



## Economic & Political Roundup

Monthly roundup | Investment companies | December 2020

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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.

### Roundup

November was a remarkable month, with announcements on the vaccine front delivering a feat of science few thought possible. The news triggered a resurgence in stocks affected by measures taken to tackle COVID and 'value' stocks were favoured over 'growth stocks'.

### Global

#### A new phase of growth

We hear from JPMorgan Elect Managed Growth, with its managers Katy Thorneycroft, Simin Li, and Peter Malone, noting that the world has entered into a new phase of growth. Their favoured regions are the US, Europe and Asia as their growth is levered to global growth.

Joe Bauernfreund, the manager of AVI Global, says that when economies return to some form of normality he expects high-quality companies with solid balance sheets and reasonable valuations to thrive, especially against a backdrop of ultra-low interest rates.

The manager of Scottish Mortgage says it is important when accessing companies to look beyond the pandemic's near-term impact on share prices. The manager provides a case study on Tesla.

### UK

#### Brexit goes down to the wire

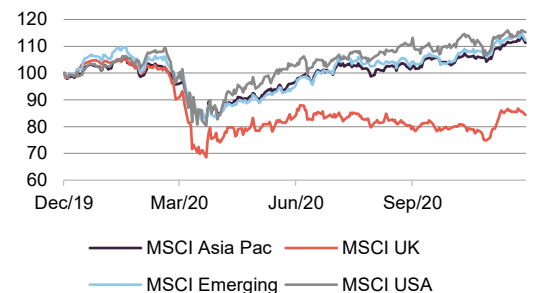
The manager of Chelverton UK Dividend noted that in light of UK equities being at their cheapest in around 40 years, once there is greater certainty on COVID and Brexit, investors are likely to look for value in the UK.

Exchange rate	30/11/20	Change on month %
GBP / USD	1.3323	2.9
USD / EUR	0.8385	(2.3)
USD / JPY	104.31	(0.3)
USD / CHF	0.9089	(0.9)
USD / CNY	6.5789	(1.7)

Source: Bloomberg, Marten & Co

#### MSCI Indices rebased to 100

Time period 01/12/2019 to 30/11/2020



Source: Bloomberg, Marten & Co

	30/11/20	Change on month %
Oil (Brent)	47.59	27.0
Gold	1776.95	(5.4)
US Tsy 10 yr yield	0.8389	(4.0)
UK Gilt 10 yr yield	0.305	16.4
Bund 10 yr yield	-0.572	(8.9)

Source: Bloomberg, Marten & Co



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Global Investors

## November's highlights

### UK (continued)

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The 'old economy' makeup of the UK market has not helped performance

Jane Tufnell, chair of Odyssean, says that at some point, the recent strong performance generated by highly rated higher growth AIM companies, particularly those in the technology and telecoms sectors, will lose momentum.

The resetting of the economic cycle could deliver a period of sustained recovery

Iain McCombie and Milena Mileva, the managers of Baillie Gifford UK Growth, list a few reasons that might be behind the underperformance of UK stocks, including the 'old economy' makeup of the market.

Ordinary shares will continue to benefit from extremely low-interest rates

According to the chairman of Shires Income, Robert Talbut, the sharp shock to the global economy has also reset the economic cycle. Prior to the health crisis, many investors were waiting for the next recession. That has now come and there is a chance of a period of sustained recovery and growth as businesses restock, initiate new investment plans, and consumers spend savings that many have been able to build up over the past year.

A better balance between paying out dividends and retaining cash for reinvestment or de-gearing could benefit shareholders over the long-term

Richard Burns, the chairman of Aberdeen Standard Equity Income, believes that while the failure of President Trump to win re-election has been generally welcomed outside the United States, it is doubtful whether this will carry much significance for investors in the UK. Much more important to them will be the outcome of the Brexit negotiations, whose terms, astonishingly, are still to be agreed. Richard adds that it does appear likely that whatever else happens, extremely low-interest rates at all maturities will continue, at least into the medium term. This should provide firm support for asset prices in general and ordinary shares in particular.

Montanaro UK Smaller's manager says that until the "deal or no deal" uncertainty is resolved, investors are likely to continue in their cautious approach to UK equities.

Troy Income & Growth's manager notes that a select few UK companies resumed dividend payments over recent months, reflecting the marginally more stable trading backdrop for many businesses. Nevertheless, the manager continues to believe that the overall level of market dividends will be structurally lower going forward. It is also noted that a better balance between paying out dividends and retaining cash for reinvestment or de-gearing will be in the longer-term interests of UK shareholders.

The manger's report for Schroder Income Growth offers the view that the gloomy backdrop of COVID-19 and Brexit has obscured the positive long-term prospects of many UK businesses.

James de Uphaugh, manager of Edinburgh, believes that the perception of the UK market predominantly providing access to relatively staid stocks, such as high street banks and oil producers, is unfair.

The longer-term effects of historic stimulus arguably warrant more attention

Richard Staveley, manager of Gresham House Strategic, takes a step back from the main newsflow to highlight that there appears to be little analysis on the medium-term effects of this historic stimulus. He says that the burden of debt on governments and many companies will linger; austerity appears a highly unpalatable option, and tax increases across society are likely to be necessary alongside a change in perspective on inflation.

Unemployment in the UK could rise sharply over the next few months

The next few years could bring the highest rate of corporate failures in decades

South Korea has shone in its handling of the pandemic. Some of its world-leading companies have strengthened their market positioning

Recent vaccine breakthroughs are being seen as amongst the impressive medical breakthroughs of the last 100 years

M&A activity within the biotech sector could be a signal that there are still companies that are undervalued

Patrick Harrington, manager of Value & Income, says that, in the UK, the true economic cost of the pandemic is still being disguised by the Chancellor's furlough scheme, but this comes to an end shortly, to be replaced with a far less generous job retention programme. Patrick says that it is likely that unemployment will rise sharply in the coming months and this is likely to dent consumer confidence.

BlackRock Smaller Companies's manager, Roland Arnold, is of the view that COVID-19 is simply bringing on an acceleration in many of the structural trends that have been happening in various industries over many years.

The manager's report for Downing Strategic Micro-Cap states that over the next few years, we are likely to see the highest number of corporate failures for decades.

## Global emerging markets

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Chetan Sehgal, manager of Templeton Emerging Markets, takes us on a detailed tour around the world's largest growth markets, including China, India, Brazil, and South Korea. On the latter, Chetan says that it embodies much of emerging markets' new realities; namely institutional resilience, improved economic diversification and the emergence of world-leading companies.

John Rennocks, chairman of Utilico Emerging Markets, says the war on COVID-19 has taken its toll and is ongoing. He notes that many nations have seen borrowings balloon to over 100% of GDP, interest rates trending to zero and unemployment jump.

## Biotech & healthcare

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According to Sven H. Borho and Trevor M. Polischuk, managers of Worldwide Healthcare, the industry has responded to this crisis in unprecedented fashion, from collaborations with academic institutions, industry partnerships, and collaborations with government bodies around the world. The managers refer to the comment by Pfizer's CEO, Albert Bourla, that its co-announcement with BioNTech of positive Phase III data announcement was the "largest medical breakthrough in the past 100 years."

Geoff Hsu, manager of Biotech Growth, discusses the encouraging trend of M&A activity continuing, despite management teams operating remotely.

The manager's report for International Biotechnology also highlights the M&A trend. The manager says that their view that many companies within the sector remain undervalued is supported by the increased level of M&A.

## Other

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We have also included comments on the flexible investment sector from Hansa, Personal Assets, and JPMorgan Global Core Real Assets; Europe from Baillie Gifford European Growth and JPMorgan European Growth; Japan from Aberdeen Japan; the Asia Pacific region from Henderson Far East Income and Schroder Oriental Income; Latin America from Aberdeen Latin American Income; India from Aberdeen New India; private equity from HarbourVest Global Private Equity; renewables from JLEN Environmental Assets and NextEnergy Solar; and UK property from Schroder REIT, Urban Logistics REIT, Sirius Real Estate, Civitas Social Housing, and AEW UK REIT.

## Global

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(compare global funds [here](#))

### **Katy Thorneycroft, Simin Li, and Peter Malone, managers of JPMorgan Elect Managed Growth – 20 November:**

After a short but deep recessionary period, triggered by measures to control the spread of COVID-19, the world has entered into a new phase of growth. This is characterised by persistent and highly supportive monetary policy accommodation, which should remain a tailwind for growth and financial markets for the foreseeable future. Medium-term, we expect fresh rounds of fiscal stimulus and the prospect for higher inflation. Although the final results of the US election are as yet unknown, a Biden presidency with split Congress seems most likely and election uncertainty has faded as an influence on markets. In recent weeks we have seen a rise in COVID-19 infection rates and a return to lockdown measures in some European countries. More positively, reports of success in COVID-19 vaccination trials has driven equity markets higher and could prove a catalyst for a rotation away from this year's equity sector winners.

Our favoured regions remain US, Europe and Asia as their growth is levered to global growth. We still expect above-trend growth, on average, through 2021, although most economies have made the transition to a more normal pace of early-cycle expansion after the explosive initial rebound in April 2020.

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### **Joe Bauernfreund, manager of AVI Global – 13 November:**

The spread of COVID-19 around the globe has had an unprecedented and severe impact on national economies. The scientific community is only starting to get to grips with the heretofore little-studied virus; this, coupled with the fluidity and speed of the pandemic's development, renders any 'outlook' discussion almost obsolete before the ink even dries.

Nonetheless, there are some reasons to be hopeful. The introduction of a vaccination programme would pave the way for economies to normalise and return to full capacity; as such, national governments have an increasingly clear map by which to navigate out of the forest. However, we are by no means out of the woods yet, with the timing of any vaccination programme being uncertain and fears of a 'second wave' stalking Western economies.

If or when economies return to some form of normality, we expect high-quality companies with solid balance sheets and reasonable valuations to thrive, especially against a backdrop of ultra-low interest rates.

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### **Manager's report for Scottish Mortgage – 6 November:**

Looking at the recent period, we must avoid the temptation to match outcomes with easy or obvious explanations. The global pandemic has, for sure, had big short-term impacts but a company's stock price incorporates an estimate of all future cash flows and is not simply a measure of relative success at this unusual time. The oddities of the pandemic will fade, some long-running shifts in our economy will have been accelerated and the stresses we have experienced will spark new waves of innovation.

