy tightening; a weak auto cycle in many countries; and an inventory correction associated with the trade war. Ian says that the opportunity set increased in India due to the current economic slowdown. India offers one of the best structural growth stories in Asia supported by a government that is bringing about tangible structural change.

Thematically, the manager sees opportunities in companies that have a competitive edge in what they would consider the next technological wave after smartphones, including 5G, Artificial Intelligence, and the Internet of Things. On the subject of China's tech sector, Ian notes that while internet companies have generally been excellent investments, the past few years has seen management show a propensity for 'land grabbing', spending on new initiatives to improve their footprint in non-core areas including ecommerce, social media, gaming and other online services.

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Japan

Significant progress has been made in the areas of capital efficiency, corporate governance and shareholder returns

Harry Wells, chairman of CC Japan Income & Growth, reflects on Shinzo Abe becoming the longest serving Prime Minister in Japan's history. Harry says that while the jury will remain out for some time on the ultimate success of Abenomics, policy initiatives to reinvigorate and reform the economy, the significant progress in the areas of capital efficiency, corporate governance and shareholder return should be highlighted.

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Global emerging markets

Sentiment improved in India and Turkey over 2019

Ross Teverson and Charles Sunnucks, managers of Jupiter Emerging & Frontier Income, discuss a number of markets, including India and Turkey, where sentiment improved over 2019. In Argentina, where the trust has no direct exposure, international investors retreated when it became apparent that economic reformer, Mauricio Macri, would lose to a more populist and potentially fiscally profligate Alberto Fernandez. The managers continue to believe that emerging and frontier market equities have some of the most compelling bottom-up opportunities of any asset class.

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Russia

Dividend yields in Russia are significantly higher than for other emerging markets

Russia was one of the best performing markets in 2019. Oleg I. Biryulyov and Habib Saikaly, managers of JPMorgan Russian Securities, say that although the thorny topic of Russian sanctions did not disappear and remains fluid, optimism increased that the worst of this particular storm may have been weathered: there were no fresh sanctions from the United States this year so the spotlight of attention shifted to the Chinese-US wrangles, allowing Russian investment markets to progress relatively unhindered. The Russian economy still grew - albeit at a more moderate rate than last year, with negative sanctions noise and concerns over corporate governance both still casting a shadow.

Rising dividend payments from several of Russia's largest companies, as part of a broader transformation of distribution policy, have been significant drivers and dividend yields in aggregate are significantly higher than for other emerging markets.

The managers note that with local Russian investors becoming bigger participants in the equity market, they expect the hunt for income sourced from dividends to become more prevalent.

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Private equity

It is increasingly difficult to generate outsized returns in the large and mega-cap end of the buyout market due to asset-price inflation

The manager’s report for Standard Life Private Equity goes over the industry’s landscape, noting that the private equity asset class’s AUM has grown to a record high of around $3.4trn globally. The strong fundraising environment has led to record levels of ‘dry powder’. The US buyout market currently has around $410bn of uninvested capital committed, or over double the amount when compared to Europe.

The report goes on to say that asset-price inflation is a significant factor when considering new investments in today's market. Capital is continuing to flow mainly to managers focused at the large and mega-cap end of the market, pushing up valuations and therefore making it harder to generate outsized returns. By comparison, the European mid-market segment has not been accumulating dry powder at the same rate.

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Growth capital

The ratio of private money raised to public climbed to another high in 2019

The manager's report for Merian Chrysalis notes that in private markets, while they saw some anecdotal signs of risk contagion from public markets - such as pre-emptive capital raises - late last year, this receded quickly in 2019. We continue to see significant levels of activity in private markets and engagement with the company's investment proposition.

A theme discussed is the apparent disparity between the public and private fundraising environments. The manager believes secular trends are currently driving diminishing numbers of IPOs, as companies stay private for longer, but these appear to have been exacerbated by turbulent public market conditions. The difference in listing activity pre and post-2008 is stark, but in the year to 30 September 2019, the number of UK IPOs was nearly half that of the preceding eight years. When compared to public markets, this means the ratio of private money raised to public has climbed to another high.

