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INVESTOR

Economic & Political Roundup

Monthly roundup | Investment companies | February 2021

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

Exchange rate	31/01/21	Change on month %
GBP / USD	1.3708	+0.3
USD / EUR	0.8239	+0.6
USD / JPY	104.68	+1.4
USD / CHF	0.8903	+0.6
USD / CNY	6.4283	(1.5)

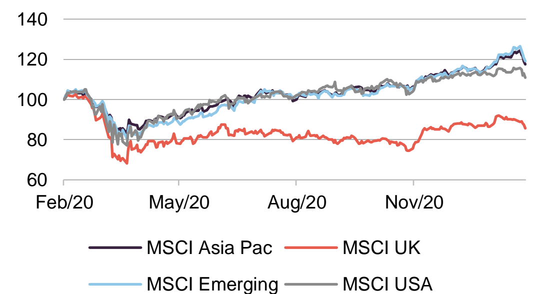
Source: Bloomberg, Marten & Co

Roundup

Emerging markets were quickest out of the gates in January, building on a strong 2020. The oil price was stronger too. 10-year bond yields in the US and UK rose were up, after hitting record lows last year, pushed on by improving sentiment tied to vaccines, and the prospect of more stimulus in the US especially. Elsewhere, the growing power of organised retail investors in the US, was one of January's main themes.

MSCI Indices rebased to 100

Time period 01/02/2020 to 31/01/2021



Source: Bloomberg, Marten & Co

Global

Biden presidency should ease trade tensions

Sue Inglis, chair of Bankers, looks at what to expect as Joe Biden begins his presidency. She notes that with the likely exception of China, trade tensions should ease, resulting in lower market volatility.

	31/01/21	Change on month %
Oil (Brent)	55.88	+7.9
Gold	1847.65	(2.7)
US Tsy 10 yr yield	1.0655	+16.7
UK Gilt 10 yr yield	0.327	+66.0
Bund 10 yr yield	(0.519)	(9.3)

Source: Bloomberg, Marten & Co

UK

Severe tests remain for corporates

The manager of Aberforth Smaller Companies makes the point that the consensus view is that yesterday's winners will be tomorrow's winners and there is little questioning of taut valuation stretches between and within markets.

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January's highlights

UK (continued)

Neil Hermon, manager of Henderson Smaller Companies, says that in the corporate sector, conditions are intrinsically stronger than they were during the financial crisis of 2008-2009. Balance sheets are, in particular, more robust. However, he adds that the scale of economic shock means that this 'strength' will be severely tested and key questions for investors today revolve around a company's available liquidity, leverage, bank covenants and ability to see the economic downturn through.

North America

Are we nearing the end of the almost 40-year bull market in US bonds?

Baillie Gifford US Growth's manager recaps on an excellent year for the fund, with a review of the areas of the healthcare and technology sectors it invests in.

The manager of Gabelli Value Plus+ says that we are probably in the final innings of an almost 40-year bull market in US bonds.

Asia Pacific

Invesco Asia's chairman, Neil Rogan, recaps an excellent 2020 for Asian markets. He also explains how a political risk discount is one of the reasons why Asian markets have typically traded at lower valuations than, say, America.

China has been opening up selected areas of its economy to foreign investors

Ayaz Ebrahim, Robert Lloyd, and Richard Titherington, managers of JPMorgan Asia Growth & Income, explain that although trade wrangles between the US and China remain a source of uncertainty, the Chinese government continues to open up selected areas of its economy to foreign investors. Areas such as insurance, banking, asset management and automotive production are gradually being liberalised and becoming more accessible, with strong interest from foreign investors.

Other

We have also included comments on the flexible investment sector from BMO Managed Portfolio Growth and BMO Managed Portfolio Income; country specialist: Europe - ex UK funds from JPMorgan Russian; private equity from Standard Life Private Equity; growth capital from Chrysalis Investments; leasing from KKV Secured Loan; and UK property from BMO Real Estate Investments, U and I Group, and Safestore.

Global

(compare global funds **here**)

Sue Inglis, chair of Bankers - 18 January:

Since our year-end, Joe Biden's success in the US presidential election, positive news flow regarding COVID-19 vaccines and approvals of a new US stimulus deal and a UK - EU trade deal have all acted as catalysts for another global stock market rally.

The rollout of COVID-19 vaccines will significantly improve the outlook for the global economy in the year ahead. However, until an effective vaccination programme is implemented globally, economies will remain vulnerable to further national or localised lockdowns as the struggle to contain the spread of the virus continues, which means that economic recovery is likely to be bumpy and a return to the "new normal" will take time. In the meantime, we expect both monetary and fiscal policy to remain extremely accommodative which, in conjunction with continuing low-interest rates, should be supportive for equity markets. There will almost certainly be some profound long-term consequences of COVID-19 for businesses, economies and geopolitics, but these will only become clearer over time.

