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ASSET MANAGEMENT (C.I.) LIMITED

Investment Memorandum

Market turbulence, in January, has made this a difficult quarter for international equity investors as markets reacted badly to developments in the Chinese stock market at the beginning of January. Sterling investors, with internationally diversified portfolios, have obtained some relief as sterling weakened and, with a market weighted portfolio, will have seen little change, but, for investors who are US dollar or euro based, returns will have been significantly negative. Bond yields fell as investors headed for perceived safety. The feature of the quarter in currency markets was the weakness of sterling, which we discuss later, whilst commodity markets continued to be weak.

The tables below detail relevant movements in markets :

International Equities 30.10.15 - 29.01.16

Total Return Performances (%)				
Country	**Local Currency**	**£**	**US$**	**€**
Australia	-4.1	+3.6	-4.9	-2.9
Finland	-1.1	+5.5	-3.2	-1.1
France	-8.4	-2.3	-10.3	-8.4
Germany	-9.4	-3.4	-11.3	-9.4
Hong Kong, China	-11.7	-4.2	-12.0	-10.2
Italy	-17.4	-11.9	-19.1	-17.4
Japan	-8.4	-0.6	-8.7	-6.8
Netherlands	-5.1	+1.2	-7.1	-5.1
Spain	-14.3	-8.6	-16.0	-14.3
Switzerland	-6.0	-1.5	-9.5	-7.7
UK	-3.7	-3.7	-11.6	-9.7
USA	-6.6	+1.7	-6.6	-4.7
Europe ex UK	-7.9	-2.2	-10.1	-8.3
Asia Pacific ex Japan	-6.4	+0.1	-8.0	-6.1
Asia Pacific	-7.6	-0.3	-8.4	-6.5
Latin America	-6.7	-4.9	-12.6	-10.8
All World All Emerging	-9.1	-4.1	-11.9	-10.1
The World	-6.7	N/C	-8.2	-6.2

Source FTSE World Indices

FTSE UK Government Securities Index All Stocks (total return) : +3.5%

International Bonds - Benchmark Ten Year Government Bond Yields (%)

Currency	30.10.15	29.01.16
Sterling	1.92	1.56
US Dollar	2.15	1.92
Yen	0.30	0.10
Germany (Euro)	0.52	0.33

Sterling's performance during the quarter ending 29.01.16 (%)

Currency	Quarter Ending 29.01.16
US Dollar	-7.9
Canadian Dollar	-1.2
Yen	-7.7
Euro	-6.4
Swiss Franc	-4.6
Australian Dollar	-7.1

Other currency movements during the quarter ending 29.01.16 (%)

Currency	Quarter Ending 29.01.16
US Dollar / Canadian Dollar	+7.3
US Dollar / Yen	+0.2
US Dollar / Euro	+1.6
Swiss Franc / Euro	-1.9
Euro / Yen	-1.4

Significant Commodities (US dollar terms) 30.10.15 - 29.01.16 (%)

Currency	Quarter Ending 29.01.16
Oil	-28.2
Gold	-2.5

MARKETS

Turbulence in international stock markets in January meant that, apart from the sterling return on the FTSE World Index, in other currencies, a negative performance over the quarter was shown. In total return terms and in local currency terms, the FTSE World Index returned -6.7%, in sterling terms it was unchanged, in US dollar terms the return was -8.2% and, in euro terms, it was -6.2%. Looking at local currency returns first, we note slightly below average returns from the FTSE Europe ex UK Index, -7.9%, the FTSE Japan Index, -8.4% and the FTSE All World All Emerging Markets Index, -9.1%. Markets which showed a less negative performance than the FTSE World Index included Australia where the FTSE Australia Index returned -4.1% and the UK where the FTSE UK Index returned -3.7%. However, in sterling adjusted returns, because sterling was so weak over the quarter, a different picture emerges. Against an FTSE World Index which was unchanged, we note below average performances from the FTSE Europe ex UK index which returned -2.2%, the FTSE Latin American Index which returned -4.9% and the FTSE All World All Emerging Market Index which returned -4.1%. Whereas the FTSE UK Index had outperformed in local currency terms, the weakness of sterling meant that this return underperformed the FTSE World Index in sterling adjusted returns. Positive returns against the FTSE World Index were seen from Australia where the FTSE Australia Index returned 3.6% and the USA, where the FTSE USA Index returned 1.7%.