Contents

Global

(compare Global funds **here**)

Alex Crooke, manager of Bankers:

Markets have a habit of discounting both good and bad news well before events unfold. So, while the outlook for the year ahead has improved in recent months much of this is priced into shares given market movements since our year end. We expect corporate earnings to resume growth on the back of a resolution of US trade discussions and greater certainty around the United Kingdom's status outside Europe. With little prospect of interest rates rising and further support from central banks, it seems likely that corporates will continue using cheap borrowings to buy ever more of their stock for cancellation. The supply of new equity remains low by historical standards and the wall of money that is committed by private equity investors must surely start to be deployed taking listed companies private. It is therefore not difficult to paint a positive story of increasing demand over supply.

Overall we see the supportive background for equities, both from a liquidity point of view and increased earnings, being countered by the elevated level of valuations relative to history.

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Flexible investment

(compare flexible investment funds **here**)

Colin S McGill, chairman of BMO Managed Portfolio Growth/Income:

It appears the actions taken by the US Federal Reserve and other central banks has had the desired effect and prospects for growth in 2020 have modestly improved such that the economic cycle appears likely to be extended and the chances of a recession pushed out until 2021 at the earliest. Whilst for most developed countries growth remains moderate by historic standards, inflation is subdued and interest rates will remain low. This is an encouraging backdrop for equity markets. Since the end of the period under review much has changed for the UK and following a decisive general election it appears the uncertainty caused by Brexit is likely to wane. Post the Brexit Referendum in 2016 the UK equity market has been out of favour with global institutions and has underperformed most other major markets. The UK equity market offers very attractive value not only relative to other global equity markets but also in a historical context. In this regard smaller companies or those with mainly domestic revenues could benefit most from a reduction of uncertainty and perhaps slightly better growth from the UK economy. Since the end of the period under review both new and existing holdings which have significant exposure in the areas identified above have either been introduced or increased.

Looking forward there are certain factors which could unsettle markets: China/US trade tensions being unresolved, or an EU/UK trade deal not being concluded. However, should the policy adopted by monetary authorities continue in the same vein, then that provides a positive background for equity markets to make modest progress.

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United Kingdom

(compare UK funds **here**)

Mangers of Aberforth Smaller Companies and Aberforth Split Level Income:

Experience should overcome surprise, but what a difference a year can make! As 2018 drew to a close, pessimism reigned as trade wars clouded the global outlook and the Brexit process was mired in uncertainty. Twelve months on, higher equity markets attest to a rediscovered optimism. The received wisdom is now that Donald Trump will act in a rational fashion to conclude a "great" deal with the Chinese as he enters the election year. At home, one of the extreme political outcomes has been avoided and the expectation in the immediate aftermath of the election was that Boris Johnson, now free of the Brexit hardliners, would use his majority to cultivate a softer form of Brexit. However, events quickly highlighted the risk of such assumptions, as the government sought to make it legally impossible to prolong the transition period beyond December 2020. With a hard Brexit still therefore on the table, sterling and UK equities have been given pause for thought.

The point here is less about the further twists and turns of share prices on the road to the UK's eventual relationship with the EU, or indeed to the US's eventual relationship with China – stockmarket gyrations of this sort are inevitable. It is more about the problems of an investment climate in which politics in general and the whims of individual politicians have so great an influence. Faith in the capabilities or good intentions of politicians is no substitute for a system in which the state plays a defined and understood role – whether American or Scandinavian in its reach – and lets other participants in the economy conduct their affairs accordingly. It may be argued that today's situation is effectively normality, with the exception being the "great moderation" of the two decades or so before the financial crisis. Either way, it might not be unreasonable to expect today's political uncertainty to be reflected in greater scepticism about the promises made by governments and in the valuations of assets particularly reliant on these promises. And yet, even as fiscal spending seems set to rise, vast swathes of even long-dated government bonds yield close to zero, which allows investment horizons to be generously extended to support the valuations of speculative growth companies.

However, as the closing months of 2019 showed, sentiment can turn quickly, while the tentative pick-up in M&A points to how some of the valuation anomalies will be rectified. The timing of such events is impossible to call.

Neil Hermon, manager of Henderson Smaller Companies:

The Conservative election victory has given a significant boost to the UK small and mid-cap equity market. The result has provided political clarity and removed the risk of a market unfriendly Corbyn government. It has also provided more certainty to our negotiations over Brexit. However, it is still unclear as to what our future trading relationship with Europe is and what trade deal can be negotiated.

The UK economy has been flirting with recession. The political and Brexit uncertainty has weighed on consumer and business confidence, delaying and postponing investment and purchasing decisions, and dampening economic growth. One would hope that now some of this uncertainty has cleared, the UK economy will strengthen, helped also by potential tax cuts and boosts to public spending.