Away from COVID-19, Joe Biden will be sworn in as US President on 20 January 2021 and, unlike his predecessor, is expected to adopt a constructive and considered approach to diplomatic matters. Consequently, with the likely exception of China, trade tensions should ease, resulting in lower market volatility. With the Democrats having secured control of the Senate in the Georgia run-off elections earlier this month, President-elect Biden will have the chance to take more political control, including increasing taxes and regulatory oversight. However, this should be balanced by a further COVID-19 relief package, which is expected to be an early priority for the new administration.

The UK stock market, dogged by Brexit uncertainty and held back by its low exposure to technology and other high-growth stocks, has been shunned by both domestic and international investors for some time. With Brexit uncertainty now much reduced following the eleventh-hour agreement of a UK - EU trade deal and the UK stock market's bias towards cheap cyclical stocks, investors should begin to be tempted back.

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Flexible investment

(compare flexible investment funds **here**)

Colin S McGill, chairman of BMO Managed Portfolio Growth and BMO Managed Portfolio Income - 28 January:

After the experience of 2020 where the pandemic caused an unprecedented sharp and deep recession the news of a number of effective vaccines has brought the hope that by the second half of this calendar year economies will be moving towards normalisation. Financial markets are assuming this will be the case. In the meantime, massive monetary and fiscal stimulation from various governments and Central Banks is being undertaken to ensure recovery will be robust as the year unfolds. Valuations of many equity markets (particularly the US) are at high levels,

however, the expectation is that economic recovery will be accompanied by a rapid and substantial recovery in corporate earnings in 2021.

Since the Brexit referendum in 2016 UK equities have been a persistent underperformer relative to most other major equity markets. This has left the UK very attractively valued when compared to other global equity markets. Conclusion of the post-Brexit trade agreement and the removal of the accompanying prolonged uncertainty should help to clear the way for a revival in the relative performance of the UK equity market. Although current lockdowns may delay the recovery, there is confidence that widespread vaccination will eventually bring about a concerted move towards normality.

UK (continued)

(compare UK funds **here**)

Manager's report for Aberforth Smaller Companies - 29 January:

After the initial period of confusion, reflected in the precipitous drop in share prices, the summer months brought some stability and clarity. While the full economic impact of lockdown – the longer term "scarring" – has been deferred by the official support measures, it became clear that the virus could be controlled. This allowed some tentative recalibration of forecasts both by companies and investors. Meanwhile, the immediate and most pressing corporate liquidity issues were quantified and addressed. At the same time, the easing of lockdown brought a recovery in companies' revenues and suggested a willingness on the part of consumers to revert, more or less, to previous habits. It was through this middle part of the year that the boards of small companies proved that they could meet the challenges posed by COVID-19 and proved the resilience of their businesses, as they did in the global financial crisis and in the wake of the EU referendum. Trading updates through the Autumn were generally better than expected and several companies were able to resume dividend payments.

Against this background, which was encouraging despite the advent of the second lockdown, the vaccine announcements arrived in November. These proved the catalyst for a broad reappraisal by the financial markets of the prospects for economic activity and for cyclical companies. Investment horizons elongated as confidence rose that a return to a normal way of life was achievable and that a recovery in profits could commence. The stockmarket re-engaged with businesses that it had previously priced to be without a future of more than a few years. These companies were aggressively re-valued. This was another damning episode for market efficiency, with the equity market again struggling to calibrate value in a period of stress. Echoing the experience of the Nifty Fifty and the TMT bubble, the market focused narrowly on those businesses immune to or benefiting from the effects of COVID-19. It, therefore, lost sight of the beneficiaries of the ingenuity that it otherwise prized so highly.

The inspiration from the remarkably rapid vaccine development would have been a good way to have ended a bad year. However, Brexit politics threatened to complicate the immediate outlook for the UK economy. In the event, a trade deal with the EU was secured. The detail of its implementation is not yet fully clear, but the near term prospects for the UK economy are undoubtedly better with an agreement in place. From the perspective of the portfolio, it reduces uncertainty and removes an excuse for overseas investors to ignore UK assets, which have been

global pariahs for several years. Nevertheless, beyond Brexit, any upside from the UK's regained sovereignty may be complicated by the political fallout from COVID-19 and questions about the Union itself.

Most companies are sensitive to the economic cycle, with their profits waxing and waning in step with broad economic activity. It is certainly the case that, since the global financial crisis, cyclicality around the world has been shunned by most investors – stockmarket valuations of such businesses had fallen to the extent that they have attracted value investors, such as the Managers. With the onset of COVID-19 and lockdown, cyclical companies have suffered disproportionately in terms of profits and share prices. However, cyclicality does not equate to low quality. The businesses within the portfolio, while predominantly cyclical, are resilient. They can cover their cost of capital and can grow from cycle to cycle. They are well managed and balance the interests of their shareholders with responsibilities to other stakeholders. These characteristics are often overlooked, seldom to such a degree as in 2020, but give confidence that future challenges can be met.