The increase in Tesla's stock price and its dramatic impact on the Trust's returns should be seen in context. Whilst the company and its colourful founder attract an unusually high degree of attention, emotion and noise, the underlying return picture is far from an aberration. Returns are concentrated in a handful of big winners. With far less drama, this has been the case for our holdings in both Amazon and Tencent over the past decade. Tesla's success has been earned over a period of ownership extending back to 2013 and, as with most successful investments, we have endured large drawdowns in its stock price on the way to the current position.

Tesla has made significant operational progress. It has successfully added capacity and the production ramp of its latest model has progressed far more smoothly than for any of its previous vehicles. Demand for its products is strong and the response from its traditional competitors remains muted.

The era of electrification that Tesla is helping to materialise will take decades to arrive and have far-reaching consequences. Technological progress is driving down costs along an exponential curve that the fossil fuel industry will be unable to match. It is challenging to predict the impact of such change on the complex system that is the global economy. We eschew prediction and prefer to partner with the entrepreneurs that are driving change. Encouragingly we are seeing more opportunities.

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## Flexible investment

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(compare flexible investment funds [here](#))

### **Jonathan Davie, chairman of Hansa – 26 November:**

I write this after the US election has taken place, with a continuing resurgence in the number of COVID-19 cases in the Northern Hemisphere as winter approaches and little sign of a China rapprochement with the West. However, the extremely positive news on a number of vaccine candidates has possibly given the market some impetus for the long-awaited rotation out of Growth Stocks into Cyclical and Value together with steepening yield curves. It goes without saying that the positive effects for the beaten down travel and hospitality industries will be immense. The potential spending by prospective clients will be very substantial, due to the large increases in the savings ratios and the pent-up desire to get out and have some fun with friends. However, the Schiller cyclically adjusted price-to-earnings ratio remains very high, only surpassed in 1929 and 1999 and the increase in IPOs, particularly using Special Purpose Acquisition Companies (SPACs), together with heightened Merger and Acquisition activity and increasing retail involvement in the options market leads one to the inevitable conclusion that a bubble may be forming, particularly in the growth stocks.

Notwithstanding the above, there continue to be significant amounts of liquidity on the sidelines which, together with the greater use of fiscal policy, ongoing economic improvement as the impact of COVID-19 diminishes with the commencement of vaccination programmes. This leads us to remain supportive of risk assets. As a result, whilst we wouldn't be surprised to see increased market volatility in the coming months, we continue to focus on the upside in view of our long-term investment horizon.

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## Sebastian Lyon, manager of Personal Assets – 20 November:

Whilst the shift towards digital payments has been occurring for some time, there is evidence that this is now accelerating as ecommerce becomes ubiquitous and governments around the world are shaping regulation to drive the share of digital payments, which incur less cost and help reduce crime. During the pandemic, cash has also become a vector for virus transmission, causing more merchants to accept card and encourage contactless payments. There are also substantial opportunities in digitising payments between businesses (B2B) and other channels such as bill payments and government disbursements in addition to the core C2B (consumer to business) payments which make up the majority of the card networks' businesses today. During the period we added to the Trust's holdings in American Express and Visa, both beneficiaries of these dynamics that we expect to strengthen as the economy begins to reopen.

Asset prices have been supported by aggressive monetary and fiscal policies, which are endeavouring to replace the collapse in demand resulting from the pandemic. Interest rates have been nailed to the floor indefinitely, making yielding assets relatively more attractive. The prospect of interest rates in the UK following Japan and Europe into negative territory, supports our longstanding thesis of a shift to negative *real* rates. Zero-bound yields in fixed income are less appealing but index-linked bonds and gold should provide protection against a financially repressive future. This said, there is no guarantee that either asset class will provide an offset to equities during short-term bouts of volatility, as conventional bonds once did. Correlations have now increased across the board, as was apparent during the weakness in March, and we are entering an era in which it will become harder to generate low risk, absolute returns.

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## Manger's report for JPMorgan Global Core Real Assets – 19 November:

After an extraordinary 43 consecutive quarters of global economic growth, the onset and spread of COVID-19 resulted in a shuttering of nations and economies around the world. This created severe public market volatility as investors balanced concerns about how shutdowns would impact economic growth and corporate health with the boost provided by vast quantities of fiscal and monetary support implemented by governments. After bottoming in March, markets rebounded and initially the pace and size of the rally struck many as premature given COVID-19 continued to spread globally; nevertheless, market sentiment has generally remained positive since April allowing for a broad-base recovery of asset prices.

It is worth noting that whilst both the sell-off and rebound in public markets have been severe, pricing action in the majority of the core real asset market has been more subtle. This is somewhat driven by the natural delay these markets experience but also their longer-term, high quality nature. However, similar to the public market, broad market performance for real assets does not tell the whole story. For example, in the real asset market truly 'core' real assets - that is, assets supporting sectors which have longer term, contracted revenue and lower demand sensitivity, have remained resilient. In contrast, demand sensitive assets or assets which stray outside the traditional core sectors - such as hospitality within real estate or toll roads within infrastructure have struggled. We believe the lack of volatility of core real assets has demonstrated their worth during highly volatile underlying economic and market conditions.

The unprecedented market conditions have also emphasised the benefits of global diversification as the virus took hold of different economies at different times and



with varying severity. Geographic diversification will remain important for both protecting against, and taking advantage of, some of the likely trends resulting from the pandemic. For example, the continued success/adoption of flexible working will likely vary by geography as will how certain governments may use stimulus packages to drive their carbon neutral agendas.

One of the lasting outcomes of the COVID-19 pandemic has been the scale of the world's governments', and central banks', support for their respective economies. This stimulus has pushed bond yields even lower which, in our view, further increases the attractiveness of real assets as both a diversifier and a source of income. Additionally, the Federal Reserve has now shifted its policy towards average inflation targeting, allowing inflation to run above target for a while to compensate for periods of below-target inflation. The key implication is that rates are likely to remain lower for even longer and investors may need to prepare themselves for higher inflation in the future.

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## UK

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(compare UK funds [here](#))

### **Manger's report for Chelverton UK Dividend – 30 November:**

Despite the current extraordinary conditions we expect that once we as a nation have navigated the next six months, a period when the political situation in the USA will be clarified and, when the arrangements with the European Union have been resolved, life will return to a more stable and normal position once the COVID-19 pandemic has been brought under control.

It is being consistently reported and routinely discussed in the media that UK equities are cheaper than they have been for some 40 years. Once the matters referred to above are resolved then it is reasonable to expect that the improved certainty and clarity in the UK will encourage investors back to invest in UK companies.

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### **Jane Tufnell, chair of Odyssean – 30 November:**

At some point, the recent strong performance generated by highly rated higher growth AIM companies, particularly those in the technology and telecoms sectors, will lose its momentum. Market leadership will move to companies and investments with different attributes and characteristics. However, given the limited liquidity of smaller companies, an institutional investor is unable to reposition a portfolio over a short time frame. There is a material polarisation of valuations in the smaller quoted company space.

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### **Iain McCombie and Milena Mileva, managers of Baillie Gifford UK Growth – 27 November:**

Perhaps the elephant in the room is why the UK stockmarket continues to perform poorly relatively to most other markets. Smarter people than us have offered various theories but none strike us as wholly convincing. Perhaps the Brexit talks are a factor or perhaps it is the 'old economy' makeup of the market but in truth nobody knows, and it is not something we spend a huge amount of time theorising about,

particularly as it may reverse at any point. With all the uncertainty out there, it is easy to lose sight of the things that matter.

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## **Robert Talbut, chairman of Shires Income – 26 November:**

Approval of at least one vaccine over the next few months remains likely, particularly following the positive trial data recently issued by Pfizer and BioNTech, with good prospects of more vaccines to follow, boosting the chances that there can be a mass immunisation program in the first half of 2021. This will certainly help personal and business confidence and aid economic recovery, but the production and distribution of any vaccine will present significant challenges and it is unlikely to be 100% effective, meaning the world will still need to live with COVID for some time to come and its impact upon the way we live and work.

The effect on economies globally has been an unprecedented recession in terms of its sharpness and depth. In the second quarter of 2020, UK GDP was still 20% below the prior year. While figures for the third quarter will show a strong recovery, albeit one which will now have stalled to some extent by new restrictions as we move into the fourth quarter. Overall however, it is likely that the UK economy will still be around 10% smaller at the end of 2020 than where it started the year. Throughout this period, monetary policy has become even more loose with the likelihood that interest rates will remain negligible for a considerable period into the future. It remains uncertain as to whether the unprecedentedly loose monetary policy will at some stage herald higher inflation.

Most of the talk now is over the future role that fiscal policy can play in supporting recovery, irrespective of the size of government deficits that already exist in the UK and overseas. Notwithstanding this monetary and fiscal largess, we expect it will take a number of years before global economic output returns to pre-COVID levels and there will be significant structural change in the economy. Some sectors and companies will be winners but there will be many losers including some who will never recover to their previous economic state. The real challenge in the UK and elsewhere will be how to sustainably boost economic productivity and underlying growth rates over many years in order to fundamentally address some of the key issues faced by the UK and many other developed economies.

Since the end of March, the market has rewarded companies with resilient and defensive earnings. In the UK, the best performing sectors in 2020 have been technology, materials and consumer staples. More cyclical sectors like energy, financials and industrials have struggled. The timing of the Company's half year means there has been a reversal in market direction since the end of March with a strong rally, but the relative performance of different sectors has remained consistent - investors are understandably cautious and have been avoiding the higher risk sectors that face structural challenge from the pandemic. However, the euphoric equity market reaction to positive news on the vaccine saw a massive spike in unloved "value" sectors. Whilst there has subsequently been some correction to this move, it does highlight that the divergence between "growth" and "value" is at an extreme and even a slight unwinding of this may lead to significant swings towards the very unloved value segments of the market.

## **Outlook**

The outlook over the next six to 12 months remains primarily driven by how the pandemic develops and how governments and economies react. We should expect some continuation of uncertainty and volatility, with the US Presidential election and its aftermath and the UK's exit from the European Union further complicating the

outlook. However, the Manager has always tried to invest for the long term so that the company owns high quality companies that should perform well in most scenarios. As we look further out, the chances of effective vaccines for COVID-19 appear high and we should expect much of the world's economic activity to normalise.