The turbulence in international stock markets in January meant that bond yields fell quite sharply where, taking the ten year government bond indices as benchmarks, the gross redemption yield on the UK government bond fell by 36 basis points to 1.56%, on the US Treasury bond by 23 basis points to 1.92%, on the Japanese government bond by 20 basis points to 0.10% and on the German Bund by 19 basis points to 0.33%.

In currency markets, sterling endured a torrid quarter, falling against all the major currencies. Against the US dollar, it fell by 7.9%, against the yen by 7.7%, against the Australian dollar by 7.1%, against the euro by 6.4%, against the Swiss franc, by 4.6% and against the Canadian dollar by 1.2%.

In the commodity markets, the stand out feature was oil, which, as measured by Brent crude, declined 28.2% over the quarter. Gold fell slightly by 2.5%.

ECONOMICS

From the first working day of 2016, when the Chinese market was halted because of the slide in share prices, volatile conditions have been a feature of stock markets. Another point to note has been the weakness of sterling where, over the month of January, its trade weighted index has declined by 3.4%.

So, we have to ask, what, if anything, has changed? China has been the main focus of investors' attention. Everyone knows that the era of double digit growth has ended - we have not seen that level of growth since 2010 - but it is also known that the Chinese government is attempting to engineer a change in the profile of the Chinese economy to increase the emphasis on services and consumption and away from fixed investment and exports so that, if this is achieved, growth will be lower than in the past but of higher quality. Over investment has led to too much spare capacity which is wasteful and expensive for the banks in terms of bad loans. So, from a recent peak growth rate of around 15% nine years ago (the historic peak was 15.4% in the first quarter of 1993), the latest annual growth rate for the fourth quarter of 2015 was 6.9%, down slightly from the previous quarter's level of 6.8%. There are those who believe that the published growth rates do not mirror the actual growth rates. Whether that is true or not, the figures for fourth quarter 2015 growth, as published, were not a surprise. The next issue, which was what caused markets to fall sharply last August, was the changing of the trading bands for the renminbi with those taking a negative view reading the move as a devaluation to stimulate a weakening economy and those who broadly agreed with the official line that it was a move by China to make its currency more market determined and, therefore, more acceptable to the IMF in its bid to have the currency included in the Special Drawing Rights basket, which was what happened later in the year. Those fearing that China is trying to devalue its currency gradually believe it is happening because of concerns about the state of the Chinese economy. Since it widened the trading band last August, the onshore renminbi has weakened against the US dollar by about 7%, at the time of writing, and the offshore renminbi, which is more market orientated, has declined by about double that amount. This, however, is against the background of the US dollar's trade weighted index strengthening by about 6% since that time. More general concerns are that China is experiencing a major capital outflow which would be a function of a lack of confidence in the country's prospects and that competitive devaluations may be sparked off, which is a "no win" situation all round. None of this is new, however,

It is easy to rationalise an event after it has happened. We see this every morning on our screens as the headlines seek to explain why markets have moved in a particular direction. We are in the strange situation where markets can react well to a recovery in commodity prices and badly to a fall, with oil being the most high profile commodity. With Brent crude standing at around US$33 a barrel, around about one fifth of its peak price, the positive implications are significant for many oil importing economies. It is the equivalent of a tax cut and a quite significant one for many people and also for many businesses. It is a restraining influence on inflation. It will improve the balance of payments for oil importing countries. We recall the concerns when the oil price peaked. In July 2008, Brent crude peaked at just under US$146 a barrel and we remember the anguish which it caused many businesses including road hauliers and the resulting pressure on governments to take action. Those in oil importing countries have a higher propensity to spend than those in the oil producing countries in the Middle East. So, overall, one would think that this is good news. However, for a minority, the oil producing countries (and we are talking about oil here but it could be other commodities where the price has fallen) can present serious difficulties. Even the oil rich Gulf States, notably the largest producer of all, Saudi Arabia, are having to draw on their vast reserves to finance their budget deficits. As an interesting side effect, in the case of Saudi Arabia, it is producing a rethink of its economic model to raise the profile of the private sector with a partial sale of a stake in Aramco. The volatility of stock markets could also be partly related to sales of more liquid assets by oil producing states.