Outlook

It is difficult to do justice to just how extraordinary 2020 was. A normal year would have been defined by the recently decided presidential election, remarkable for the conduct of the incumbent, or, closer to home, by the on-going wrangling over a trade deal with the EU. Both these issues have, of course, been overwhelmed by COVID-19. The stockmarket's verdict on the impact of the coronavirus was abrupt and decisive: the share prices of the strong but cyclical businesses favoured by the fund were crushed, while the share prices of the highly valued technology companies benefiting from lockdown conditions rose further. The fund's performance suffered accordingly.

The managers do not disagree with the stockmarket's differentiation between those two cohorts of companies in the context of the onset of the coronavirus or with the proposition that the prospects of some businesses have been fundamentally changed by the pandemic. However, the degree of the differentiation was harder to understand, unless numerous inherently profitable businesses were going to fail. As government and shareholders offered their support and as management teams took the necessary actions, it became clear that this would not happen. Additionally, the stockmarket's reasoning only went so far: it was fascinated with the ingenuity underlying the technology businesses that benefited from pandemic conditions but did not appear to contemplate which companies might benefit from the astonishing human endeavour involved in developing the vaccines. From this it was clear that much of the universe of small UK quoted companies, already more attractively valued than usual at the start of the year, was offering exceptional value.

The vaccine news went on to challenge the stockmarket's prejudices and, alongside the Brexit trade deal, allowed the year to end more encouragingly. The recovery is, though, in its early days and the portfolio's valuations remain lower than their long term historical average. This in part reflects lingering uncertainty about COVID-19: as the new year begins, the world is grappling with a new more highly transmissible variant of the virus, which is necessitating incremental lockdown measures in the UK and elsewhere. Nevertheless, the vaccines continue to be rolled out and thus allow markets to contemplate prospects beyond the duration of the current lockdown.

Further out, the impact of normalisation will inevitably fade, which is likely to bring the broader influences on investment style back to the fore. The disinflationary trend of the past 40 years, accelerated by the extraordinary monetary policies imposed after the global financial crisis, has favoured the growth style. It remains to be seen

how the world reacts to the shock of the pandemic. The initial collapse in demand is undoubtedly deflationary, but the supply side has also been affected. On top of this, governments appear to be looking to move on from stimulus policies that have relied heavily on monetary actions. Fiscal spending, sometimes under the banner of “modern monetary theory”, is being widely heralded as the solution to the coronavirus deficit, low growth and wealth disparity. Even leaving aside the dubious recent record of politicians, fiscal stimulus and a larger role for government usually lead to inflationary pressure.

Despite the complexity of the generational issues that affect the debate between inflation and deflation, the financial markets harbour little doubt. The consensus view is that yesterday’s winners will be tomorrow’s winners and there is little questioning of taut valuation stretches between and within markets. Government bonds are priced as “return-free risks” and most listed companies, in the UK and more broadly, are very lowly valued by the stockmarket.

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Neil Hermon, manager of Henderson Smaller Companies - 27 January:

The COVID-19 outbreak has dramatically changed expectations for global economic growth. The lockdown measures we have seen across the globe are having a profound effect on economic growth and have caused an unprecedented demand shock. Government actions to protect consumers and businesses from the worst impact of this shock will soften the blow but ultimately can only be short-term in nature given the scale of the bail-out required.

The virus will pass and the global economy should recover. However, the shape and magnitude of the recovery are, at this point, uncertain. In the UK social distancing measures and national lockdown had an initial positive impact on infection and death rates but a 'Second Wave' has seen restrictions tighten again. The positive vaccine news announced in November has raised the very real possibility that life may return to some sort of 'normal' during 2021 with a consequent sharp rebound in economic activity.

Outside of COVID-19, there has been positive progress on other key matters. The EU and the UK have finally agreed on a trade deal removing the threat of the damaging implications of a hard deal Brexit. The US election outcome was closer than expected but a definitive resolution has now been reached. Hopefully a Biden presidency should see a more conciliatory and pragmatic approach to US foreign and trade policy.

In the corporate sector, conditions are intrinsically stronger than they were during the financial crisis of 2008-2009. Balance sheets are, in particular, more robust. However, the scale of economic shock means that this 'strength' will be severely tested and key questions for investors today revolve around a company's available liquidity, leverage, bank covenants and ability to see the economic downturn through. On the whole, so far, the UK corporate sector has performed well during the crisis and most companies are beating their initial, post COVID-19, earnings and cash expectations.