The sharp shock to the global economy has also reset the economic cycle. Prior to the health crisis, many investors were waiting for the next recession. That has now come and there is a chance of a period of sustained recovery and growth as businesses restock, initiate new investment plans, and consumers spend savings that many have been able to build up over the past year. Many businesses have found ways to be more efficient in the last six months and productivity gains should be consolidated. Such a period should also lead to changes in market leadership, with economic growth driven by additional government spending, likely to benefit value and income stocks to a greater degree than has been the case for some time where growth companies have dominated equity market returns. However, it may take some time to get to this environment, and hence more growth-oriented businesses are likely to remain attractive to investors.

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## **Richard Burns, chairman of Aberdeen Standard Equity Income – 26 November:**

The immediate issue facing investors in nearly every part of the world is how severe the effects of the pandemic are going to be over the northern winter and how much more damage is going to be done to economies and companies in the meantime. The very recent news on successful vaccine trials is most encouraging, but with the best will in the world it will be quite a number of months until vaccines can be distributed in sufficient volume to allow more or less normal life to resume. However, there is no doubt that this is the best news that investors, and citizens generally, have had this year. The failure of President Trump to win re-election has been generally welcomed outside the United States, but whether it proves to have much significance for investors in the London market is doubtful. Much more important to them will be the outcome of the Brexit negotiations, whose terms, astonishingly, are still to be agreed with less than six weeks to go till the existing arrangements expire. Whatever is decided, there are bound to be winners and losers both in the UK and the EU and no doubt quite a bit of sand in the gears until the new arrangements, whatever they turn out to be, bed in. However, the Brexit issue has been a debilitating issue for this country and its stockmarket for a number of years now and its final resolution will come as a relief to almost everyone.

It does appear likely that whatever else happens, extremely low interest rates at all maturities will continue, at least into the medium term. This should provide firm support for asset prices in general and ordinary shares in particular.

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## **Manger's report for Montanaro UK Smaller – 26 November:**

2020 will enter the history books. The spread of COVID-19 - widely perceived as the worst global health crisis in more than a century - had a grave effect on the world, both in human and economic terms. The global death toll surpassed 1 million and billions of people were instructed to stay at home as shops, factories and schools all closed in an effort to stop the spread of the virus.

Initially, turmoil was experienced in financial markets as the Bull Market came to a crashing end. The economic outlook seemed dire: weekly jobless claims in the US

exceeded 6.6 million (the highest weekly figure reached during the Financial Crisis of 2008 was less than 700,000), while the Bank of England forecast a decline in GDP of 14% in 2020. This would be the worst slump for over 300 years, beaten only by the 15% contraction of 1706, during The War of Spanish Succession.

Yet a visitor from Mars, studying the six-monthly returns for equity markets to the end of September, would be hard pressed to identify that it had been such a dramatic period for investors. For as the world ground to a halt, Governments and Central Banks unleashed an unprecedented level of monetary and fiscal stimulus, estimated at some \$15 trillion across the G10 countries plus China. Plummeting interest rates pushed investors into riskier assets that offered a return on their investment.

This resulted in a sharp rebound in equity markets, with smaller, more economically sensitive companies benefitting the most. SmallCap in the UK recovered by some 23% over the period, a remarkable outperformance of almost 20% compared to large cap.

## Outlook

Despite the strong returns posted by UK equity markets during the past 6 months, the UK remains an unloved market. This is due to the effects not only of the coronavirus but possibly also of politics: Brexit continues to loom over the landscape, with the latest deadline moving into view over the horizon. Until the "deal or no deal" uncertainty is resolved, investors are likely to continue in their cautious approach to UK equities.

As always, there will be winners and losers in the months and years ahead. The immediate outlook for consumer businesses that rely on customer footfall - such as restaurants, hotels, cinemas, theatres, high street retailers and airlines - continues to look bleak. The recent encouraging news of COVID vaccines has been widely cheered by investors. However, until these vaccines become widely available, the economy may struggle and many businesses (particularly in these sectors) will not survive. By contrast, healthcare and technology companies, where we are overweight, should continue to benefit from structural growth tailwinds.

At a time when UK equity markets are cheaper than they have been for a generation, especially on a global perspective, a selective approach to investing in the quality companies that exist in these markets should not be overlooked.

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## Manger's report for Troy Income & Growth – 24 November:

It is increasingly clear that the COVID-19 pandemic has had a permanent impact on the UK equity market's aggregate dividend. Although many stocks will see their dividends rebound over the coming months, a significant portion of high yield stocks will not.

Short-term challenges undoubtedly remain. Longer term, issues such as technological disruption, changing consumer habits and climate change are important fundamental trends that companies need to confront. This year to date has served to emphasise the necessity for businesses to invest in order to tackle such shifts.

Importantly, the final quarter of the reporting period saw a select few UK companies resume dividend payments, reflecting the marginally more stable trading backdrop for many businesses. Although we are encouraged by this development, there remains significant uncertainty as to the length of disruption from COVID-19 and the

lasting impact of the crisis. Understandably, most companies are maintaining a cautious approach to dividend setting. Despite this, we continue to believe that the overall level of market dividends will be structurally lower going forward. However, we believe that a better balance between paying out dividends and retaining cash for reinvestment or de-gearing will be in the longer-term interests of UK shareholders.

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### **Manger's report for Schroder Income Growth – 20 November:**

COVID-19 is the quintessential exogenous shock. The range of potential outcomes appears very wide. This holds true for companies at both an operational level of profitability and their ability and desire to reward shareholders with dividends. On the positive side there is the potential for vaccination. Areas which would do best in such a scenario would be those that have been hardest hit - for example, banks and consumer discretionary sectors such as travel and leisure. On the negative side, it may take a long time. In such an outcome markets could fall as some expectation of a vaccine has been priced into markets. Areas which would hold up relatively well would be defensive growth companies with resilient balance sheets and franchises. In this instance COVID-19 may prove such a shock that some industries are permanently changed through overcapacity, technological changes or changes in consumer behaviour - e.g. airlines, cruises, and traditional retail/office companies.

We also believe that there is good reason to be optimistic about UK equities, not least because sentiment remains so poor. The uncertainties are well known but the positive long-term prospects of many businesses have been obscured by gloomy headlines on COVID-19 and Brexit alongside high-profile dividend cuts.

Notwithstanding the high levels of uncertainty, there has been a resumption of bid interest from overseas buyers as companies seek to take advantage of cheap prices, low financing costs and an attractive exchange rate. We also note the appearance of activist investors.

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### **James de Upaugh, manager of Edinburgh – 20 November:**

Despite the deteriorating COVID-19 pandemic health situation across many economies in October and early November, we remain of the view that progress is being made against the pandemic:

As the virus has become better understood, healthcare has improved for those in need of medical intervention – and there is also the welcome development of lower fatality rates.

Progress on vaccine development has exceeded even the most optimistic predictions of six months ago. To add to the extremely positive interim data announced in the last fortnight for the Pfizer and the Moderna vaccines, a number of others are now in advanced 'phase three' trials around the world. Large scale roll-outs of approved vaccines are likely in the first half of 2021, allowing a big release of pent up demand as economies reopen.

A trade deal with the EU is now seemingly more likely, which would bring greater resolution to the whole Brexit process. There is thus scope for this UK valuation discount to narrow, in turn supporting UK equity returns relative to overseas equities. UK equities are also unfairly perceived to be exposed to relatively staid stocks, such as high street banks and oil producers. The reality is that the UK market offers globally competitive businesses at compelling valuations.



**Richard Staveley, manager of Gresham House Strategic – 11 November:**

Fast growing companies have accelerated their recent outperformance of the rest of the market. This has driven the dispersion in the valuation of fast growing versus slower growing companies within the market to extreme levels compared to stock market history

These fast growing companies have been alighted upon across industry sectors but have been heavily weighted towards Technology, eCommerce and Healthcare. The AIM market has more of these companies than the FTSE All Share and has therefore outperformed

Retail investor activity has materially increased, both in the US (often through the use of single-stock options) and in the UK, evidenced by market operator reports. Passive Index trackers have continued to acquire more shares in their underlying indices, irrespective of valuations or, particularly in the case of the US, higher concentration in a handful of market leaders

Companies with excess leverage have underperformed. The economic impact of COVID-19 has forced a range of businesses to address balance sheet debt levels and loss of cash liquidity through the issuance of new equity, often highly dilutive to existing investors. This phase has accompanied net outflows from UK equities. Less AUM, but more requests for capital

Certain industry sectors are facing incredible business model stress, mainly in Transportation, Consumer Leisure activities and physical Retail. Commercial property rent collection and tenant strength has been severely tested. The vast majority of companies have cut dividends to shareholders materially, despite many having the capability to continue to distribute, accessing government schemes being a sensitive factor

There have been pockets of winners in the face of the crisis; including the computer games industry, DIY and gardening retail, vaccine developers, food delivery, online retail, gold miners, video conferencing and cycling. The UK Government policy has stimulated the housing market

Banks' shares have performed very poorly around the world, despite strong capital positions, whilst sustained weakness in the oil price and mass investor adoption of the ESG agenda has meant traditional Energy shares have also been out of favour

Regional economic activity has broadly reflected differences in lockdown rules and efficacy with the UK GDP in Q2 down a huge, estimated -20.4%, whilst Chinese GDP, where the virus originated, is expected to grow its economy overall in 2020 by c.4%

The level of monetary and fiscal stimulus has been enormous around the world. As a result, M2 and saving rates have soared and government bond yields have been kept extremely low with many territories negative (e.g. Germany, France, Switzerland), indeed total negatively yielding debt now exceeds a record \$16 trillion. Bonds aren't the investment they once were

UK Government debt has ballooned to the highest ever, now above £2 trillion and is on track compared to GDP to WW2 levels, above 100%. These are genuinely rare economic times. The fiscal outlook has therefore deteriorated markedly with tax collection down and government spending up. Governments around the world will be grappling with how to solve this in the coming years, without choking off economic recovery, alongside central banks who will surely be considering further



innovative policies to meet their mandates, which are being re-orientated to allow for more inflation.

In Q3, concerns over a second wave of the virus and likely renewed lockdown restrictions, impending easing of fiscal help and the inevitable pick-up in unemployment weighed on sentiment and confidence in the strength and timing of recovery. In the UK this is combined with worries over the likelihood of a hard Brexit, scheduled for the end of the year

A range of government leaders contracted and recovered from COVID-19. Data suggests death rates are highly concentrated in the very old and those with pre-existing conditions. The UK Government has pre-ordered over 400 million doses of potential vaccines currently in various stages of development. Insolvency and unemployment rates began to rise by the end of the period. 'Lives' versus 'livelihoods' will dominate national debate for at least the rest of the financial year

Governments around the world have had a novel but material issue to deal with during the last six months. The policy response has unsurprisingly been difficult to calibrate effectively, particularly with many competing demands and perspectives from different parts of society. What has been uniform, is a massive fiscal and monetary response from government institutions.