A second issue for the pessimists arising from the effect of weak commodity prices is that, where this has caused currencies to weaken and substantial US dollar and other foreign currency debt has been taken out, the risk of defaults or financial strain has increased. This also affects the high yield bond market in the USA where energy companies have borrowed to finance the fracking boom and where oil prices have fallen to levels which endanger the energy companies' finances.

The third issue is that the weakness in commodity prices is felt by some to indicate significant weakness in the world economy. In fact, oil demand continues to increase and it is supply which is the issue, which is a much better reason for the fall in oil prices than one caused by lack of demand. Saudi Arabia, in order to be able to control the oil price in the longer term, is flooding the market with oil to put the pressure on smaller or marginal producers, such as the US fracking industry. With Iran coming back into the fold following the lifting of sanctions and the enmity between the two countries, Saudi Arabia will also want to leave its mark there. In other commodities, for example iron ore, demand has been affected by the fall in Chinese steel production and the move away from fixed asset investment.

Coming back to the Chinese stock market and the volatility and price weakness which we are seeing there, a significant part of the problem seems to us to be communication problems with the markets. Investors have not understood what China has meant by various actions. Market signalling has been unclear. So, for example, last August when China increased its currency trading bands, its actions were capable of the two different interpretations which we mentioned earlier and, at the time, the pessimistic view won the day, at least for a time. Exacerbating the problem were the actions which the authorities took to try to stem the slide in the markets. The tussle between free market actions and central control was apparent in market trading halts, short selling bans and bans on sales of shares by certain investors. These are not the actions which investors associate with free markets and they have been counter productive. However, at the end of the day, as far as the Chinese economy is concerned, the stock market's movements are unlikely to affect its performance but it may have an effect further afield. Reflecting the uncertainty created by what has happened in recent months, the IMF, in its January 2016 World Economic Outlook update, has slightly downgraded its forecasts from last October. So, for 2016 and 2017, it has reduced its forecast for world growth for 2016 and 2017 by 0.2% and this latest projection suggests growth of 3.4% in 2016 and 3.6% in 2017. Within that overall total, the forecast for Advanced Economies has fallen by 0.1% each year and the forecasts for 2016 and 2017 both stand at 2.1%. Within the Advanced Economies, the IMF has pulled back its projections for the USA by 0.2% for each of 2016 and 2017 to 2.6% each year. It has actually raised slightly its forecast growth rate for the eurozone for 2016 by 0.1% to 1.7% and left 2017's forecast at 1.7%. Amongst the tweaks in the forecasts for eurozone countries, perhaps the most noticeable is a reduction in the forecasts for France, a country facing significant economic difficulties. This year's forecast has been downgraded by 0.2% to 1.5% and that for 2017 by 0.1% to 1.5%. Elsewhere, there has not been a lot of change in the projections for the Advanced Economies. In Emerging Market and Developing Economies, there has been an overall downgrade of 0.2% in 2016 and 2017 to growth rates of 4.3% and 4.7% respectively. Russia, not surprisingly in view of the profile of its economy, has seen a sharp downgrade of 0.4% for this year to -1.0% growth, although next year remains unchanged at 1.0%. Brazil has taken a big downgrade this year by 2.5% to -3.5%, and by 2.3% to 0.0% in 2017. However, for the other two members of the BRIC countries, China and India, forecasts have been left unchanged, 6.3% and 7.5% respectively for this year and 6.0% and 7.5% next year.