In terms of valuations, the equity market is now trading below long-term averages if we apply historic earnings. However, corporate earnings will be sharply down in 2020 and the extent of recovery in 2021 and beyond is uncertain. Additionally a significant proportion of corporates have suspended or cancelled dividends, preserving cash to shore up their balance sheets.

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North America

(compare North American funds **here**)

Manager's report for Baillie Gifford US Growth - 18 January:

After a long and bleak year, we have entered 2021 with light at the end of the tunnel. Countries around the world are starting to vaccinate their populations. The number of people whose immune systems are primed to fight coronavirus is growing each day. We must not get complacent, and there is still a long road ahead, but there is a chance that we are now at the beginning of the end of the pandemic. We have science to thank for this. Vaccine development has traditionally taken years. There are many infectious diseases where there is still no vaccine available (e.g. HIV). The coronavirus vaccines have been developed in little over a year. Importantly, these vaccines are highly efficacious. It has been a huge effort which has required co-ordination amongst many parties. As well as capital and will, modern science has been an important catalyst for this breakthrough.

For decades drug discovery has largely been a process of trial and error. Our understanding of disease pathways has been relatively limited. Even in cases where diseases have been well understood we have had few tools with which to intervene. This has led to low success rates. Furthermore, in the traditional drug development model outcomes are independent of one another. Success with one drug tells you nothing about the probability of success with the next. But we may be entering a new era for drug development. One of true platforms, where success begets success. A cohort of biotechnology companies are emerging which are built upon foundational technologies which may be reusable across multiple diseases and disease categories.

We are moving from a world of spaghetti at the wall drug development to something more akin to industrial manufacturing.

These developments would not have been possible without commensurate progress in our understanding of the molecular basis of disease. Techniques like low-cost whole-genome sequencing, which was pioneered by portfolio holding Illumina, have helped build our knowledge of the DNA that serves as the blueprint of life. More recently, Google's AI division DeepMind achieved a breakthrough in the field of protein folding. By using an AI-powered programme called AlphaFold, DeepMind was able to predict the 3D structure of a protein to a high degree of accuracy by just looking at the protein's corresponding DNA sequence. This problem has vexed scientists for half a century. Only a tiny fraction of protein structures have been solved. DeepMind achieved what experts thought would take another decade in two years. This breakthrough has the potential to drive a step change in our understanding of biology.

Healthcare is not the only sector which has seen major breakthroughs this year. In the energy sector, there has been an acceleration in the shift towards electric vehicles. Alternative energy sources such as solar have continued their march down the cost curve. Increasingly, they are competitive with carbon-based fuels. They are only going to get cheaper from here. And energy storage costs are falling too. The way we produce, store, and consume energy is changing rapidly. For the better. The end of carbon is getting closer.

And then there is space. 2020 was the year that America sent astronauts to the space station again.

Manager's report for Gabelli Value Plus+ - 5 January:

At the beginning of April, the US economy was virtually shut down as many businesses were ordered to close in order to slow the spread of the disease. The stock market fell during the month of March but, starting in April, the market began to recover slowly and gradually. The Federal government responded to the crisis with a massive fiscal and monetary stimulus. On the fiscal side, a number of programs were implemented to help prop up the economy and assist businesses that were shut down and individuals who were unemployed. On the monetary side, short term interest rates were quickly lowered essentially to zero in early 2020, and the Federal Reserve promised the markets that short term interest rates would stay near zero for at least a couple more years. In Congress, the Trump administration was not able to move forward with any major legislation, other than COVID-19 related stimulus, as partisan bickering continued ahead of the Presidential election in November.

The Economy

The US economy went into a deep but short recession in 2020. During the first calendar quarter of the year, the economy contracted by 5% as the pandemic began to impact the economy. Then, in the second quarter of 2020, the US economy experienced a massive contraction of slightly over 30%, as many businesses were shut down and travel was drastically reduced. Two consecutive quarters of negative GDP growth are defined as a recession. During the third calendar quarter of 2020, the US economy started to grow once again, with quarter over quarter growth of about 25% after the big contraction in the second quarter. We expect the economy will continue to grow in the fourth quarter, probably in the mid-single digit range, as the health care community gets better at treating and preventing the COVID-19 virus.

The Markets

Investors are facing an acute shortage of good income generating opportunities. While not a realistic choice for some investors, stocks must play a larger role overall in meeting investors' income needs. At this writing, the dividend yield on the S&P 500 Index is higher than the 10-year US Treasury yield, which currently is around 0.7%. Stocks offer compelling current income and growth of income for investors who can tolerate stock market volatility. Stocks also offer the potential for growth in capital over time. It is hard to imagine growing capital by investing in bonds at historically low interest rates. We are probably in the final inning of an almost 40 year bull market in US bonds.