Globally economic conditions are challenging. Europe, in particular, is showing signs of economic weakness. Trade tensions are providing additional negative commentary and the volatility of relations between the US and China is not helpful. However, recent progress on a stage 1 deal raises hopes that trade tensions can be de-escalated in 2020. After a rise in US interest rates last year, 2019 has seen that policy reverse although the commentary from the Federal Reserve would now indicate we are currently in a mid-cycle pause.

In the corporate sector, conditions are intrinsically stronger than they were during the financial crisis of 2008-9. Balance sheets are more robust and dividends are growing.

In terms of valuations, the equity market is now trading below long-term averages. M&A remains a supportive feature for the smaller companies sector. If corporate confidence improves, M&A will increase, especially as little or no return can currently be generated from cash and the cost of debt is historically low. We have seen significant interest in UK corporates from abroad and from private equity, and given the relatively low valuation of UK equities and a weak currency, we expect this trend to continue.

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Douglas McDougall, chairman of Independent:

One of our major concerns throughout the financial year was the risk of adverse political developments. The prospect of continuing stalemate or, worse still, the election of a left wing Labour government tended to overshadow our enthusiasm for the companies in which we are invested. The election of a Conservative government with a substantial majority shortly after our year end has dispelled this concern. There are, of course, plenty of other things to worry about - not least the terms on which we exit the EU - but we believe that the removal of a major worry justifies a less cautious stance.

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George Ensor, manager of River and Mercantile UK Micro Cap:

Geopolitical wrangling has dominated the market backdrop over the last twelve months. The US-China trade war is now clearly having an impact on the US economy with weak business investment, driven by falling CEO confidence, and the manufacturing sector in recession whereas US stock markets remain sanguine with the S&P 500 just 2.1% from its all-time high at the end of September. Eurozone manufacturing has also been in contraction for much of 2019.

Whilst the result of the General Election does not provide answers to our future trading relationship with the EU, or indeed any other trading partner, the relative political stability of a Conservative government with a large majority should provide encouragement for global investors to return to the market following a prolonged period of underperformance. This underperformance has been particularly acute for small and micro cap indices, with several factors likely contributing. One being the greater exposure within smaller companies to the domestic economy; and so a greater exposure to the uncertainty and a lesser exposure to the benefits of the weakness in sterling which has boosted international earners. A second factor is the increased focus on liquidity in the aftermath of high profile daily dealing funds suspending redemptions which has created an aversion to illiquidity.

Outlook

It has been a frustrating year with strong underlying progress in some stocks not being recognised and any disappointment being punished. It is our opinion, supported by long term trends, that this is cyclical not structural, and the UK micro caps remains a fantastic source of idiosyncratic risk.

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North America

(compare North American funds **here**)

Manager's report for Baillie Gifford US Growth:

As we reflect on the previous decade and look towards the next, we remain optimistic on the potential for technological progress to power sustainable increases in share prices. We are moving from the exploration age into the deployment age where new markets and business models that were created in the past decade will grow and become the new normal. Technology will become ubiquitous and extend into all parts of society. We will no longer talk about "internet-enabled" businesses, no more than we talk about "electricity-enabled" businesses. This will become table-stakes and embedded in our expectations. The technology is maturing, but the opportunity is only beginning. As technology becomes ubiquitous, so will innovation itself. Innovation is the new normal.

Asia Pacific

(compare Asia Pacific funds **here**)

Ian Hargreaves, manager of Invesco Asia:

Market review

Asian equity markets have fallen back slightly over the past six months, twice recovering from sell-offs triggered by the see-saw nature of US-China trade negotiations which have rumbled on in the background. Civil unrest in Hong Kong and trade tensions between South Korea and Japan have added to geopolitical uncertainty in the region. Recent news flow has turned more positive, with a 'phase 1' US-China trade deal appearing within reach.

Meanwhile, the US Federal Reserve System (the Fed) has twice cut interest rates, assuming a more dovish policy stance given the lack of inflationary pressure and a weakening outlook for global growth. Asian central banks have also been cutting interest rates, which combined with policy stimulus measures such as India's corporate tax rate cut, should support growth. China's economy appears relatively robust, but has continued to slow, in part a result of the authorities' reluctance to resort to significant stimulus measures that might jeopardise progress made in deleveraging and reducing financial risk in the economy.