Growth estimates have been pared back in recent months as increased demand has not come through but, as the year progresses, we would expect the benefits of cheap oil to flow through to oil importing countries and for demand to firm up. However, one very likely effect of current subdued growth rates being maintained for a while is that interest rates will remain lower for longer. It is tempting to think that this is good news, and it probably is in the short term, but the ultra low interest rate environment presents medium term problems. We have seen the first rise in US interest rates last December and, at the current interest rate level, this is no more than symbolic. The expectation was that, by the end of 2016, the federal funds rate might stand at around 1.375%, implying a target rate of 1.25% to 1.50% compared with the present level of 0.25% to 0.50%. Last September, it was felt likely that the FOMC would start its programme of raising interest rates but the aftermath of the Chinese currency move in August temporarily spooked markets and the FOMC held off starting the process of raising interest rate rules. By December, when things had settled down a bit, the FOMC felt that there was no reason for holding off an interest rate increase as data from the US economy was sufficiently strong to justify an increase. But as growth forecasts are pared back, as we have shown above in the IMF's latest January update, it casts doubt on the timescale of rises elsewhere. In the UK, the G7 economy which most closely resembles that of the USA in terms of economic data (growth and unemployment, for example), the Governor of the Bank of England is less bullish than he was on the scope for an early interest rate increase and, in the eurozone, if anything, monetary policy might be loosened further. In the short term, this confirms the attraction of equities against bonds and cash, in our view, but, beyond that, it is storing up potential economic trouble. The reason for this is that, in the event of a deterioration in the world economy, monetary policy will lose its power to be effective because interest rates cannot be reduced meaningfully, if at all, and quantitative easing becomes less effective, the more it is undertaken. Meanwhile, the distortions introduced by very low interest rates and quantitative easing have undesirable side effects by causing dislocations in the financial system. Savers have been adversely affected and the search for yield has led to bubbles in some markets, such as the lower quality high yield bond market and areas of the property market. This stores up risks for the future and we are already seeing signs of distress in some high yield bonds. Property prices have become extended in some markets leading to the risk of a bust with the unpleasant side effects which this delivers. For companies with pension liabilities, the lower discount rate increases the burden of these liabilities absorbing cash which could be used in the business.

So, a move towards normality in monetary policy is in investors' best interests, even though, as currently being operated, it is helpful to asset prices. For that move towards normality to happen, we need to see some accelerating economic growth. The latest forecast from the IMF, as we saw earlier, sees only a modest increase in world growth this year compared to last year, 3.4% against 3.1%, and, for next year, sees only a modest further acceleration to 3.6%.

One reason why interest rates can remain at these extraordinary levels is because inflation is so low or even negative. There can, in some countries, still be positive real interest rates even at current levels of nominal interest rates. Deflation has been a worry to investors and rightly so if it were to take hold. The reason that deflation can be as big a problem as the one we are more used to, inflation, is because it threatens a downward spiral of economic activity in an economy as consumers hold off discretionary purchases in the belief that they will be able to make the purchases more cheaply later on. The weakness of commodity prices, not only oil but food as well, has contributed to the current unusual inflation levels. As year on year comparisons drop out of the calculations, one would expect a gentle upturn in price levels. Prices for oil can hardly be expected to go much lower and food prices could be subject to adverse climatic conditions, not to mention market forces coming to bear. The IMF's latest forecast in its January World Economic Outlook is for consumer prices in Advanced Economies in 2016 to rise 1.1%, against 0.3% in 2015, and 1.7% in 2017. The only very slight change from last October's forecast is a 0.1% reduction for 2016's figure. Its forecasts for Emerging Markets and Developing Economies have been raised, however. Against an inflation level of 5.5% in 2015, the IMF sees a slight increase to 5.6% in 2016 and a larger one to 5.9% in 2017. The 2016 projection is 0.5% above its October forecast and that for 2017 is 1.0% higher. Core inflation rates which strip out erratic items like food and energy are higher than headline figures. We think that the prospects for a sustained, as opposed to a temporary, period of low inflation are remote. On the other hand, demand is not likely to be strong enough to push prices up significantly.