The direct impact of 'lockdowns' and restricted economic activity and movement will clearly leave permanent 'scarring' in many regions, industries and companies. However, given time, many behaviours will return to 'normal'. It seems credible though that for a number of trends initiated or accelerated by the pandemic, long-lasting change will occur. It will be critical for investors to identify and differentiate therefore the opportunities for mean-reversion, the underappreciated longer-term changes to the nature of demand and supply and most importantly any structural effects which could create 'value traps'.

While market commentary remains focused on the very short term such as the US Presidential Election and the timing or likelihood of an effective vaccine for COVID-19, there appears to be little analysis on the medium-term effects of this historic stimulus. The burden of debt on governments and many companies will linger; austerity appears a highly unpalatable option, and tax increases across society are likely to be necessary alongside a change in perspective on inflation, which some central banks have already begun to acknowledge.

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### **Patrick Harrington, manager of Value & Income – 6 November:**

The changes imposed on the global economy by the lockdown measures applied by governments around the world have been profound. Some sectors, such as technology and food retailing, have benefitted, but others have been devastated. Global travel has plummeted, in part due to governments imposing quarantine requirements on travellers, and the hospitality sector, particularly those areas most affected by social distancing rules, has also been hard hit. However, economies have begun to recover as lockdown measures have been eased. It seems likely that world economic activity will shrink by around 5% in 2020 given the economic rebound seen since the Q1 low point. As more social interaction has been allowed, recorded infections have begun to climb once more, but they remain well below the levels seen earlier in the year after allowing for the large increase in testing. Some governments, including our own, have opted to re-impose some of the lockdown controls and this will inevitably hamper the economic recovery. Initially, the UK economy made good progress in recovering the ground lost in March and April when the full lockdown was in progress; approximately half the lost value of GDP has

been recouped but this progress is likely to be reversed given the new lockdown recently announced by the UK Government.

Unfortunately, the UK's service-based economy and relatively dense population have made it especially vulnerable to the virus and this has meant a poor relative economic performance compared to other world economies. Consequently, the UK is likely to experience a larger percentage contraction in economic activity this year than most developed nations. The UK is also facing the uncertainty of whether or not it will leave the European Union (EU) with a trade deal. A 'No-Deal' exit would inevitably lead to further disruption, which would not be helpful given the difficulties already being faced as a result of the pandemic.

Nonetheless, global share prices worldwide have advanced, driven by the US technology giants. They have been supported by a combination of monetary stimulus and optimism regarding the pace of economic recovery. Future equity returns and economic performance are still inextricably linked to the success that the authorities have in controlling the spread of the virus and the picture here is concerning. In both the USA and Europe, there has been a rebound in new case numbers after the lull over the summer months. In the UK, the true economic cost of the pandemic is still being disguised by the Chancellor's furlough scheme, but this comes to an end shortly, to be replaced with a far less generous job retention programme. Consequently, it is likely that unemployment will rise sharply in the coming months and this is likely to dent consumer confidence and spending. The UK stock market has also had to contend with the stalemate in negotiations with the EU and, consequently, has been a poor performer versus other world markets. Nonetheless, UK shares are not highly rated by historical measures and look good value relative to other world markets, but it is difficult to see them making a great deal of progress until the political and economic issues hanging over them are resolved.

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### **Roland Arnold, manager of BlackRock Smaller Companies – 5 November:**

The current environment continues to present a number of challenges as the outlook remains highly uncertain and investors vary as to how they are pricing COVID-19 risks. The smaller end of the market remains very narrow and, in our opinion, continues to inconsistently value risk. This can be seen in valuations of the winners which have continued to stretch, while the losers compress. This has also been evident in a number of cases where share prices have become completely detached from fundamentals, and we can point to a number of examples where investment cases are playing out, but the share price is telling a different story. This disconnect cannot last forever. We must all remind ourselves that in the short-term share prices are driven by supply and demand (investor sentiment); however in the long-term it is company earnings that will drive share prices.

Nevertheless we are prepared for the remainder of 2020 to be volatile, fuelled by a number of high profile events that will dominate newsflow, creating a lot of 'noise', driving investor sentiment. Brexit negotiations, the US election, Trade, Monetary and Fiscal policy represent just a few of these. In addition updates on the development of a COVID-19 vaccine will have potential to create large market swings, both positive and negative.

We have said many times in recent months, that we can't pretend to have the answers to many of the questions that have arisen as a result of the COVID-19 pandemic. The scale and duration of the virus; the impact of a second wave; the scale of the impact on the global economy. These are all questions that are on the

minds of investors and individuals alike, with no real answer. One thing that we are sure of though, is that things will get better, and eventually return to normal, or at least settle at the 'new' normal. In our mind the result of COVID-19 is simply bringing on an acceleration in many of the structural trends that have been happening in various industries over a number of years. Whether it's the shift to more agile/remote ways of working or falling footfall for bricks and mortar retailing as more people shop online, these changes were happening already, it's just that now they are happening a lot faster. This environment could be perfect for well-managed smaller companies that have more agile structures that are able to adapt quickly to take advantage of these market shifts.

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### **Manager's report for Downing Strategic Micro-Cap – 2 November:**

The strong will grow stronger, consuming market share and margin, and the weakest will fail to survive. Over the next few years, we are likely to see the highest number of corporate failures for many decades.

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## Europe

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(compare European funds [here](#))

### **Moritz Sitte and Stephen Paice, managers of Baillie Gifford European Growth – 25 November:**

#### **Europe's Technology Renaissance**

In stressful times like these it's very easy to forget about the big picture and fixate over short-term data that gets over-emphasised and over-analysed. As investors we try not to get bogged down in the minutiae of quarterly results or guess the short-term direction of markets. Our aim is to identify long-lasting secular trends and characteristics of companies and management teams that will enable them to be genuine outliers. We think about how big a company could grow if things really work out over the next decade, and we put a lot of emphasis on ambition and purpose. These are less tangible and more oblique than simple financial metrics, however, we consider them to be critical to long-term value creation.

We have been thinking a lot about ambition recently, specifically in a European context. Over the last 30-40 years, ambition has produced some of the most successful companies in the world. Most of them, however, have been in what we would consider to be traditional industries. What Europe has lacked though are the big-tech companies seen in the US or China. These companies, by virtue of their massive and growing user bases and network economics, have built tremendously powerful businesses and produced spectacular returns.

So why have we not had anything like this in Europe? There are lots of reasons but the two that come up repeatedly are of a financial and cultural nature. European start-ups simply have not had the financial support - the cold hard cash from early investors - which is needed to build scale. You could argue that this is the reason many European tech companies sell too early and to foreign acquirers. Even more critical is the idea that European tech companies have generally lacked global ambition or the understanding that growth, and the scale that it brings, is all that really matters. Investors also need to take some of the blame here as short-termism

and risk aversion have encouraged flawed strategies that try to maximise profitability too early. For young, fast growing companies this simply does not work.

Before getting too despondent, the good news is that there are now clear signs that Europe's technology ecosystem has been shaken up by a new breed of European entrepreneur who understands how to scale and grow dominant digital platforms. Over the past six years, the number of billion-dollar tech companies in Europe, both public and private, is up nearly four-fold; the aggregate valuation of these businesses is up five-fold to more than \$400bn; and the total equity raised is up 13-fold. We have also seen bold acquisitions from companies. If successful, these deals will help build the largest global platforms in their respective businesses outside China. More than that though, they signal a real cultural change and a level of ambition in Europe that we have not seen for a very long time.

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### **Manger's report for JPMorgan European Growth – 24 November:**

The combination of a second COVID-19 wave leading to another round of lockdowns across Europe, a faltering recovery which means that the outlook for corporate earnings remains unclear, and political concerns around the outcome of the Brexit negotiations suggest that the next few months may be volatile. However valuation spreads remain very elevated which implies that there should be opportunities for stock selection to add value. Moreover there are signs that some companies that cancelled their dividend payments in the crisis are starting to reintroduce them.

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## Japan

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(compare Japan funds [here](#))

### **Manger's report for Aberdeen Japan – 25 November:**

Japanese equities rose by 14.8%, in sterling terms, in the half year under review, bouncing back from a sharp fall earlier in the year. The market recovery was driven by effective government efforts to control the outbreak of COVID-19, in conjunction with generous fiscal and monetary policies.

Compared with most other developed nations, Japan was spared the worst of the coronavirus outbreak. This was surprising given the country's ageing population, dense cities and overcrowded public transportation system. Yet the situation on the ground was less severe than in some other countries, helped primarily by a socially-responsible populace who were quite accustomed to wearing masks even before the pandemic hit. This allowed the government to cautiously re-open the economy only a month after a state of emergency was declared. While Japanese companies reported material declines in their June quarter earnings due to reduced global economic activity, the results were better than expected due to prudent cost controls. Furthermore, Japanese balance sheets were in better shape before the pandemic than those of global peers.

Two supplementary budgets and the continuation and expansion of the central bank's lending programme helped cushion the economy from the sudden halt in international travel and trade. Although second-quarter gross domestic product contracted by an unprecedented 7.8%, Japan still outpaced its peers, including the US, Europe, and the rest of the OECD.

What could have derailed the market's rise was Abe's unexpected resignation due to ill health. Investors were concerned that this could herald the end of his signature policies, dubbed 'Abenomics', that had fostered seven and a half years of stable growth. Those fears were allayed by Abe's being succeeded by his right-hand man and former Chief Cabinet Secretary, Yoshihide Suga, who reaffirmed his commitment to policy continuity.

In geopolitics, US/China tensions are likely to persist, even under a Democratic US Administration. Japan will remain a crucial political and security ally of the US, although China remains a crucial trade and investment partner for the Japanese corporate sector.

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## Asia Pacific

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

### **Matthew Dobbs, manager of Schroder Oriental Income – 13 November:**

Despite the global disruption of the COVID-19 pandemic, widely-followed Asian equity benchmarks recorded positive returns for the twelve months under review. This has been thanks to a robust recovery following sharp falls in the first quarter of 2020 as the potential implications of the virus sunk in.