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Asia Pacific

(compare Asia Pacific funds **here**)

Neil Rogan, chairman of Invesco Asia - 25 January:

Many are wondering if they have missed the opportunity to invest in Asia that presented itself in 2020. Asian markets have bounced 59% off their March lows and are at new highs. However, even now Asia has underperformed the MSCI World Index sharply over 10 years with the MSCI Asia ex Japan Index +147% versus the World's +218%.

There are possible tailwinds for markets with the return of consumer and corporate confidence post COVID-19, a recovery both of domestic and export markets for Asian companies, support for capital inflows from a weaker US dollar. The new Regional Comprehensive Economic Partnership comprising the ASEAN countries plus China, Japan, South Korea, Australia, and New Zealand will provide fresh longer term benefits. Possible headwinds include above average starting valuations, COVID-19 related setbacks, the threat of rising interest rates as economies recover and greater regulation of the large technology companies that have dominated stock markets last year.

Overall there are too many variables to make a confident prediction of absolute returns from here. But the case for Asia relative to the world does appear strong and that is a good starting point. Moreover, political uncertainties have risen to the fore. Political risk has always been a feature of investing in stock markets and it is particularly so in Asia. While political risk can lead to falls in stock markets, it can also lead to opportunities for gains. One of the reasons why Asian markets have typically traded at lower valuations than, say, America is the political risk discount. The recent US Executive Order restricting US persons from investing in certain Chinese companies has affected some of our institutional shareholders who manage money on behalf of American citizens.

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Ayaz Ebrahim, Robert Lloyd, and Richard Titherington, managers of JPMorgan Asia Growth & Income - 11 January:

What a difference a year can make; Asian equities ended 2019 on a strong note, supported by positive investor sentiment, backed by incremental central bank liquidity, supportive government policies and the unwinding of trade and geopolitical tensions. Notable developments included the emergence of a phase one trade deal between the United States and China, as well as the United Kingdom moving away from a disorderly exit from the European Union.

The constructive macro backdrop was rudely disrupted in the first quarter of 2020 by the outbreak of the coronavirus pandemic, with Asian equities dropping sharply along with other global markets. However, equally remarkable was the sharp rebound from late March, fuelled by an unprecedented level of monetary and fiscal stimulus offered by central banks and governments globally. Unlike in the previous market cycle, the driver for the market rebound was not cyclical stocks, but structural growth sectors such as Information Technology, e-commerce, and Healthcare: businesses which proved less vulnerable to the pandemic, or where demand actually accelerated as a result of it.

China was one of the best performing markets, along with Taiwan, thanks to effective government interventions on COVID-19 and therefore a faster recovery in economic activity.

In India, Financials continued to struggle as the macro outlook remained highly challenging.

The pandemic accelerated many of the structural trends we were already observing, such as digital transformation, the shift to the cloud and the adoption of online alternatives. The crisis also forced consolidation across many sectors where firms with leveraged balance sheets were struggling, while favouring industry leaders with strong balance sheets and competitive positions. Consolidation in sectors such as restaurants, textiles and Chinese real-estate benefitted the best and largest players.

On the flipside, the pandemic hit the more macro-sensitive cyclical sectors, such as banking and energy, the hardest. Unlike 2008's global financial crisis, the financial sector is not at the epicentre of the current downturn, however banks have had to conserve capital, extend credit and cut shareholder benefits. This was most notable among large state-owned banks in China. Energy has been hit because of the sharp decline in travel and our holdings across the region were negatively impacted.

Although the trade wrangles between the US and China remain a source of uncertainty, the Chinese government continues to open up selected areas of its economy to foreign investors. Areas such as insurance, banking, asset management and automotive production are gradually being liberalised and becoming more accessible, with strong interest from foreign investors.

Increasing geopolitical pressures have also meant that Chinese companies in particular are increasingly raising capital in local markets instead of the US, with many existing US-listed firms issuing new capital in Hong Kong and China.

From a bottom-up stock selection perspective, there are many businesses which are driven by domestic demand, irrespective of geopolitical tensions. Rising incomes in such an enormous country that is undergoing economic transformation is leading the shift to a consumer-led economy resulting in many attractive stock opportunities.

After such a landmark year dominated by human and economic shock and its aftermath, predicting the outlook for the coming year is rather challenging. The continued spread of COVID-19 in some parts of the world whilst other territories see a gradual normalisation in household mobility and spending epitomises our conundrum in forecasting what lies ahead. However, it is clear that investors are already considering the potential for recovery. At the time of writing, valuations have risen to the higher end of their 10-year historical range, while earnings expectations continue their own recovery, with positive revisions apparent in more sectors and countries.

As the world attempts to adjust to some sort of 'normal order', we believe that the pre-existing structural trends in Asian equities will reassert themselves. The fundamental backdrop remains favourable, as the secular growth trends that we have witnessed in this region have either remained intact this year or even accelerated as a direct result of COVID-19. Examples include the growth in e-commerce and online gaming, increasing adoption of industrial automation, and surging demand for semiconductors. Furthermore, governments and central banks in Asia are committed to maintaining their accommodative policy stances which should cushion their respective economies in what remains of this economic downturn.