While US-China trade tensions have been a source of uncertainty for Asian manufacturers, Taiwanese technology companies were amongst the best performing stocks in Asia over the period, buoyed by an improvement in the growth outlook for electronic components. …benefiting from Chinese telecom equipment makers swift momentum in shifting development of their telecommunications infrastructure towards 5G. Expected adoption of 5G by mid to low-end smartphones has also lifted earnings growth expectations. We appear to be nearing the bottom of the downturn in the memory chip cycle.

The challenging global macroeconomic backdrop and the Fed's decision to shift back to a more accommodative monetary policy allowed Asian central banks to cut interest rates without compromising their currencies. State-owned banks in India continue to be constrained by asset quality problems and weak balance sheets, while the expansion of non-banking financial companies has been hampered by higher wholesale funding costs due to funding pressures.

Outlook

Global growth has decelerated over the past eighteen months, with particular weakness in the manufacturing sector. It is now undershooting relatively solid final demand growth in the developed world. There are several reasons for this: the lagged effect of China's earlier policy tightening; a weak auto cycle in many countries; and an inventory correction associated with the trade war. Companies are not willing to hold high inventory when there is so much uncertainty about tariffs, and at the same time, they remain cautious about making investment decisions in their businesses.

The geopolitical outlook remains clouded, but with the potential for some improvement in trade and many parts of the world now pursuing more supportive policy measures, we would expect to see economic fundamentals start to bottom out and the divergence between manufacturing output and final demand begin to reverse. This is important for Asia as earnings revisions tend to be correlated to the global manufacturing cycle. As the outlook for earnings improves, this should support Asian equity returns.

Any improvement in growth momentum would help the valuations of banks where concerns about asset quality has led to a de-rating, particularly in countries such as Korea, Thailand and Indonesia.

Although a recovery is likely, it may be more gradual than in previous cycles as China is not easing as aggressively as it has done during past slowdowns. The authorities have shown more discipline in attempting to strike a balance between maintaining an acceptable level of economic growth whilst managing financial risk. As such, we believe it is important to retain a well-balanced portfolio by having exposure to companies that are less sensitive to the global manufacturing cycle.

Fortunately, opportunities have emerged in India due to the current economic slowdown. India offers one of the best structural growth stories in Asia supported by a government that is bringing about tangible structural change. Historically, it has been a challenge to find undervalued investment opportunities in high quality well-run businesses. However, recent market weakness in the mid-cap space has led to several new opportunities.

Companies that have a competitive edge in what we would consider the next technological wave after smartphones, including 5G, Artificial Intelligence, and the Internet of Things, are an important theme in the portfolio. Asia is home to companies that can benefit from semiconductor proliferation as the trend is towards more processing and storage of data from an increasing number of connected smart devices with 5G at its core.

Chinese internet companies have generally been very good long-term investments. However, in the past few years management have shown a propensity for 'land grabbing', spending on new initiatives to improve their footprint in non-core areas including ecommerce, social media, gaming and other online services. This has had the effect of diluting their overall profitability. There are signs that this is improving, and we favour companies that are showing more discipline than the market is giving them credit for.

Finally, we believe there is an impressive trend of greater capital discipline being displayed by companies across the region, with strong balance sheets and improving free cash flow generation, which we seek to capitalise on. This is an important feature of the portfolio, maintaining high exposure to heavily cash-backed businesses with strong free cashflow generation and offering the potential for dividend growth. This is prevalent within the technology sector in Taiwan and Korea as well as the consumer sector in China. Selected financials across Asia are very well capitalised which should leave them relatively protected in a period of softer global interest rates.

Japan

(compare Japan funds here)

Harry Wells, chairman of CC Japan Income & Growth:

On 20 November 2019, Shinzo Abe became the longest serving Prime Minister in Japan's history. This is notable not just because of the length of his service but also the stability this has offered during a period of an increasingly uncertain political environment around the world and also Japan's recent history which saw six Prime Ministers in as many years prior to his appointment in December 2012.