While some of the rapid recovery was due to the effectiveness with which a number of regional authorities handled the crisis, the global monetary and fiscal response was also of material impact. Looser credit, led by the US Federal Reserve but mirrored by all the major monetary authorities, resulted in a rapid reversal in the spike in credit spreads. With widespread direct support for both consumers and companies (in Asia primarily focused upon Small/Medium-sized Enterprises or SMEs), equities recovered strongly over the summer, also supported by the weakness in the US dollar.

Although China has been at the epicentre of the pandemic and has also faced mounting pressure from the United States across a range of contentious issues, its economic performance has been particularly notable. Despite relatively mild stimulus measures by global standards (but pretty comprehensive, if ruthless, lockdowns) China has led the regional recovery as supply disruptions were speedily resolved, and end demand recovered the bulk of the previous collapse. However, reflecting the global picture, areas such as long-distance travel, entertainment and tourism have proved slower to revive.

The overall regional index performance disguised a wide dispersion in performance between both countries and sectors. As can be seen above, three markets were up over 20% in sterling terms, balanced by four down over 20%. The latter were all in ASEAN, and while there were easily identifiable negatives (collapse of tourism and political tension in Thailand, understandable lack of COVID-19 preparedness in Indonesia), much of the disparity can be put down to sectoral exposures. Heavy weightings towards banks, property, telecommunications and resources have hampered South East Asia, while higher exposure to technology and the "new economy" of e-commerce, online gaming, digital payments, social media, electronic vehicles and health care have supported China, Korea and Taiwan.

It is unsurprising in the circumstances that we have seen a number of dividend cuts around the region. However, on the whole we would say that management have been sensible and have had due regard to the fact that many companies in the

region remain profitable and boast relatively strong balance sheets. More systemic areas of weakness were banks (particularly in Australia and Singapore where the regulatory authorities have counselled prudence), and the Singapore REITs where lockdown and government relief measures curbed pay-outs. However, given that there have not been the same direct payments to support companies seen in the United Kingdom, we have not seen the same moral pressure to limit dividends.

The rate of earnings downgrades across the region has slowed recently, but there is still a lack of visibility on the timing of an end to global lockdowns and travel restrictions, and the likely path of the subsequent recovery in activity. This is especially the case now given secondary spikes in infections in several countries. It is, therefore, no surprise that companies are providing limited guidance on their shorter-term outlooks and continue to plan conservatively. In our interaction with management teams, our focus has been on understanding what measures they are taking to deal with the crisis and how well placed they are to ride out the downturn - operationally and financially. For many companies, this year's earnings are likely to be something of a write-off, so it is important to focus on the longer-term prospects for our investee companies. As performance in the past few months has demonstrated, markets by and large are willing to look beyond this crisis, as long as there is scope for a healthy recovery next year to a more 'normalised' level of profitability.

Consequently, aggregate valuations for the region have risen to slightly above historic average levels. This is clearly already pricing in a measure of the recovery in earnings expected into 2021 and the upside for the 'lockdown winners'. There is scope for disappointment, but the ultra-low level of interest rates and bond yields around the world provides support to valuations. It also makes the dividend streams from those companies able to sustain pay-outs particularly attractive.

Behind the aggregate valuation measures, there is a very wide spread of multiples. This means that valuations in some of the sectors with strong momentum this year - notably selected healthcare, e-commerce, online gaming, 5G equipment, electric vehicle-related and other popular China A-listed shares - are much more stretched. We are also seeing some signs of 'froth' emerging in the very strong flows and performance of new initial public offerings in Hong Kong and South Korea. This froth is also evident in the high levels of retail participation in these deals and in market trading more generally. Although not yet at worrying levels, this sort of optimism does leave markets more vulnerable to disappointment.

The obverse of this is that many companies with solid dividend prospects are offering great value. Clearly, we must be very selective as some industries are facing severe disruption.

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### **John Russell, chairman of Henderson Far East Income – 4 November:**

Asia with its massive population, rising middle class, burgeoning consumption levels and rapid take-up of technology will provide superior growth in the long term.

The COVID-19 pandemic has and continues to have a devastating impact both socially and economically across the world. However, the impact will be felt unevenly. Asia seems to have coped much better than many other countries in the west and elsewhere. China is largely back to work and is forecasted to have 1.9%<sup>1</sup> GDP growth in 2020, significantly better than the global forecast of minus 4.4%<sup>1</sup>. South Korea and Taiwan too appear to have stabilized the situation and are returning to growth.



Not all of Asia, however, has been so well prepared and organised. India, the second largest economy in the region, and Indonesia, the fourth, are struggling to contain the spread of the virus while many of the emerging Asia economies have not had the necessary infrastructure in place to deal with a health emergency like an entirely unexpected global pandemic. Despite positive growth from China, the IMF is forecasting a modest decline of 1.7%<sup>1</sup> for the emerging and developing Asian economies as a whole - significantly better than the decline in advanced economies of 5.8%<sup>1</sup> for 2020. But Asia learns and after the 2008 financial meltdown many Asian countries introduced structural reforms to cope with events like that and tangible economic benefits emerged. It is likely that COVID-19 will also accelerate further reforms with long term positive implications.

Financial stimulus and monetary response have been very restrained within the region. China has provided a stimulus package representing 4.5%<sup>2</sup> of GDP whereas in the 2008/9 financial crisis it provided 12.5%<sup>3</sup>. Unlike in many developed economies, the Chinese Central Bank has not used its balance sheet to buy government bonds. Instead, it is leaning on the credit channel to stimulate the economy. This response from the region's largest economy stands in contrast to the trillions of dollars outlaid by the west, a heavy financial burden that will take years to resolve, negatively impacting growth.

The US/China trade and technology war is not going away whoever wins the Presidential election and many developed countries now see it is in their own interests to decouple the supply chain and lower their dependence on China. The EU, led by Germany and France, is redefining its relationship with China citing unfair trade practices and human rights abuses notably the Uighur issue that is contrary to accepted western values. Australia, too, is going down a similar path and the US has an even wider agenda to contain China which they see as a threat to the US led world order.

This push back is understandable from a western perspective but in practice will be mitigated significantly by reality. China remains the second largest economy in the world and will continue to have significantly higher levels of growth than in the west resulting from its huge population, continued rapid infrastructure development, technology advancement (much of it home grown) and rapid adoption and integration into the wider Asian region with a combined population of 4.5 billion which is estimated to contain 66% of the world's middle class within 10 years. This is a reality no western business can ignore. China is going to be the world's largest market for an increasing number of products and services for the foreseeable future. Major US corporations, regardless of Presidential tweets, cannot afford to abandon such a market opportunity. Germany too is wrestling with how best to redraw its relationship with China which accounts for 50% of its trade with the Indo-Pacific region. German companies have concerns about doing business and protecting their intellectual property in China. But it is a difficult path to tread. About 40% of vehicles sold last year by Volkswagen, as well as nearly 30% by Daimler and BMW, were in China. Volkswagen CEO Herbert Diess refers to China as his company's most important market.

The introduction of the Chinese Security Law into Hong Kong has been painful for Britain which feels a moral responsibility to maintain the status quo until 2047 when the arrangements of the Special Administrative Region come to an end. It has been painful for China as well. Social and political risks in Hong Kong are not new. These risks drastically increased over the last year when the mass transportation systems and the aviation system were brought to a standstill and violence erupted in the streets. Business was seriously disrupted and the outlook for continued chaos forced China to provide a solution. Although there has been no noticeable exodus

of expatriate professionals or foreign business to date, we will have to wait and see whether the solution is successful in the longer term.

While Hong Kong is less important to China today it remains an essential part of regional development in south east China. What is known as 'The Greater Bay Area' (GBA) is a massive experiment in how best to develop a cluster of cities that enable superior development but in a more sustainable and greener way and one that improves the lifestyle of residents. The GBA is a cluster of 9 large cities including Hong Kong, Macau, Shenzhen and Guangzhou, in the Pearl river delta. As part of this programme, Hong Kong has been linked to Macau by a 34 mile cross water bridge. An investment of this magnitude does not support the view often expressed in the western press that Hong Kong is of little importance to China. Interestingly, and rather perversely, the recent introduction of US financial restrictions passed by the Senate in May and to be signed off by the President later this year will benefit Hong Kong. Under these regulations it will not be possible for any company to list in the US unless it can prove it is not controlled by a foreign Government and opens itself to inspection by the Public Accounting Oversight Board. The Chinese regulator allows audit trail access in investigations but not inspections. Hence Chinese companies with secondary listings in the US will have to move elsewhere or liquidate. According to a recent report from UBS, 42 of these companies already qualify for listing in Hong Kong. This will lead to a series of very large initial public offerings that are likely to keep Hong Kong's financial sector buoyant over the medium term and limit any tendency for foreign banks to withdraw. It will have an added benefit for the A share market which will welcome the increase in quality listings and provide a better balance between nominal GDP and equity market capitalization.

Policy makers in China have announced that they will measure progress in the GBA against environmental metrics, health and lifestyle ratings, innovation and education scores and measurement of economic output in both absolute and value added terms. This is a reflection of some of the modern demands made on western business and perhaps in time developments in the GBA will produce some lessons useful for us all.

Taking the big picture again the outlook for Asia, with China at the centre, offers attractive opportunities for investors. China will continue to have much stronger growth than in the west over the next 20-30 years driven by its huge population, better financial health at both the corporate and government level, further urbanisation involving around 300 million people providing huge infrastructure growth and development, a vibrant technology industry accompanied by rapid take up. China is now fully integrated into the US led world order and is the largest trading partner for many countries. The rest of Asia is participating in this transformation as well, as many countries in the region have risen from poverty, from utter destitution and damage in the aftermath of World War II. This process has taken a very long time with many painful events along the way but now they represent a formidable competitor to the west.

As described, Asia is on a strong upward economic growth path. But what about the politics of Asia? Should we, as investors, be concerned about this? China is by far the largest and most important country in the region and its political system matters. It matters because many of its policies do not sit well with western observers with an entirely different political tradition and many other countries in Asia are looking enviously at China's success to see what lessons they might usefully learn.

China has a socialist political system together with a capitalist economic system. This has never been tried before, certainly not by any country of size. The system

has led to uneven wealth distributions - hardly an expected socialist outcome and President Xi has publicly acknowledged that high wealth imbalances erode social cohesion. China's political system then is a 'work in progress' that needs to address this problem and it will continually evolve for many years to come. This transition is by far the biggest and most difficult problem facing China. If the socialist side of the equation adversely impacts the free market economy the middle class will suffer. It will not willingly sacrifice its newly achieved privileges of modern housing, good education for their children, the latest cars and foreign holidays. They will look at Taiwan and South Korea with equally successful economies, but much less Government control and ask 'why not China?' Continued economic success is therefore critical to social stability which is probably the most important objective of the Chinese government. A modern technology driven economy needs openness to new ideas and an ability to think the unthinkable. Will the current level of Party control allow that? Economic and social realities in China will dictate developments, but over time.