We will discuss in more detail individual countries and regions, but the above picture is one of slow nominal growth in GDP which, because of very low inflation, is not greatly different in many countries from the real growth of GDP. Companies' revenues and profits are therefore likely to grow at only a modest rate, and dividends likewise, but the level of dividend yields is still likely to remain attractive to investors relative to those on bonds and cash where these investors have the ability to make equity investments. Against this background, one would expect to see a modest growth in equity prices over the year but with volatile quarterly performances such as we saw last year reflecting the political and economic uncertainties.

We have discussed current very low interest rates which are in danger of being taken for granted. That is dangerous, certainly as far as the bond market is concerned. Yields are being held down, partly because of quantitative easing with central banks in the eurozone and Japan being large purchasers of bonds. We are also starting to take for granted that quantitative easing is a normal way of dealing with economic weakness where it occurs. This is dangerous. Creating money electronically to buy assets risks inflation and currency debasement. This is especially true when the money starts to circulate more quickly as the velocity of circulation increases. This has not really started to happen yet, but when it does, the increased economic activity will lead to output gaps being closed and inflationary pressures to appear. When there is spare capacity in an economy, this is not an issue, but when capacity has been reached, inflationary pressures appear, perhaps in the employment market as firms bid up wages or in the raw materials' markets as demand cannot easily be met. With commodity prices flat on their back, this seems an unlikely scenario at present but capacity cutbacks and, eventually, higher demand will lift prices. What all this means is that, whilst inflation does not appear to be likely to be a problem in the foreseeable future, it could be later on. For the bond market, this could be serious. There is a wide range of shorter dated European government bonds on negative yields (Swiss government bonds even have negative ten year gross redemption yields). Elsewhere in developed countries, where yields are not negative, they are only mildly positive. Should inflation increase significantly or central banks, where quantitative easing has been practised, decide to tighten monetary policy, bonds would be very vulnerable. Because bond yields are so low compared to historical levels, any reversion to mean would result in much lower prices and losses which could not be recovered or, if the bonds were held to redemption, very low returns. Liquidity in markets is not as good as it was because of regulatory requirements and, when there is a rush for the door in open ended funds, there are likely to be some sharp downward price movements. We have seen problems at the end of last year in certain US high yield funds as liquidity dried up. It has not spread so far but, remembering that it was the suspension of three funds in 2007 which fired a warning about what was to come, investors need to be alert to the difficulties which arise from the elevated level of the bond market. We have been warning about this for a long time and the fact that there has not yet been a major sell off in the bond market does not make the warning any less valid. Quantitative easing, where still practised, cannot go on indefinitely and will have to be reversed at some stage. The "taper tantrums" in 2013 in the USA which occurred when a reduction in the rate of quantitative easing, but not a reversal, was foreshadowed, shows how vulnerable markets can be to fears of monetary tightening. So, this remains a theme of ours for 2016. Whilst one can understand why there are negative or very low yields on bonds, there is no valid reason why this should be any other than an exceptional position.

Turning now to individual areas of the world, starting with the USA, December, as we noted, marked the beginning of the step upwards in US interest rates, a move which was symbolic rather than having much practical significance, given the still extremely low level at which they stand. As we have seen from the IMF's economic growth forecast for this year, the USA is expected to grow at roughly the same level as 2015 (2.5% on the IMF's forecast and 2.6% for this year and next), a level which is not, in normal circumstances, consistent with the current federal funds rate of 0.25% to 0.50%. Although the USA has a low labour market participation rate, 62.6%, the labour market has been robust with the unemployment rate standing at 5.0%, not a level normally consistent with current interest rate levels. The purchasing managers indices give mixed signals, with that for the manufacturing sector standing at 48.2, which implies modest contraction, and that for the more important non manufacturing sector standing at a reasonably robust 55.3. Year on year consumer prices were 0.7% higher. Weak spots in the USA can be found in the energy sector as exploration budgets are pared back and fracking activity reduced. US corporate earnings have been under pressure, with the strength of the US dollar in 2015 impacting earnings for US companies with overseas activities. Relatively speaking, however, its position is good but no more than that. Perhaps of more interest, at the moment, is the political outlook in the USA in front of November's elections. The race for nominations in the primaries has shown some unusual features and the centre ground seems to be being vacated. If the next President is someone who is not considered mainstream, stock markets could easily be concerned, although the checks and balances in the US system mean that Congress could be a stabilising influence. At the moment, things are quite quiet on the day to day political front as far as the running of the economy is concerned, with all eyes on the forthcoming elections. That has something to do with the stalemate in US politics, with a President from one party and both houses of Congress controlled by the other. Even if Congress manages to put a check on the next President, if that person is considered to come from outside the mainstram of politics, as some candidates from both parties are at present, this could be a negative market factor. At the moment, this is no more than a consideration which one may need to take into account later this year. For the moment, the stability of the US economy in uncertain economic times remain a plus point. The relatively closed nature (trade is about 23% of GDP) of the US economy gives it some insulation from turbulent economic times internationally.