Whilst we remain broadly optimistic on the long-term outlook for Asian equities, the current environment renders it crucial that we exercise caution. The road to recovery from the pandemic remains uncertain whilst the gradual withdrawal of stimulus programmes (such as unemployment benefits and fiscal aid) may create a roadblock along the way. It is also important to highlight that valuations are above-trend and that it may become more challenging to beat market expectations given that the low hanging fruit on consensus upgrades have already been factored into prices. As a team, we adopt a patient approach and having a valuation framework is vital in that respect, allowing us to look beyond short-term trends in order to identify attractive long-term growth opportunities.

The quality of growth from companies trading at rich multiples will become more important as those corporates that fail to meet market expectations may see their heady valuations come under pressure.

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Global emerging markets

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

Ross Teverson, manager of Jupiter Emerging & Frontier Income - 29 January:

While emerging and frontier markets recovered substantial ground from the lows reached in March and April of this year, most markets outside of North Asia were in negative territory over the period. MSCI benchmark returns for key markets were as follows: China 27.9%; Taiwan 27.7%; India -2.2%; Frontier Markets -7.3%; Mexico -23.8%; Russia -18.9%; and Brazil -34.9%. From a funds flow perspective, North Asia benefitted from inflows, while most other markets, particularly those in Latin American and frontier markets, experienced quite persistent outflows.

We believe that it is important to recognise that while coronavirus daily case numbers have remained high in most markets, many companies' results and guidance suggest that the worst of the COVID-19 impact on operational performance may be behind us. Similarly, macro data points in markets such as Brazil, Mexico, and India, indicate that economic activity has substantially recovered from the lows experienced in the second quarter of 2020, despite continued high levels of new COVID-19 infections in those countries. We believe that a combination of an improving operating environment for companies and attractive valuations, creates considerable opportunity for investors in the asset class.

Clearly banks have been some of the hardest hit businesses through the pandemic. However, the overall picture is one of banks having provisioned conservatively during the first half of 2020 and now being in a position where capital ratios, which are generally higher in emerging markets than in developed markets, are improving on a sequential basis.

This was evident in quarterly results for Bank of Georgia, which is held in the portfolio. The bank saw its total capital ratio improve at the end of the second quarter of 2020, having taken very prudent provisions in the previous quarter. Further evidence of an improving picture came from leading Russian bank, Sberbank, which, having earlier in the year delayed its dividend decision, later confirmed that it would distribute a normal level of dividend (which the Company received in October, rather than the usual June/July timing).

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Russia

(compare country specialist: Europe - ex UK funds **here**)

Oleg Biryulyov and Habib Saikaly, managers of JPMorgan Russian - 27 January:

This has been a unique period in which Russia's economy and investment markets were, along with the rest of the world, negatively impacted by the COVID-19

pandemic. It has been a testing time for us as investment managers, with COVID providing an unsettling backdrop from January onwards. The pandemic exacerbated an already challenging situation in which global trade was muted, demand for major commodities had weakened materially and corporate profitability was under severe pressure. Moreover, the country's position as the world's largest energy exporter created specific challenges, with severe oil and gas price weakness an inevitable consequence of a global economy that shuddered to a halt in early 2020 and remained challenged throughout the year.

When we wrote to investors in June, we commented on Russia's 'perfect storm' of freefalling commodity prices and very real disruption to both the Russian economy and civil activities. By the end of April, Russia had posted its worst ever drop in retail sales, unemployment had risen to its highest level in four years, and the rouble had devalued materially. Russian equities plunged some 30% as a result of the pandemic, in volatile trading days that were reminiscent of 2008's global financial crisis. Markets subsequently bounced back relatively quickly, with some commentators judging that the country's significant reserves would render it well equipped to handle the economic fall-out. However, although equity valuations have been in recovery mode since April, progress has been rather 'stop-start', with investors remaining cautious through to the end of the reporting period.

To date, Russia has managed the crisis adequately. The medical system was relatively well prepared to cope with a pandemic event like this, thanks to the Government's health care programme and its investment in new medical facilities over the last decade. Financial stimulus packages were admittedly modest by global standards, with less than 5% of Gross Domestic Product (GDP) spent on dedicated economic support. Nevertheless, financial support was made available to those residential households most affected by enforced lockdowns. There was also support for pensioners, plus a popular subsidised mortgage programme designed to bolster demand in the crucial residential construction sector. Businesses were offered credit holidays, subsidised loans and deferrals of tax payments. Also, the Bank of Russia acknowledged the uncertain environment by making successive cuts to its key interest rate to kick-start the economy and reduce domestic bills. There were four interest rate cuts in all in 2020, with the most recent one, in July, taking the rate down to 4.25%.