While the jury will remain out for some time on the ultimate success of his Abenomics policy initiatives to reinvigorate and reform the economy, the significant progress in the areas of capital efficiency, corporate governance and shareholder return should be highlighted. These trends are particularly relevant to the philosophy of the manager and the investment case for Japanese equities. There are quantifiable improvements. Return on Equity has doubled for all listed constituents from under 5% to 10.8% between FY12 and FY18. The percentage of Tokyo Stock Exchange 1st Section companies appointing outside independent directors is now 93%, up from 17% in 2012. There is a consistent increase in the total dividends paid from Y6.8 trillion in FY2013 to Y15.0 trillion in FY2019. The corporate sector in Japan has aggregate cash balances of Y240 trillion (US$ 2.2 trillion), which underscores the potential.

Japan's Stewardship Code was adopted in 2014 and revised in 2017, while their Corporate Governance Code was adopted in 2015 and revised in 2018. These initiatives have been integral to the positive developments by encouraging dialogue between investors and corporate managers that were not previously evident and is continuing to reap benefits. Cross-shareholdings continue to fall and there has been an acceleration in the unwinding of the parent/subsidiary listing relationship through consolidation or sale, which enhances business focus, decision making and capital allocation.

The clear conclusion from these initiatives and the ongoing discussions is that these improvements are here to stay and have established a foundation for the next leg of progress. The recent slowing of economic growth has not tempered the enthusiasm for change. It is particularly encouraging that corporate managers are demonstrating a commitment to the stability of dividends over time despite earnings volatility and also demonstrating a more flexible approach to share buybacks in order to achieve greater capital efficiencies. The increase in share buybacks over the last twelve months (almost 100% year-on-year, as equity valuations have fallen), is a notable feature of recent market dynamics and a commendable response to any weakness in share prices.

These improvements will feature prominently amongst Prime Minister Abe's legacy achievements. The framework created through the introduction of the codes of behaviour, market index creation and law revisions will ensure that the improvements will be maintained well beyond his tenure. The manager believes that the favourable characteristics will continue to be recognised by domestic and international investors and should ensure that they are able to differentiate between long term investment opportunities and short term market trends.

Some disquiet has arisen as a result of recent moves to restrict stock activists. Private equity firms have been very busy in Japan. The Japanese parliament (Diet) has amended the Foreign Exchange and Foreign Trade Act to introduce pre-filing requirements for foreign investors wishing to purchase stakes in certain business sectors deemed of "national security". The Government Pension Fund has also announced that it will cease its stock lending programme which as a major holder of equities will curtail the activities of short sellers. These moves may have affected sentiment but are largely irrelevant to our manager in the execution of our investment process.

Perhaps the 2020 Tokyo Olympics will act as a catalyst for investor interest in Japan. Additional fiscal stimulus announced in December 2019 is positive and more than offsets the apparently negligible effects of the increase in the Government Sales Tax. Recently, foreign investors have turned net buyers of Japanese equities after nearly two years of net selling. It seems bizarre that domestic savings continue to have an obsessive appetite for foreign high yield products with inherent currency risk, when it is possible to invest in a basket of leading domestic companies offering yields of over 4%. Indeed, the yield on the TOPIX exceeds that of the S&P 500.

A US - Iranian war would undermine confidence in world equity markets, besides driving oil prices higher, in itself a negative for Japan as an oil importer. We must hope that diplomatic efforts to calm a dangerously unstable Middle Eastern situation will prevail. Any improvement in China / US trade relations would be a positive catalyst for Japanese equities.

Global emerging markets

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

Ross Teverson and Charles Sunnucks, managers of Jupiter Emerging & Frontier Income:

Market Review

Over the period, trade tensions between the US and China, as well as elections in markets from Argentina to India, generated volatility within emerging and frontier markets. We have experienced several false dawns in the ongoing US-China trade dispute, and we have seen that a single tweet by President Trump on the topic can trigger large swings in markets. Given that we are unable to claim any great insight into how US-China negotiations might play out, we have avoided trying to pre-empt developments on this front, preferring as always to stick to stock selection, rather than taking a top-down view. It is worth noting, however, that our bottom-up-driven approach to portfolio construction has led to a portfolio that has a significantly lower weighting in Chinese companies compared to the benchmark and most other emerging market funds.

During the period, investors' confidence in the Turkish economy began to recover and the Turkish Lira regained some of the ground it lost in the previous year. In India, Narendra Modi's re-election as Prime Minister, and a subsequent reduction in corporate tax rates, were taken positively. By contrast, international investors retreated from Argentina when it became apparent that economic reformer, Mauricio Macri, would lose to a more popularist and potentially fiscally profligate Alberto Fernandez. The company avoided the fallout in Argentina, as we have no direct exposure to the country.