The centre of attention in the eurozone and EU generally is, of course, the refugee crisis and border control but the chronic problems of the eurozone continue with some potentially unsettling political developments for eurozone policy makers. The backlash against austerity has found its manifestation in the recent Portuguese and Spanish general elections. In the case of Portugal, a left wing coalition is turning against austerity and undoing some reforms of the previous government. It is difficult to see how long they can meet their budget deficit targets with the measures which they have introduced. That could set up a clash with the eurozone. In Spain, where, from a very depressed level, the economy has made an impressive recovery, an estimated growth rate of 3.2% in 2015 (IMF) and projected growth of 2.7% this year and 2.3% next year, the recent election has provided a result as inconclusive as it can get. Given the need for Spain to continue on the path of reform which has helped to engineer the economic recovery, the election result was not helpful in that respect. In France, with its own particular problems, the strength of the FN vote in the recent regional and local elections shows the extent of the hostility to the eurozone's economic targets being visited on individual countries. France is raising security spending and the budget targets have been put back. France is finding it very difficult to enact reforms which will improve its long term growth prospects and remains a concern as the second largest eurozone member. As we saw earlier, France is showing sub average growth and, with its level of outstanding public debt as a percentage of GDP rising, there is some concern. In Italy, the third largest eurozone country, the Prime Minister, Mr Renzi, is also pushing back against the eurozone's budget deficit plans for his country. For investors, the danger is that, if the dam bursts, and anti austerity parties continue to gain traction, the credibility of the euro will be damaged. Although Mr Draghi has hinted at more action to try to stimulate the eurozone economy if necessary, it would be likely to have a diminishing effect and raise the risks of currency depreciation. The eurozone's problems continue to look chronic. Nevertheless, there are some positive signs. The latest purchasing managers indices for the eurozone, although lower than for December, show the composite index at 53.6 and, within that, the services sector reading at 53.6 and that for manufacturing at 52.3. These are moderately encouraging figures. The eurozone should obtain a meaningful boost from low oil prices, being a major oil importer, so that a slight pick up in the growth rate to 1.7% this year from an estimated 1.5% last year, feels a reasonable estimate at this very early stage of the year. However, a lot of things can go wrong for the eurozone so forecasts will no doubt change as the year progresses. As always, it is important to distinguish between the high level problems of the eurozone and the fortunes of individual companies based in the eurozone, many of which remain attractive. Appealing dividend yields can be found in the European markets.