This time last year we were cautiously optimistic on the prospects for the Russian economy, having witnessed tentative signs of recovery and relative stability in both oil and currency prices. However, COVID-19 came from nowhere and changed everything: the Russian economy is expected to have shrunk by around 3.5% over the course of 2020. Whilst this is better than most other global economies it still has a very negative impact on the country's earnings. Oil prices, so pivotal to the fortunes of the Russian economy, have been in historic decline with the price per barrel for Brent crude oil collapsing to $20 in April before recovering to circa $40 by the end of October. Such unprecedented price movements impacted the purchasing power of households and suppressed consumer demand, not to mention shaving away 70-80% of profits for the Russian energy sector.

One positive consequence of lockdown and lower interest rates has been the record numbers of private investors shifting towards bonds and equities. In the first half of 2020, Russians invested more money in financial markets than they deposited in banks, with private investors playing an increasingly important role in market activity.

We continue to believe that the market in Russia provides a good long-term investment opportunity, although the biggest unknown right now is how long the

impact of COVID-19 will endure. Consumers and businesses are likely to remain risk-averse and wary on the economic outlook until the impact of COVID-19 recedes and there is a gradual restoration of the normal order. However, we note that the government's economic recovery plan aims to achieve 3% GDP growth in 2021.

We expect to see:

- Firmer oil prices in 2021, after the price shocks of 2020. These will be driven by production cuts and improving compliance with the guidelines, which will be positive for the earnings of Russian companies. As the world emerges from lockdown, transportation should recover and demand for oil products could be supported.
- The Central Bank of Russia likely to pause before considering further interest rate cuts from the current 4.25%, allowing time to consider how successful the cuts have been in stimulating spending and investment. We expect the rouble to recover some of the losses it sustained against the US Dollar and Sterling over the last year, bearing in mind that Russia's macro situation continues to be one of the best amongst leading global economies.
- After an extremely negative 2020, we expect 2021 and beyond to be positive for both earnings growth and the outlook for dividends.
- The environment around sanctions remaining fluid, and we will continue to monitor the situation. We do not expect any significant progress on diplomatic relations, as it will require a massive shift in stance over events such as the Ukrainian situation, which may not happen until there are leadership changes in the countries involved in this conflict. The state of the Russian economy will dictate how much pressure there is to resolve the current stalemate which clearly impinges on economic ties and trade relationships.

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Private equity

(compare private equity funds **here**)

Alan Gauld, manager of Standard Life Private Equity - 26 January:

The COVID-19 pandemic impacted pricing risk in the year, with relatively large fluctuations in portfolio valuations during the second half of the financial year. This stabilised towards the end of the financial year but the Manager remains alert to potential instability moving forward.

Periods of lockdown also resulted disruptions to private equity M&A. This has pushed out the timing of some exits in the portfolio but, nevertheless, the Company has still experienced strong realisation activity in the year. The Company also has a strong balance sheet position to mitigate any further unanticipated delay in the timing of exits.

We also look positively upon prospects for private M&A, despite the practical issues posed by the pandemic. Much like in 2020, M&A activity in 2021 is likely to be hampered by restrictions on physical meetings until the world returns to some form of normality. However, even if physical restrictions remain in place, we expect private equity to continue transacting high quality assets in popular sectors.

Fundamentally we believe that private equity thrives on the opportunities that present themselves during periods of market dislocation and economic headwinds. The private equity industry currently has plenty of capital, with record levels of dry

powder ready to deploy. Furthermore, we expect that secondary activity will increase as investors in illiquid assets come under liquidity or allocation pressures and need to rebalance their portfolios by selling exposure to private equity assets.

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Growth capital

(compare growth capital funds **here**)

Manager's report for Chrysalis Investments - 29 January:

The primary focus of global stock markets during the year was the impact of COVID-19 on society.

The NASDAQ performed strongly from September 2019 until the pandemic's effects began to be felt in February and into March, when it experienced a drawdown of approximately 30%. From that trough it rallied approximately 63%, to end the year to September 2020 up approximately 40%.

In the UK, the FTSE 250 suffered a drawdown of approximately 42% during the pandemic and rallied only about 32%, to end the year to September 2020 still down approximately 17%.

We believe the much stronger performance of the NASDAQ towards the end of the financial year illustrates the shift that occurred in investors' minds over this period. The initial COVID-19 response saw indiscriminate selling of stocks, with little differentiation in terms of likely impact on investment cases from the pandemic. As investors began to analyse its likely effects, it became clear that COVID-19 was likely to accelerate the pre-existing structural shift of consumers and businesses towards online and digitally enabled models.

This dynamic underpinned investor confidence in tech names, and saw the NASDAQ recover strongly. As a result, the FTSE 250, with its much lower exposure to structural growth names, underperformed relatively.