Towards the end of the company's financial year, Hong Kong and Chile made the headlines because of mass protest movements and sporadic violence.

The volatility that characterised markets for much of the period belied the strong and consistent operational performance delivered by many emerging and frontier market companies.

Outlook

We continue to believe that emerging and frontier market equities have some of the most compelling bottom-up opportunities of any asset class. We remain mindful of the fact that further developments in US- China trade talks and ongoing unrest in Hong Kong will continue to influence investor sentiment. However, what we consider to be more important is that at a portfolio level, operational progress remains broadly encouraging throughout, even in markets where economic activity has weakened.

Russia

(compare country specialist: Europe – ex UK funds here)

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

Global economic backdrop

The health of the broader global economy dominated minds over the year to 31st October 2019, with a marked economic slowdown and ongoing political and geopolitical upheaval creating an uncertain environment for investors. The year was characterised by a cavalcade of global issues rather than local ones. In Russia, the economy still grew but at a slower pace. The ongoing trade wrangles between China and the United States dominated news flow, although the shift in US monetary policy, the strength of the US dollar and the trajectory of oil price movements were also significant influencers. Although the thorny topic of Russian sanctions did not disappear and remains fluid, optimism increased that the worst of this particular storm may have been weathered: there were no fresh sanctions from the United States this year so the spotlight of attention shifted to the Chinese-US wrangles, allowing Russian investment markets to progress relatively unhindered.

Economic growth was fragile across most of the world. The Russian economy still grew - albeit at a more moderate rate than last year, with negative sanctions noise and concerns over corporate governance both still casting a shadow. However, there are tentative signs of recovery, with more recent stability in oil and currency prices positive indicators. Rising dividend payments from several of Russia's largest companies, as part of a broader transformation of distribution policy, have been significant drivers and dividend yields in aggregate are significantly higher than for other emerging markets. Energy giant Gazprom soared this year, as we will discuss later, and its enhanced dividend policy announcement was the key.

Oil prices, so pivotal to the fortunes of the Russian economy, trended lower: the average price of Brent crude oil over the review period was US$56 compared with US$65 for the company's previous financial year.

Whilst it is true that domestic consumption is likely to be constrained by relatively low incomes in the short-term and that the rouble could remain weaker than it should be (in the aftermath of sanctions) these factors do not deter stock pickers like ourselves. We can counter any negative and uncertain conditions by sticking to quality and income-generating businesses and by prioritising exporters that can source growth opportunities from elsewhere in the world over domestic names where we are underweight.

Although global trade fears cast their shadow over the whole of the company's review period, sentiment did improve somewhat after the US Federal Reserve led other central bank policy makers in changing direction and cutting interest rates. Russia's central bank followed suit, cutting rates four times so far in 2019, in an attempt to offset other risks, kick-start the economy and reduce household bills. Despite this, consumers and businesses remained risk-averse and wary on the uncertain economic outlook.

Market review: Russian markets make considerable progress

Against this uncertain macro backdrop, and a deteriorating global economic outlook, Russian stock market valuations defied expectations, outperforming their emerging market peers by a considerable margin. Returns were amongst the biggest anywhere in the world, with high and increasing dividend yields a real attraction for investors seeking higher-paying assets.

Outlook

The risks of slowing global growth, trade tensions and a stubbornly strong US dollar are lingering concerns, but central banks may be able to offset these risks with further interest rate cuts, which have gathered pace in Russia and around the world in 2019.

Looking ahead, our views have not changed materially since we wrote to shareholders in June. We continue to believe that the market in Russia provides a good long-term investment opportunity, particularly if sentiment towards Russia becomes more positive. We expect to see:

