2012 OUTLOOKS

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Asset allocation outlook 2012 – Bill McQuaker

The balance of economic data already appears to show that the eurozone is in recession and is likely to stay there until at least the first quarter of 2012. The US is more finely balanced and has a good chance of avoiding recession, although it remains vulnerable to global events such as those unfolding across Europe.

Overall, we favour equities because they are the asset class that has most discounted a weak outlook and therefore offer the most upside potential. The possibility of a broader economic collapse cannot be ruled out but for the time being the odds are tilted against this.

Within equities we are most optimistic about the US, especially as investors, in general, have been sellers of US equities for the last 10 years, making the US potentially better placed as an investment. The Federal Reserve has a large tool kit, given its reserve currency status, and, importantly, is prepared to use it when the economy hits a weak patch. The US dollar remains relatively weak, which is good for the country's exporters, while the growing importance of shale gas – a cheap domestic source of energy – is providing a fillip. Labour markets in the US are flexible and responsive and the entrepreneurial spirit is encouraged, which is essential to helping a country develop the small businesses and jobs that tend to lift economies out of the mire.

- Bill McQuaker, Head of Multi-Asset at Henderson Global Investors

European Equities outlook 2012 – John Bennett

We believe we have entered the end game in Europe's sovereign crisis. Crucial to that view is the fact that markets have started to take control. That is a necessary pre-condition: a rout is so often the requirement to remind politicians that they are not, in fact, in control. Italian and Spanish sovereign bond yields hitting 6%, en route to 7% and beyond, was, to us, that point. Thus, while we believe that European equities may have further short-term downside, the fact that markets are in the mood to riot can only mean a solution to the EU situation is crawling closer to hand. With politicians scared, investors chasing the 'safety' of paltry fixed income yields and European equities slumping to compelling values it is hardly the juncture to be turning bearish. Blue chip bargains help remind us that bull markets are born in recessions.

- John Bennett, Director of European Equities at Henderson Global Investors

European Equities outlook 2012 – Richard Pease

European equity markets are likely to remain volatile in 2012 due to macroeconomic and political uncertainty. The current challenge would appear to be to persuade Mrs Merkel to allow the European Central Bank to resort to the printing presses to help both the funding crisis and the euro dilemma. Interestingly, following the forced de-leveraging by banks, consumers and governments, inflation is unlikely to be a major short-term issue, but with the Weimar Republic in mind, Germany is understandably nervous of releasing the inflation genie.

Whilst a disorderly default/ break-up of the euro cannot be entirely ruled out, a sensible solution is in everyone's interest even though politics have made this hard to achieve in a timely fashion. European equities are already discounting a bleak outlook and one could argue that with European indices trading on less than 9 times 12-month forward earnings (at 30.11.11) the market is inexpensive on any long-term view. Political uncertainty means the near term is difficult to predict but average dividend yields above 4% mean investors are being paid to wait. Strong balance sheets also offer some defensive cushioning as well as a ready fuel for a wave of merger and acquisition activity should sentiment improve. In our view, equities look underpriced relative to other asset classes. Investors need courage in these markets but this is precisely the time when long-term opportunities can be seized.

- Richard Pease, Director of European Equities at Henderson Global Investors

UK Equities outlook 2012- James Henderson

So much of investment thinking nowadays is dominated by euro area related headlines when instead it should be about valuations – currently at very undemanding levels, while earnings growth gathers pace.

2012 might surprise analysts – contrary to the consensus belief that margins have peaked and are on a downward path – I believe they will trend upwards. While current views are obscured by the constant flow of headlines, the outlook actually looks promising. The spring earnings season should prove a pleasant surprise. Top line sales have held up in the export areas to developing markets. With labour costs relatively stable, and lower raw material costs in some markets, margins have had room to grow.

Among the winners will be manufacturing, in particular aerospace and engineering, and some parts of the financial sector. Order books continue to grow in the aerospace industry while companies servicing the sector are not seeing a slowdown. Insurance and life assurance names in the financial sector on the other hand are substantially undervalued and are likely to benefit from the slightest return to confidence. But it will be a difficult period for consumers, with real spending powers reduced – there will be no place to hide on the high street.

Thus the year ahead looks promising. Away from the economically sensitive areas, the market has the potential to move substantially higher – maybe even as much as 20% – as earnings growth surprises to the upside and company valuation ratings converge towards a mean. Dividend payouts should also pick up to march side by side with earnings.

- James Henderson, manager of the Henderson UK Equity Income Fund

Asian Equities outlook 2012 - Michael Kerley

The obvious

Over the last decade the western world spent more than it saved, but Asia did the opposite – whereas there is a deficit in the west, there is a savings surplus in Asia. In the coming year we hope to see the beginnings of a reversal of this cycle as consumption levels rise in Asia with governments more focused on domestic demand rather than exports, which given the deterioration in global growth are likely to decline. If Asia succeeds in turning the cycle, the outlook should be bright.

The positives
Asia has the ingredients to perform. Company valuations are cheap, corporations are not highly indebted (in fact many are cash rich), and company management have been largely rational with capital expenditure. This gives Asian firms the ability to ride out any cyclical downturn much better than in the past. At a macroeconomic level, there are two advantages over the west. First, growth in Asia is likely to be at or above trend as opposed to the west, where it is likely to come in at or below trend. Second, whereas western governments are left with diminishing options to generate growth and eradicate ballooning deficits (given ultra low interest rates and high levels of debt), many policy levers are still open to Asia, allowing it flexibility in a downturn.