This dynamic played out to a lesser degree in the private markets too, where there was initially a period of hiatus in terms of activity, as many investors drew back from fresh investment.

However, given the regular flow of information from private companies, it became clear to most private market participants that generally most tech-enabled names were coping with the seismic structural shifts in demand far better than slower-to-react, more traditional business models.

As a result, activity in private markets picked up again over the summer.

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Leasing

(compare leasing funds **here**)

Manager's report for KKV Secured Loan - 27 January:

Highly volatile pricing of all assets across the risk spectrum and intermittent volatility spurts have been facets of all fixed income sectors during the reporting period. All fixed income products fell violently from March onwards and this was particularly severe for higher yielding assets although even US Treasury bonds were affected

briefly by a liquidity squeeze. Since the introduction of emergency market support packages from central banks, these markets have settled but the economic picture remains very uncertain.

As developed markets in the US, UK and Europe began to ease lockdown measures, market commentators expected a so-called "V shaped" recovery as businesses began to emerge from their forced hibernation. Our appraisal was more circumspect and despite spread tightening during the summer months for investment grade credits, as companies shored up their balance sheets with additional borrowing, we were particularly focussed on data relating to SME performance and securitised products such as Collateralised Loan Obligations (CLOs) and lower sub investment grade markets where the greatest pain had been observed. We expect coupon obligations to be put under pressure and forbearance to be the watch word for the next 9-12 months.

SME business confidence has fallen sharply and lower turnover due to COVID-19 has caused severe cash flow difficulties for many businesses, increasing demand for working capital finance. This has been coupled with a sharp increase in demand for loans and the uptake of government-backed schemes encouraging commercial banks to lend into the sector. Easing of credit criteria for loans by these banks has a second derivative effect of weakening capital adequacy and it is our expectation that once market conditions begin to normalise, lending patterns will revert to more conventional levels, allowing alternative lenders to pick up the baton once again.

The speed of recovery is, however, unclear at the present time. By way of stark illustration, unemployment in the US increased by 14 million in six weeks at the height of the COVID-19 emergency, whereas the total number of those losing jobs in the recession between June 2008 and June 2009 was 3.5 million and it then took four years for employment to return to pre-recession levels. Reversal of lost jobs takes time for an economy to absorb and we therefore expect this to impact consumption and consumer confidence. For lenders and borrowers alike, the safest route to normalisation is to keep sustainable businesses alive with support and forbearance, including maturity extensions and interest or amortisation "holidays", to enable them to resume trading and servicing their loans as rapidly as possible.

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Property - UK

(compare UK property funds **here**)

Peter Lowe, manager of BMO Real Estate Investments:

Despite a strong end to the year for parts of the market, buoyed by positive developments on vaccines and the resolution of Brexit, overall sentiment is cautious, with the re-imposition of lockdown restrictions increasing uncertainty around the path to recovery. Overall, the property market delivered positive total returns over the quarter [to the end of December 2020], largely driven by a strong performance from industrials and distribution. Performance was polarised, with town centre retail and leisure remaining under considerable pressure and offices faltering. Total return performance turned positive for retail warehousing.

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Richard Upton, CEO of U and I Group:

The macro environment has changed significantly, exacerbated most recently by a structural shift in behaviours resulting from the COVID-19 pandemic. Delays in completing transactions; reduced market confidence leading to a more cautious approach to decision-making; and a backlog in the planning system, have all impacted our financial performance and made it more difficult to provide clear short-term guidance on the performance of our projects. With this in mind, we are undertaking a 100-day portfolio review, starting immediately, which will critically examine all our projects so that we can refocus and reshape, strengthening our position for the future. It will assess the financial optimisation potential for existing assets; financing arrangements; a new framework to deliver more predictable income streams; focused ESG delivery and review the dividend policy. The plan produced from the review will deliver improved short- and long-term liquidity and a more efficient approach, together with revealing the potential within U+I's business to deliver compelling and sustainable socio-economic change from our core regeneration projects

Frederic Vecchioli, CEO of Safestore:

There are numerous drivers of self-storage growth. Most private and business customers need storage either temporarily or permanently for different reasons at any point in the economic cycle, resulting in a market depth that is, in our view, the reason for its exceptional resilience. The self-storage market in the UK and France remains relatively immature compared to geographies such as the USA and Australia. Self-storage capacity stands at 0.73 sq ft per head of population in the UK and 0.20 sq ft per capita in France [according to the Self Storage Association]. Whilst the Paris market density is greater than France, we estimate it to be significantly lower than the UK at around 0.36 sq ft per inhabitant. This compares with 9.44 sq ft per inhabitant in the USA and 1.89 sq ft in Australia. In the UK, in order to reach the US density of supply, it would require the addition of around another 17,000 stores as compared to around 1,400 currently. In the Paris region, it would require around 2,400 new facilities versus around 95 currently opened.

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