- Firmer oil prices in 2020, driven by production cuts and politics, which will be positive for the earnings of Russian companies.
- The Central Bank of Russia reducing its key interest rate (currently 6.5%) by a further 1 to 1.5% over the next 18 months in order to stimulate spending and investment. This would buoy the market and, notwithstanding unforeseen political/economic concerns, the Central Bank is targeting a 2.5-3% gap with the US Fed's key interest rate. The rouble is likely to appreciate moderately in such an environment but not to the extent that it would impact exporters.
- Deflationary pressures remaining in 2020, following the fall in Russian inflation in 2019. However, we also expect to see some green shoots of economic growth appear on the back of the Central Banks's monetary policy.
- After an overall positive 2019, starting from a higher base in 2020 will make earnings growth more challenging. It is feasible that the majority of returns will be driven by dividends which provides valuation support and, in this world of low interest rates, this is something we expect markets will appreciate over the coming year.
- The environment around sanctions remaining fluid, and we will continue to monitor the situation. Economic links with the European Union will be pivotal to resolving the Russia-Ukraine stalemate and a 'Minsk treaty' now looks a realistic prospect, as Ukraine's recently elected president has started to support the idea. Alongside this, EU links with Russia are improving: France is pushing fellow EU members to rebuild economic relationships with Russia while German companies have started to attend economic forums in Russia, after a five-year absence.

We believe the fundamentals for investing in Russia remain attractive for those investors prepared to take the risk. With local Russian investors becoming bigger participants in the equity market, we expect the hunt for income sourced from dividends to become more prevalent.

Private equity

(compare private equity funds **here**)

Manager's report for Standard Life Private Equity:

Private equity market review

Over recent years there has been a marked shift towards the private equity asset class (buyouts, growth and venture capital), resulting in assets under management growing to a record high of c.$3.4 trillion globally. In the US for example, the number of PE-backed companies increased by 106% between 2006 to 2017 around 4,000 to over 8,000. In contrast, according to the McKinsey Global Private Markets Review 2019, the number of US publicly traded firms fell by 16% over the same time period to around 4,300 (and by 46% since 1996). Investors who invested in private equity through and after the global financial crisis have generally achieved strong returns, driving further interest in, and growth of, the market. Whilst the total market value is at a high relative to historical levels, it remains relatively small in comparison with traditional asset classes.

Private market activity

Total transaction values in 2018 broke post-financial crisis levels in both Europe and North America, driven by the large/mega-cap segment (deals of over €1bn). The first half of 2019 saw subdued levels of activity, particularly when compared with the same period in 2018. The large/mega-cap segment was also significantly down across both markets on the 2018 peak but ahead of the level of activity in the second half of 2018 in Europe and broadly in line with long-term, post-crisis levels.

Exit activity has remained buoyant over the last 10 years. Activity peaked in 2014/15 as private equity managers took advantage of a relatively stable market backdrop to realise their remaining pre-crisis portfolios. Trade acquirers, taking advantage of cheap corporate debt and pricing-in synergies, have been particularly active in recent years, consistently representing the majority of exit value. The first six months of 2019 saw a reduction in exit activity, possibly as buyers became more cautious in anticipation of a potential economic slowdown.

Fundraising and dry powder

In recent years, we have seen increased levels of capital attracted to the private equity asset class. This is due to a combination of long-term outperformance compared to public markets, high levels of cash distributions relative to historical trends and the search for strong returns in an expected low-growth environment. This has led to a fundraising environment at its most buoyant since the global financial crisis in 2008. The best performing managers across all size segments are continuing to attract capital and are raising new funds relatively easily.

The strong fundraising environment has led to record levels of dry powder. The US buyout market currently has around $410bn of uninvested capital committed, or over double the amount when compared to Europe. In both the US and Europe, the increase in dry powder has been primarily driven by larger funds (above $5bn in size). In contrast, mid-market levels remain relatively consistent on both sides of the Atlantic. The company's core focus remains in the mid-market segment.

Entry pricing and leverage

Overall, pricing levels remain relatively high when compared to the 10 year averages. Mid-market transactions are taking place at an average of around 9x EBITDA in Europe which represents a significant discount to the larger European buyout space, which saw an average entry multiple of 11x EBITDA in 2018. Average multiples in the large/mega-cap segment have consistently exceeded 10x EBITDA since 2014. The trend is similar in the US market.

Leverage multiples have also edged higher since 2009 due to improved debt availability. However, "covenant-lite" structures are becoming increasingly common and equity as a percentage of enterprise value remains high compared to pre-crisis levels. These factors are expected to provide managers with a greater level of capital structure resilience and flexibility if there were short-term trading challenges or an economic downturn. We view this as one of the industry's key lessons learned from the last financial crisis.

Secondary investment market

The development of the secondary market, whereby positions in established funds are bought and sold, has accelerated in recent years, with a combination of strong pricing, buoyant fund-raising and innovation in deal types driving record levels of deal volume.