Political developments in China over the past 30-40 years have clearly been driven by a pragmatic approach rather than a rigid dogmatic unyielding one. When it is clear that a current policy is not achieving expected results, then alternatives are tested, usually in a defined area. This has been tried in China many times, sometimes successfully other times less so. The most recent is the GBA mentioned above. Recently it was announced that Hong Kong lawyers have been given licences to operate within the GBA. Is this an early stage development to test whether importing Hong Kong law into mainland China would work?

Another example is in the fund management sector. China has an enormous pool of savings but lacks world best practice in funds management. Earlier this year BlackRock, the world's largest fund manager, was given approval to enter partnership with a state owned bank. Vanguard, another large fund manager, is relocating its regional headquarters to Shanghai and Citigroup is the first US bank to receive a fund custody licence in China. China recognises it has a problem with an existing inadequate and a non-competitive domestic fund management industry. It has no problem looking to the US for ideas if that is the best way to progress.

In summary, evidence suggests that investors can expect Asia Pacific to continue to provide attractive investment opportunities and dividend flows that meet our criteria. Of course there will be continued tensions with the west as global economic power shifts, but the underlying fundamentals of Asia remain compelling

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## Global emerging markets

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

### **Chetan Sehgal, manager of Templeton Emerging Markets – 25 November:**

China's economy contracted for the first time on record in the first quarter of 2020, reflecting the significant disruption caused by the COVID-19 pandemic and subsequent lockdowns of non-essential businesses. To bolster the economy, the government implemented fiscal stimulus measures, while the People's Bank of China took steps to lower interest rates for borrowers and enact additional stimulus measures, such as a new one-year medium-term lending facility. These efforts proved effective, allowing the economy to reopen and resume growth in the second quarter, albeit at a lower rate than prior to the pandemic. While near-term growth was severely impacted, we believe that there is pent-up domestic demand, which

will help drive growth in the future. Although US-China tensions heightened following bans on Chinese applications TikTok and WeChat, sanctions on Huawei, tighter regulatory scrutiny on Chinese companies listed in the US and export controls, commitment to the trade deal reached in early 2020 provided investors with some comfort. We expect US-China relations to remain volatile, we remain positive on China's longer-term outlook, but we are positive that domestic consumption continues to lag (although improving), other economic indicators such as industrial production and manufacturing have returned to pre-COVID-19 levels.

Moreover, China's focus on economic restructuring and long-term sustainable growth has led to quicker application of structural reforms, industry consolidation and development of local technology supply chains to replace US sources. We believe that China will become a leader in fifth-generation wireless technology (5G), which together with artificial intelligence and robotics could help drive China's economy as it seeks to rely less on the US. Additional characteristics that favour China include continued domestic reforms, technological advancement, rapid digitalisation, a huge consumer market and the availability of a multitude of fiscal and monetary tools to help weather external shocks. In this environment, Chinese equities rose during the period reassured by the government's aggressive actions to contain the virus and the economy's return to growth in the second quarter. However, renewed trade tensions with the US and subsequent COVID-19 outbreaks in China later in the period restricted further gains.

Post the end of the reporting period, there were some announcements in China indicating greater regulatory oversight over the operations of dominant internet companies and fintech companies. These announcements led to the cancellation of the ANT Financial IPO and did impact on share prices of Tencent and Alibaba.

South Korea embodies much of emerging markets' new realities; namely institutional resilience, improved economic diversification and the emergence of world-leading companies. In addition to standing out as illustrative of the aforementioned factors, South Korea is also an example in terms of its handling of the COVID-19 pandemic. As a major oil importer, South Korea has disproportionately benefited from relatively lower oil prices, while also seeing little economic impact from the collapse in international travel due to its lower dependency on tourism. An export powerhouse, several South Korean exporters are of global importance, supplying hardware that enables the modern economy to function. World-leading semiconductor and battery makers are benefitting from the secular trends of increased computing power and greener mobility-some of which are accelerating due to the pandemic. The country's internet sector has also been thriving with social distancing. South Korean companies also continue to implement policies aimed at improving their environmental, social and governance (ESG) policies. We have seen leading companies in South Korea publicly apologise for governance missteps and manage their balance sheets more effectively through returning capital to shareholders.

A rally in technology stocks and effective control of COVID-19 in the country drove Taiwan's equity benchmark to an all-time high in September, making it one of the best performing emerging markets over the reporting period. Known for its research and development strength, Taiwan's semiconductor industry is a global leader, with the island home to one of the world's largest independent integrated chip manufacturers. The industry has been benefitting from increased demand from cloud applications related to remote working and online education, trends which the pandemic has accelerated. We believe that the global outlook for memory chips will remain strong, driven by demand for memory solutions from smartphones, high performance computing, fifth-generation wireless technology (5G), artificial

intelligence, internet of things, data centres and cloud infrastructure. Taiwan's manufacturers are also at the forefront of the global push to move supply chains out of China, as rising US-China tension fuels demand for servers and chips not made on the mainland.

The implementation of stimulus measures and monetary easing efforts coupled with better-than-expected second-quarter GDP data provided a conducive environment for the Russian market. However, in an environment where technology-related stocks outperformed, the MSCI Russia Index, which is more heavily exposed to energy and materials stocks that were adversely impacted by relatively low oil and basic metals prices as well as demand concerns as a result of the pandemic, lagged its emerging markets counterparts, over the six-month period.

Brazil has been among the countries hardest hit by the COVID-19 pandemic, just behind the US and India in the number of reported cases. However, we have started to see the number of new cases decline from its peak in July. Heavy government spending and monetary policy easing, with interest rates cut to record-low levels, have helped bring some stability to the economy. Moreover, Brazil has continued to make progress on the reforms front despite political noise. In terms of investment opportunities, we continue to favour the financials sector, including companies with strong capital market exposure. Interestingly, Brazil's stock exchange itself has a strong sustainability agenda, while ESG principles are not only implemented within the exchange itself, but also promoted in the Brazilian stock market broadly. E-commerce is another exciting investment theme. As in other countries, the COVID-19 crisis has accelerated the adoption of internet-based retailing in Brazil.

Although India took bold steps to contain the spread of COVID-19, enforcing a complete lockdown across the country on 25 March 2020 by sealing international borders and restricting domestic travel, the daily number of COVID-19 cases in the country started to increase in late-August as the country continued to ease quarantine restrictions and economic activity began gradually to normalise. A silver lining is that India has not seen a corresponding jump in mortalities, reflecting improved treatments and wider testing revealing asymptomatic cases. While this may raise uncertainty on the pace of economic recovery, government stimulus and support from the Reserve Bank of India, which also helped restore some confidence in financial markets and boost liquidity, should filter into the real economy gradually, supporting a recovery in due course. India may also benefit from change in global supply chains in select products, as companies diversify their production base away from China. Importantly, while the government is working on reviving growth, the current challenging macro environment provides opportunities for stronger companies to gain market share at the expense of weaker ones. For example, stronger private-sector banks have increased their lead at the expense of weaker public sector banks and non-financial banking companies.

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### **John Rennocks, chairman of Utilico Emerging Markets – 25 November:**

By any "normal" metric the global economies face unprecedented challenges today. The war on COVID-19 has taken its toll and is ongoing. Few countries have reopened their borders to travel and most have ongoing local shutdown responses to COVID-19 flareups, thereby limiting full recovery. Many nations have seen borrowings balloon to over 100% of GDP, interest rates trending to zero and unemployment jump.

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## Latin America

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(compare Latin America funds [here](#))

### Richard Prosser, chairman of Aberdeen Latin American Income – 5 November:

The near-term outlook for Latin America remains challenging. Many countries face the difficult decision of whether to keep their economies open to stave off a deeper recession or to re-impose draconian social-distancing measures and localised lockdowns amid elevated numbers of COVID-19 cases. Worsening relations between the world's two largest economic giants, the US and China, also pose a substantial danger to both financial markets and international trade as they engage in tit-for-tat punitive measures. That said, in Brazil, the Bolsonaro administration's fiscal stimulus has provided ammunition to better cushion the impact of the virus on its citizens. Subsequently, continued reforms to ensure fiscal discipline will be needed in light of the massive government spending and rise in debt levels. For Mexico, the ratification of a trade deal by key partners, the US and Canada should help its economy recover in the longer term. Elsewhere, receding coronavirus cases in Chile would allow the government to focus on putting key sectors, such as mining, back on the growth track. And finally, with the successful conclusion of debt restructuring talks in Argentina, more foreign investment could eventually find its way back.

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## India

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(compare country specialist: Asia Pacific ex Japan funds [here](#))

### Manager's report for Aberdeen New India – 26 November:

Indian equities advanced over the six months ended 30 September 2020, reversing the steep sell off in March after COVID-19 spread worldwide. The resumption of economic activity, continued fiscal and monetary support at home and abroad, and reports of progress on COVID-19 vaccines drove the rebound. This was despite daunting challenges for the domestic economy and capital markets. Chief among these was COVID-19, with India having, to date, the world's second-highest number of infections after the US. Efforts to curb the virus' spread resulted in further damage to an already slowing economy. Although a nationwide lockdown was lifted in May, localised restrictions continued to constrain consumption and business activity. Rising border tensions added further uncertainty with China which boiled over into a fatal skirmish.

Nonetheless, the market appeared to take all of this in its stride. For the six months under review, the MSCI India Index (sterling-adjusted) rose by 33.2%.

The COVID-19 situation appears to be improving, but the near-term outlook for India remains tough. The economy is still feeling the effects of the pandemic, which have been hampered by localised lockdowns. Also, the central government has less room to expand stimulus given its already strained fiscal position. That said, green shoots are emerging. Recent data, including exports, factory output and car sales, hint at a tentative rebound, albeit these gains need to be sustained, and consumption remains weak. Encouragingly, downgrades to earnings forecasts from companies seem to be moderating.