The risks
The most immediate will be political risk from the west impacting Asia. Lower than expected global growth could also exert a negative influence. In a somewhat more extreme scenario – possible but perhaps not probable – political interference could force some Asian currencies down and ultimately, severe trade restrictions might be applied to the detriment of all.

- Michael Kerley, manager of the Asian Dividend Income Unit Trust

Emerging Market Equities outlook 2012 – Chris Palmer
Global emerging markets should enjoy an upturn in 2012, as anxiety over Europe's seemingly endless debt crisis is remedied through a series of fiscal and monetary reforms aimed at reigning in profligate government borrowing and spending. Most countries in the global emerging markets index have been forced in one way or another over the past twenty years to restructure and reform their economic models, and to improve their national balance sheets. There is no reason to believe that Europe cannot accomplish these same tasks. With Europe's troubles receding in 2012 investors will be better able to focus on the strong fundamentals and growth opportunities presented by emerging markets. With global emerging markets trading on approximately 10x forecast earnings for 2012 (at 30.11.11), and despite many downgrades to consensus earnings expectations in recent months, we still expect 2012 to show positive earnings growth for global emerging markets equities overall.

Emerging market countries we are positive on for 2012 include Brazil, Russia, and South Africa. In the case of Brazil, we are encouraged by the recent easing in monetary policy and the relaxation of certain financial taxes which had discouraged foreigners from purchasing equities. Consumer-related shares and the energy sector are areas of interest in Brazil. Russia should enjoy a strong year from low valuations, stable commodity prices, and strong evidence of an improving attitude towards foreign direct investment and financial market reform. We are particularly optimistic on the natural gas industry, where there has been significant evidence that deregulation has boosted private investment. South Africa remains another favourite market, as strong domestic demand continues to propel the returns of a number of consumer-facing industries such as retailing and basic food products. Our strategy in Asian emerging markets is led by a positive view on China, where we expect further relaxation of monetary policy in 2012. This will provide an important catalyst for domestic cyclical stocks in areas such as machinery and cement. We are also positive on Thailand, where stable interest rates and a recovery in private capital investment should help the pace of loan growth in its banks.

- Chris Palmer, Director of Emerging Market Equities at Henderson Global Investors

Chinese equities outlook 2012 – Charlie Awdry

China's economic growth is visibly softening due to weaker demand from key export markets such as Europe and slower domestic growth. We expect inflation to continue to trend downwards as 2011 draws to a close and into 2012, giving the authorities more reason to ease monetary policy, which is traditionally positive for equity markets. We have already witnessed early signs of a pro-growth stance with fiscal efforts to boost the economy including VAT reforms, an easing of bank lending restrictions and reducing the reserve requirement ratio for banks.

Heading into 2012 we are cautiously optimistic. The once-in-a-decade leadership transition will create some policy uncertainty as there are signs of strong debates regarding China's future development path. We will be keeping an eye on global macroeconomic conditions, which are difficult in particular as a result of the euro area problems. As a result, in the short term we are likely to see more volatility. However, Chinese equity valuations remain low and this period of weakness should present us with investment opportunities over the long term. In the coming year high-end consumption, software and internet companies as well as natural resources such as gas and water are our preferred investment themes. 2012 promises to be another dynamic year for China.

- Charlie Awdry, manager of the Henderson China Opportunities Fund

Fixed Income outlook 2012– John Pattullo

Inflation and interest rates are unlikely to be a major threat for fixed income markets in developed countries in 2012, the key concern will be the impact of across-the-board deleveraging. Governments are embarking on austerity at a time when households and the banking sector are also deleveraging. This could hamper economic growth and worsen debt-to-GDP ratios. Although European politicians finally understand the gravity of the situation, they need to promote growth if they are to avoid further haircuts and potentially defaults amongst a number of peripheral eurozone countries. The eurozone's survival in its current form will depend upon whether Italy is forced into a haircut on its debt. Italian bonds are a widely held global asset so the consequences would be horrendous – Italy has the potential to be Lehmans II.

The disruption in the sovereign debt markets means that corporate bond spreads are discounting a lot of bad news. Current yields imply that over a five year period a cumulative 16% of BBB-rated European corporate bonds will default, which appears excessive when the worst ever historical figure was 5.8% and the average 2% (since 1970). For the coming year, we favour the lower end of investment grade and the better-rated high yield bonds. We are wary of AAA-rated investment grade, particularly in the UK where gilt yields are low as they are being manipulated by the government. At the other end of the spectrum, we are also avoiding CCC-rated issuers because their high debt levels may prove too much of a burden in a low or negative economic growth environment.

- John Pattullo, Head of Retail Fixed Income at Henderson Global Investors

UK Commercial Property outlook 2012 – Ainslie McLennan

Over the last 12 months, the UK commercial property market has shown considerable resilience at a time when other asset classes have been volatile. Although the market has lowered its return expectations for the year ahead, it does not mean that demand for the asset class is waning. With UK government bond

yields set to linger at historical lows for longer than envisaged, dividends from equities still uneven and cash deposit rates often failing to keep up with inflation, the yield profile of commercial property remains compelling.

The view is strongly that 2012 will be all about income. Having a tenant base which is strong enough to withstand further economic strain will be important, so high occupancy rates and low-risk tenants are key. It is the robust income stream of UK commercial property that will keep it in the frame as an attractive diversifier for multi-asset portfolios.

- Ainslie McLennan, co-manager of the Henderson UK Property Unit Trust

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