According to figures from Greenhill, deal volumes for the first half of 2019 were around $42 billion, up 56% on the same period last year. Strong momentum has continued into the second half of 2019, such that deal volumes for the full year are expected to exceed the record level of $74bn achieved in 2018. Activity levels have been boosted notably by an increase in larger deals (those of over $1 billion) and the growth in manager-led transactions, which include liquidity offerings, fund restructurings and spin-out deals.

Co-investment market

The co-investment market has continued to grow driven by a shift in investor demand towards more direct private equity products. Whilst co-investments can add single company concentration and therefore risk, appropriately sized investments can be accretive to performance. Investors are attracted to co-investment by its core advantages relative to fund investment; having greater control of investment selection and the lower level of fees.

Outlook

Current macroeconomic risks to private equity returns include US-China tensions, Brexit and the threat of a recession. Private equity is subject to the same risks as the wider market but has shown resilience versus other asset classes in the past and has consistently outperformed the listed markets throughout economic cycles. We expect this relationship to persist into the future.

We remain confident that private equity markets offer continued opportunity for value creation. Private equity managers are proving to be astute stewards of a diverse spectrum of companies, and market forces mean that these assets can, and likely will, stay in private hands for longer (as the number of publicly-listed companies continues to shrink). The best private equity managers can support the growth and development of emerging small and mid-market companies, whether that is in terms of ESG, digitalisation, operational improvement, professionalisation, innovation or internationalisation.

We recognise that the private equity market is currently very competitive due to the record levels of dry powder. Asset-price inflation is a significant factor when considering new investments in today's market. However, the weight of capital continues to flow primarily into those managers focused at the large and mega-cap end of the market, pushing up valuations in that segment to what we consider to be relatively expensive levels and making it harder to generate outsized returns.

By contrast, the company continues to focus on the mid-market segment in Europe, which is not accumulating dry powder at the same rate as the large / mega-cap space. Furthermore, the mid-market remains a deep and fragmented pool of investment opportunities with greater potential for sensible pricing and more rapid value creation. We continue to believe that strong, attractive returns will be driven by mid-market private equity managers that exhibit differentiated deal sourcing and value creation capabilities.

Growth capital

(compare growth capital funds **here**)

Manager's report for Merian Chrysalis:

Market review

The stock market has been volatile over the period, with the S&P 500 - and other major indices - falling sharply in Q4 2018, as investors fretted about slower economic growth, rising interest rates, global trade and a hard Brexit. A series of profit warnings from high profile stocks such as Apple and NVIDIA also led to increased uncertainty in the technology sector and prompted a sell-off in growth stocks.

Equities staged a recovery into Q1 2019 and have held onto gains, despite mixed political and economic backdrops. Indeed, UK shares have performed well since the start of 2019 and those areas of the market that are perceived to offer superior and defensible earnings growth have enjoyed an extended period of outperformance. Pleasingly, given the company's high-growth bias, technology stocks have performed well over the period, as investors have sought returns in a low-growth environment.

In private markets, while we saw some anecdotal signs of risk contagion from public markets - such as pre-emptive capital raises - late last year, this receded quickly in 2019. We continue to see significant levels of activity in private markets and engagement with the company's investment proposition.

What has been interesting has been the apparent disparity between the public and private fund raising environments.

We believe there are secular trends currently driving diminishing numbers of IPOs, as companies stay private for longer, but these appear to have been exacerbated by turbulent public market conditions. The difference in listing activity pre and post the Great Financial Crisis is stark, but in the year to 30 September 2019, the number of UK IPOs was nearly half that of the preceding eight years.

There has been little sign of similar ructions in private markets, with the total amount raised in areas relevant to the company in the nine months to 30 September 2019 almost equalling the total raised over 2018. When compared to public markets, this means the ratio of private money raised to public has climbed to another high.

Our view is that private markets will continue to evolve and develop, as their attractions to many of our target companies are manifold, including:

- the ability to run losses while scaling - something stock markets find hard to stomach;
- concerns over stock markets' ability to price high/accelerating growth accurately, as typically public investors are faced with stable/fading growth rate businesses; and
- as private markets continue to mature, they have grown in significance and liquidity.

This leads us to conclude that, over time, we expect there to be a "blurring" of the traditional lines of what constitutes the characteristics of a "typical" private company and a "typical" public company.

QuotedData

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IMPORTANT INFORMATION