Japan was one of the best performing equity markets in 2015, even though its economic growth rate was very low, estimated at 0.6% by the IMF. On paper, it has a lot going for it as a large energy importer, with its import bill being significantly reduced by the fall in oil prices. However, whilst many countries would be pleased to see their inflation rate at low levels, for Japan, it poses a particular problem as it makes the 2% inflation target of the Bank of Japan more difficult to reach. With the Japanese history of deflation and the negative effect on economic activity which this can have as consumers hold off discretionary purchases in the hope of buying items at lower prices, this depressing effect on the level of inflation has been unwelcome. The third leg of the original project, structural reform, is the one on which there has been the least progress and with the difficult fundamentals facing the Japanese economy, including very poor demographics, it remains essential that measures are put in place to increase the economy's long term growth potential. With its public finances in a very bad state, a sustained and stronger growth rate is essential to improve the tax base. With outstanding public debt standing at around 240% of GDP, the highest level of the G7 economies, action is necessary. One of the reforms has, however, been helpful, namely the instructions to certain public funds to increase their equity exposure at the expense of bonds. Large amounts of equity exchange traded funds have been purchased by public bodies and, whilst one may have reservations about directed investment, it is desirable that there is an increase in the equity culture in Japan. One of the benefits is that the pressure of more institutional shareholders on the register is likely to raise corporate governance standards and make companies more shareholder friendly, an example being in the attitude towards dividend payments and pay out ratios. The extent of the problems with the Japanese economy set against the potential rewards of making the necessary structural changes including creating a much greater equity culture means the risk/reward ratio for the Japanese stock market is quite evenly balanced. At the end of January, the Bank of Japan took markets by surprise when, having denied that it would do, it introduced negative interest rates.

We have talked about China early on in some detail including the issues which have unsettled markets. It should be emphasised again that nothing has really changed in recent weeks and a lot of the problems for markets have been caused by problems of communication with the markets. Whilst attempts to prop up markets by official means may seem appealing to the authorities, it creates uncertainties for investors and is, ultimately, self defeating. At the end of the day, however, even with slowing growth, it is at a rate that the developed markets can only dream of and, in money terms, lower growth in a fast growing and large economy still means very large figures. Stock market gyrations are not likely to upset the Chinese economy much but, as we have seen, they have the power to unsettle other markets. Data to be announced in the next few months will be watched very carefully by investors and the transition to a more service and consumption orientated economy will not be easy, but China has more ability than most economies to make this transition effective.

Finally, we look at the UK. As we have seen, the IMF's forecasts are reasonably encouraging in the context of subdued international growth, certainly better than the eurozone and Japan but probably lagging the USA by a small amount this year. The main feature in January has been the weakness of sterling. Up until late last year, the trend had been in the other direction. One can rationalise movements after the event. When sterling was strong, one could say that it was because the UK economy was performing reasonably well and the scene was being set for the start of the process of raising interest rates. When it has been weak, as it has been recently, one can draw attention to the UK's large current account deficit, around 4.4% of GDP in 2015 and the problems of reining in the country's large budget deficit. Perhaps, although it cannot be proved, the uncertainties over the forthcoming EU referendum is causing nervousness about the pound. The weakness of sterling is loosening economic policy somewhat as it should be helpful to companies with overseas businesses and, whilst oil prices are so weak, to have a limited impact on inflation which remains below its target level. The main UK index has been underperforming the world index as energy and mining companies' share prices have weighed down on the market. But all things are relative and, compared with the problems of the eurozone, for example, the UK position is relatively good. We can expect the EU referendum, whenever it is held, to dominate the headlines and perhaps cause nervousness in the UK market but dividend yields and valuation levels are quite appealing. When commodity prices start to recover, we can expect to see the FTSE 100 index outperforming many other markets.

So, it has been a difficult start to 2016, although sterling investors with internationally diversified portfolios have received some protection, if they were unhedged, from the weakness of sterling. The negative return on the FTSE World Index in January in sterling terms was 2.2%, a movement which is not out of the ordinary, even though there was considerable volatility during the month. As we have said, we do not see the economic background having changed noticeably since December but events in China clearly spooked markets. As always, the media highlights sharp downwards movements in markets and these make the headlines but movements the other way rarely attract headlines. This imbalance carries with it the danger of influencing investors into unwise investment decisions which they may later regret. We see no reason for investors to change their investment stance on the evidence we have before us. International equity markets, we think, will build on last year's modest rise but progress over the quarters will be uneven and volatility quite high as investors respond to the political and economic news, some of which is bound to remain bad. Bond yields are artificially low because of monetary policy being followed but, in our view, bonds remain seriously overpriced with potential problems in markets when sentiment turns against the sector. In summary, we see, at this stage, 2016 being like 2015 in markets.