## Biotech & healthcare

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

### **Sven H. Borho and Trevor M. Polischuk, managers of Worldwide Healthcare – 20 November:**

Without question, the COVID-19 pandemic will continue to influence all aspects of our lives: politics, the economy, education, and certainly public health. With this, we expect the healthcare industry's efforts to thwart the coronavirus will persist in both media coverage and investor psyche. Most importantly, we expect the cumulative efforts of the industry to prevail against this disease, and that a return to a modified normal is more likely sooner than later. We believe the positive sentiment around the collective industry efforts will continue to drive investor demand in healthcare stocks.

The industry has responded to this crisis in unprecedented fashion, from collaborations with academic institutions, industry partnerships, and collaborations with government bodies around the world. "Operation Warp Speed" is the Trump administration's mandate to produce and deliver 300 million doses of safe and effective vaccines by January 2021. This is part of a broader strategy to accelerate the development, manufacturing, and distribution of COVID-19 vaccines, therapeutics, and diagnostics.

Operation Warp Speed is leveraging the best, most talented, experts from across the federal government and private industry to develop safe and effective vaccines and therapeutics quickly without compromising safety. Progress to this end has been impressive to date and we expect news flow to accelerate into the year end and 2021.

### **Unlocking the SARS-COV-2 Genome**

The genetic sequence of the novel coronavirus SARS-COV-2 was first made publicly available on 10 January 2020, within two weeks of initial reports of a cluster of severe respiratory infections in Wuhan, China. Within nine months the number of pre-clinical and now clinical vaccine programmes is well over 200, with some of those in late stage clinical trials in hundreds of thousands of patients worldwide. Data read outs for many of these programmes are expected by year end or early next year including AstraZeneca/ Oxford, Sanofi/GSK, Moderna, and JNJ. Operation Warp Speed has coordinated with these companies in attempt to dramatically accelerate the vaccine development timelines and reduce time to market by over 80%.

However, Pfizer and their partner, BioNTech, were the first companies to declare positive interim Phase III data for their mRNA-based COVID-19 vaccine candidate, known as BNT162b2. The much anticipated and highly scrutinized data was announced on 9 November 2020. The efficacy surprised on the upside, as the vaccine candidate was found to be more than 90% effective in preventing COVID-19 in participants without evidence of prior SARS-CoV-2 infection, in those receiving the two dose vaccine regimen versus those who received the placebo. Whilst further details were unavailable at the time of disclosure (such as sub-group analysis, durability data, and safety data beyond two months of follow-up), the efficacy of >90% far surpassed expectations significantly, for both investor and medical experts alike. Albert Bourla, the CEO of Pfizer, declared the announcement as the "largest

medical breakthrough in the past 100 years". This proclamation may be considered somewhat hyperbolic but considering the vast impact this pandemic has had on global society, it may be accurate. Regardless, it is this type of innovation that has been driving the industry for the past 5 years and we expect a positive "halo effect" across therapeutics stocks to continue.

### **Operation Warp Speed: Vaccine Distribution Process**

In addition to vaccines, the biopharmaceutical industry has also been developing numerous other therapies to combat COVID-19 for both treatment and prophylaxis. These include anti-virals, anti-bodies, anti-inflammatories, and plasma-derived therapies. At the time of this publication, only one therapy had garnered FDA approval: Veklury (remdesivir) from Gilead. However, with over 3,500 clinical trials under way, we expect this number to rise dramatically. Several companies have candidates in registrational trials that could announce data and pass through regulatory scrutiny by year end or early 2021, including Regeneron, Eli Lilly, Takeda, Alexion, and Merck.

### **Healthcare Industry Response to COVID-19**

Much like vaccine developers and manufacturers, the diagnostics industry has rallied in unprecedented fashion to increase the availability and flexibility of solutions to support large-scale detection of COVID-19. Underscoring the efforts undertaken has been the incredible breadth of contributors, including incumbents like major diagnostics vendors and central lab service providers, as well as others with the technical know-how and resources to support further testing efforts like research-oriented PCR providers and genetic testing labs that have traditionally not participated in infectious disease testing. Investments in manufacturing and service capacity have led to an unprecedented level of testing, with YTD COVID-19 volumes over 100% higher than the normalised run-rate of flu testing in the U.S. alone.

Beginning with the late January 2020 declaration of a Public Health Emergency, the FDA was given the latitude to grant diagnostics manufacturers and service providers Emergency Use Authorisations (EUAs) to expedite the process of bringing tests and capacity online. Since that time, the FDA has granted EUA to over 250 diagnostics tests, including greater than 180 molecular and 50 serology tests in addition to 6 antigen tests, with a continued pipeline of tests awaiting EUA or planning to be submitted. Supported by the approvals have been a number of modalities, including high-throughput central lab environments, rapid point of care and even at-home sample collection that does not require the presence of a healthcare professional. On top of these actions undertaken at the FDA, the National Institutes of Health, with funds allocated from the CARES Act, has served as an important funding mechanism to advance innovation and capacity through its Rapid Acceleration of Diagnostics (RADx) programme, which has the stated goal of supporting accurate, fast, easy-to-use and widely accessible testing.

### **NIH RADx Initiative for COVID-19**

Over the past four years, the FDA has never been more productive from the standpoint of new drug approvals. A trifecta of influences has created record breaking numbers of new (and generic) medicines being made available to the American public. The Trump administration has attempted to use the FDA to indirectly control drug pricing by increasing competition. Recent commissioner Scott Gottlieb, a Trump appointee, oversaw the initial efforts here that saw a record number of new and generic drug approvals in 2017 and 2018. An increased budget has also allowed the FDA to use newer technologies to aid in the review process. These efforts have continued into this year, with 40 new drug approvals as of 30

September 2020, on pace for the second highest number of approvals in a calendar year (behind 2018 but ahead of 2019). Overall, this has culminated in the most productive four-year period in the history of the FDA, with over 200 novel drugs approved during this span.

### **FDA New Drug Approvals**

FDA productivity remains impressively high despite the pandemic, with many staffers required to work from home and other review personnel being heavily involved in COVID-19 related work. Whilst we have seen some disruption in clinical trial starts due to the pandemic, that seems to have been mostly a temporary situation during the initial height of the coronavirus breakout. Finally, we would note the timely drug approvals and the FDA's legal requirement to approve drugs, on or before their action dates, has mostly gone smoothly and we expect this to continue. One item of concern is the requirement of the FDA to inspect and approve manufacturing facilities in-person, ahead of a drug approval, may be partially compromised during the pandemic.

M&A has been a common industry staple in healthcare for decades, especially in the therapeutics space, and a core part of the Company's investment strategy. The fragmented and heterogeneous nature of the industry, coupled with clinical and technological complexity, will continue to generate many business development deals. We observed a slowdown in M&A in calendar 2Q20 as companies were shifting focus to operations and employees in response to COVID-19.

However, the management teams of many large capitalisation stocks assured investors that business development would continue their due diligence efforts despite the work from home environment and, in fact, that is exactly what we saw in calendar 3Q20, when a clear inflection point of biotechnology deals was observed. We expect an increased pace of M&A deals to continue this year end and into 2021.

## Outlook

Now with the U.S. Presidential election behind us, we look for some respite from the political rhetoric and headline noise that healthcare investors have plodded through over the past 24 months. Despite the immediate lack of finality surrounding the results of the Senatorial races - and perhaps some legal wrangling from the Trump administration - the putative outcome of this election was effectively the “best case” scenario for healthcare stocks. Specifically, with the U.S. Senate now expected to remain under Republican control, the “Blue Sweep” outcome was ultimately avoided. Interestingly, whilst the U.S. House of Representatives is to remain under Democratic control, the party did lose a net of five seats to the Republicans.

What do we expect from a Biden Administration? Mostly status-quo, especially given the failure of the Democratic party to sweep the election. First and foremost, the President-elect has a multitude of priorities during the first year of his presidency: the economy, the pandemic, additional stimulus, the supreme court, and so on. What will be his pandemic response? What is his immediate view of the economy? What additional stimulus will he push for, if any? What are his next steps with respect to the controversial replacement of U.S. Supreme Court Judge Ginsberg? None of this leaves much time to stump for major drug price reforms, not with the healthcare industry continuing to lead the charge against the COVID-19 pandemic. Second, with respect to healthcare, recall that President Biden has an important legacy to protect, that of President Obama and the Affordable Care Act (ACA a.k.a. “Obamacare”). This was passed into law in 2010, during the Obama administration’s reign. Fundamentally, therefore, we do not expect the incoming administration to meaningfully alter or change the ACA, but rather add to it and expand it, such as lowering Medicare age of eligibility to 60 years of age from 65. We do not view this as a platform for radical change in the way which medicine is practiced, paid for, or administered in the U.S.

Finally, our positive outlook for healthcare equities primarily revolves around the unprecedented level of innovation across the industry spectrum, from therapeutics to services, from devices to diagnostics. Certainly, technology has impacted many industries and healthcare is no exception. However, advances in genomics and biotechnology has pushed the therapeutics space to such frontiers that the number of disease states and treatable targets is at an all-time high. Meanwhile, novel platform technologies have enabled even more therapies to target diseases that were previously thought to be untreatable.

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### **Geoff Hsu, manager of Biotech Growth – 13 November:**

Thus far, biotechnology companies have fared reasonably well throughout the COVID-19 pandemic. Most companies have continued operating as essential businesses, with minimal impact to sales of established drugs. Manufacturing supply has not really been affected, and the U.S. Food and Drug Administration (the “FDA”) has largely adhered to its drug review timelines. The only significant negative impacts from COVID-19 have been some clinical trial delays (given that many healthcare institutions paused commencement of new trials to deal with COVID-19 patient demand) and hurdles with new product launches (since it’s difficult to promote effectively to physicians when many of them are working from home). As physicians have reopened their clinics for in-person visits and hospitals have resumed normal operations, these negative factors have abated.

## Mergers and Acquisitions (M&A) Continues Despite COVID-19

Despite the fact that most management teams are working remotely, it has been encouraging to see that M&A transactions have still been occurring in the biotechnology sector.

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### Manager's report for International Biotechnology – 2 November:

M&A activity continues to be a key driver of performance for the biotechnology sector despite the impact of COVID-19. Our view is that many companies within the biotechnology sector are currently undervalued, a sentiment we believe is supported by the increased level of M&A activity within the sector.

The second half of the financial year, specifically the month of August, was particularly successful for M&A activity within the biotechnology sector. This pace of M&A is showing no indications of slowing down.

Innovation remains one of the core drivers of the biotechnology sector's performance. This, in conjunction with the positive developments made in the FDA's development and review process, also contributed to the biotechnology sector's relative outperformance during the financial year. As at 31 August 2020, there were over 25,000 ongoing clinical studies, with the number of studies expected to exceed the previous calendar year's by the end of the 2020. It is expected that this pace of innovation and efficiency displayed by the FDA will continue its forward momentum and will be translated into sales and earnings for the biotechnology sector going forward.

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## Private equity

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

### Manager's report for HarbourVest Global Private Equity – 27 November:

Private equity fundraising remained robust in the US and Europe during the first half of 2020, totalling \$101.6 billion (H1 2019: \$102.8 billion) and €19.6 billion (H1 2019: €12.0 billion), respectively, across a total of 139 funds (H1 2019: 76 funds). The comparably high figures this year were driven by established GPs with long-standing LP relationships, which had started their fundraising processes earlier in the year.

By contrast, investment activity slowed down significantly across all regions with deal activity totalling \$326.7 billion in the US (H1 2019: \$404.7 billion) and €46.3 billion in Europe (H1 2019: €73.7 billion) - decreases of 19% and 37%, respectively. The sharp decline in capital deployed was driven by a multitude of COVID-19-related factors as GPs temporarily paused or terminated transactions, with attention re-focused on existing portfolio companies. Unprecedented policy action from central banks and governments has led to a partial recovery in recent months. However, the "second wave" of COVID-19-induced lockdowns could potentially dampen the prospect of an imminent return to normal levels of investment activity. In the interim, bolt-on investment strategies and distressed opportunities may be attractive propositions for GPs, along with fast-growing sectors such as cloud computing, ecommerce, cybersecurity, cashless payments, and collaboration software.

Exit value and volume in the private equity asset class were materially lower across all regions during the first half of the year. Public market volatility and economic uncertainty resulted in significant markdowns for some portfolio company valuations at the end of Q1. This may explain the considerable reduction in appetite for exits in April and May, indicating that GPs generally preferred to extend holding periods rather than liquidate assets at potentially discounted prices. Estimated exits in the US totalled \$138.4 billion and 392 in number, representing declines of 37% and 36% in value and volume, respectively, compared to H1 2019 totals. Asia Pacific and Europe were also subdued, with the latter recording a total €97.0 billion of exits, which puts it on pace for its lowest annual total in six years. Nevertheless, over the summer of 2020 we saw exit activity in all regions begin to rebound following the recovery in public markets in Q2, although considerable uncertainty remains.

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## Renewables

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(compare renewables funds [here](#))

### Manager's report for JLEN Environmental Assets – 26 November:

Against the backdrop of international collaboration to limit further climate change, the decarbonisation of the energy system is an integral part of developing a sustainable future. To make this happen a significant investment into new environmental infrastructure will be required.

Global investment into renewable energy generation will be significant to meet climate targets. 55% of the EU's energy consumption will need to come from renewable sources by 2030, requiring some €400 billion of investment. Increasing electrification of end users will drive increased power demand to be met from renewable sources.

Energy efficiency is an integral part of addressing climate change. Within the UK, widespread deployment of energy efficiency measures will be required to meet the net zero target now enshrined in law. New infrastructure will be required that either offers a more efficient way to generate or distribute energy or a means to reduce the demand of energy users.

Water deficits are expected to become more prevalent in the UK with wetter winters and drier summers. The UK water industry has pledged to achieve net zero carbon emissions by 2030. Diverting biodegradable waste from landfill remains a key policy and the use of carbon capture and storage alongside bioenergy facilities will play a future role in meeting climate objectives.

The scale of the climate challenge has resulted in government policy drivers on a global scale. Technologies and commercial partners can provide continuity across jurisdictions whilst more localised climate conditions and market dynamics present diversification opportunities.

Within the UK, a recent Government announcement to support up to double the capacity of renewable energy in the next Contracts for Difference auction, opening in late 2021, demonstrates the commitment to this sector. Although offshore wind is at the heart of this near-term strategy, an important contribution will come from other sectors. Within Europe, countries are establishing their intentions on how to meet their climate objectives.



Low-carbon investment opportunities could encompass combined heat and power systems, batteries storage and flexible generation, low-carbon agriculture, co-location of battery storage with existing assets, electric vehicle and low-carbon transport infrastructure such as biofuels.

Following waste reduction measures, further investment into materials recycling will be required; new legislation for food waste collection is expected to generate demand for new and expanded anaerobic digestion facilities. Energy from waste facilities are being developed to reduce residual waste to landfill.

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### **Kevin Lyon, chairman of NextEnergy Solar – 23 November:**

Undoubtedly, the economic shock of COVID-19 has had a profound impact on energy demand and commodity prices. However, the near-term power price recovery towards the end of the period and beyond has underlined the resilience of our sector in the current uncertain environment. The price for electricity is driven by several factors that are proving particularly difficult to predict in the current environment but is ultimately dependent on the supply and demand for electricity. A sustained upturn in demand for electricity will be driven by the pace of economic recovery once the effects of the pandemic subside.

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## **Infrastructure**

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(compare infrastructure funds [here](#))

### **Manger's report for HICL Infrastructure – 25 November:**

Despite challenges, the predictable long-term yields from core infrastructure remain highly attractive to institutional investors. Activity in the sector has resumed with a number of transactions having completed during the period and with valuations at historically high levels. Looking forward, the sector continues to benefit from strong fundamentals. These are derived not only from the anticipated infrastructure spending associated with governmental responses to the pandemic but also as a result of the powerful macro-trends that continue to shape the requirements of the infrastructure of tomorrow.

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### **Manager's report for 3i Infrastructure – 11 November:**

The European economic infrastructure market remains competitive, with strong demand for new investments. Despite the restrictions imposed in response to the COVID-19 pandemic, we have seen a reasonable level of transaction activity.

We remain cautious about the speed of the recovery in economic activity and conscious of further COVID-19 related risks. The risk exposure from market/economic risk remains elevated as a result of COVID-19, and this remains the top risk facing the Company.

The UK's future trading arrangements with the EU and the regulatory environment in which the Company operates remain uncertain and could create a generally less favourable financial environment for the Company and its investments. The majority of the Company's investments are in domestic businesses with limited cross-border trading. This mitigates the risk to the Company of there being unfavourable trading terms between the UK and the EU.

Inflation in the UK declined sharply in the period, falling to its lowest level since June 2016. This downwards trend was also seen in European inflation rates. The decrease in inflation negatively affects assets with inflation-linked revenues, but this is partially offset for assets with inflation-linked costs.

Interest rates remained low during the period. Government bond yields have declined further over the period, from already historically low levels.

A recovery in air travel commenced following the easing of restrictions imposed in response to the COVID-19 pandemic. This recovery has been hampered by restrictions being reimposed in certain countries towards the end of the period. Air traffic movements and passenger numbers remain substantially below prior year levels, and the timing and extent of future recovery is uncertain.

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## Property - UK

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

### **Lorraine Baldry, chair of Schroder REIT:**

We expect the economic recovery to remain uneven during the first half of 2021. It is however forecast to pick up later next year assuming restrictions are relaxed with improvements in testing and the probable availability of a vaccine. COVID-19 related uncertainty is accompanied by the concluding Brexit negotiations where failure to deliver a trade agreement would have a damaging impact on economic activity. These risks could lead to average real estate values falling but this will be highly polarised between sectors and the asset class will be supported by continued low or, potentially, negative interest rates.

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### **Richard Moffitt, chief executive of Urban Logistics REIT:**

The logistics market remains in focus with property investors due to its resilience at the current time and the forecast for the next few years shows a continuation of its outperformance. The UK continues to be one of the fastest growing adopters of online retail sales and there is a requirement for all tenants to develop their e-fulfilment capability accordingly. As such, key geographic regions across the UK are seeing buoyant leasing activity.

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### **Andrew Coombs, chairman of Sirius Real Estate:**

Against the background of the second lockdown in Germany in November 2020 successful trials of a potential vaccine provide hope that there may be an end in sight to COVID-19 uncertainty and the related economic difficulties. Germany appears to have been impacted less than many other countries, in particular compared with other G7 countries. Furthermore, the breadth and extent of state support has, thus far, limited the economic impact of COVID-19 and, as a result, confidence has returned within the German commercial real estate market. Occupier demand for both conventional and flexible space has remained strong while investor appetite for the German light industrial market and the stable high-yielding income returns it offers has resulted in a return of transactional activity and downward pressure on yields.

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## **Michael Wrobel, chairman of Civitas Social Housing:**

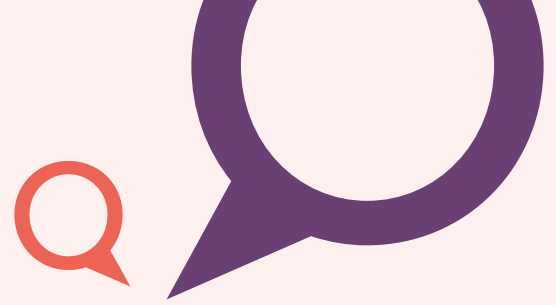
The coronavirus pandemic has reinforced the need to provide safe, high quality homes for the most vulnerable people in our society, and to bring new properties into the sector. Demand amongst those needing care-based housing continues to rise, notably amongst younger people reaching adulthood and wanting their own independence. The drive for more community-based housing with care has full support across political parties and local authorities have a statutory duty to house the homeless and most vulnerable. Civitas Social Housing sees compelling opportunities to invest further in this sector. A pipeline of £180m has now been developed which will be partly satisfied when the new debt facilities come into place and leaves open the prospect of future equity raises subject to market conditions and investors' views.

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## **Manager's report for AEW UK REIT:**

The strength and timing of the economic recovery will largely depend on the success in implementing a vaccine, while a no deal Brexit scenario will also pose a risk. The KPMG Economic Outlook forecasts growth of 8.4% in 2021, assuming a vaccine is approved in January 2021 and an outline trade agreement is reached with the EU by the end of the transition period, with the economy forecast to reach pre-COVID-19 levels by the start of 2023. However, the picture is ever changing, and it is difficult to place any significant reliance on forecasts with such variable assumptions. Inflation is expected to remain well below the Bank of England's 2% target, which should see the base rate remain at 0.1% or below until at least the end of 2021. General recovery in the UK commercial property market is expected to track that of the wider UK economy although recovery in sub sectors of the property market will be driven by structural forces as well. A much publicised example of this includes the growth of online retail sales at the expense of physical stores, which has seen a divergence in the capital values of the retail and industrial warehousing sectors.

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