17 December 2018
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JUPITER LOOKS AHEAD TO 2019

Jupiter's fund management team give their outlooks for their respective markets in 2019, answering one of the following questions:

1. What market or macro-economic trend will you be keeping an eye on in 2019?
2. What is on your wish list for 2019?

What market or macro-economic trend will you be keeping an eye on in 2019?

Preparing for the end of the economic cycle – Ariel Bezalel, Manager of the Jupiter Dynamic Bond Fund

Throughout 2018 we have been preparing for the end of the economic cycle, as we believe the Federal Reserve's ("the Fed") twin strategy of tightening and rate-hiking is the ultimate catalyst for a slowdown in the global economy as well as in the US.

This year has seen several bouts of volatility, from the emerging market selloff to the recent equity market correction in October. We believe the prime reason for the pickup in volatility has been the Fed shrinking its balance sheet and raising interest rates. The European Central Bank is also expected to bring quantitative easing to an end soon which is likely to exacerbate the tightening of liquidity. With the US dollar moving higher as the Fed have hiked rates, it's no surprise to us that the removal of global liquidity was initially felt in emerging markets since they have accumulated large piles of dollar-denominated debt. But in our opinion the slowdown in emerging markets will inevitably spread to developed economies as well.

To illustrate, the global purchasing managers index for manufacturing (a key economic growth indicator) has been declining for several months this year, led by a slowdown in the Chinese economy. China is a big driver of global GDP growth and emerging markets are highly reliant on Chinese growth. This dynamic ultimately effects developed markets given emerging markets account for around 60% of global GDP and 80% of global GDP growth. Against this context, it is little wonder that economic data in Europe has begun to sour, with even manufacturing powerhouses such as Germany and Sweden being hit by China's slowdown.

This slowing global growth, alongside record amounts of consumer and corporate debt in the US, and the flattening of the yield curve, is why we continue to take a high-conviction approach to US Treasuries and continue to keep risk off the table. We believe it's only a matter of time until the Fed needs to take a step back from hiking rates, as problems elsewhere inevitably reach the shores of the US. We continue to use the fund's global remit to find attractive yield opportunities. Recently, we have been opportunistic in parts of emerging markets (short dated paper in Argentina being a prime example) and defensive businesses in high yield (such as US healthcare), but at this point of the economic cycle we remain mindful of the need to balance the upside potential against the growing downside risks.

Chink of light on US interest rate outlook - Alejandro Arevalo, manager of the Jupiter Global Emerging Markets Corporate Bond Fund and the Jupiter Global Emerging Markets Short Duration Bond Fund

It was a very challenging year for emerging market investors. The first signs of pressure for our asset class were felt in the first quarter of 2018 as the US dollar started its one-way path upward mostly driven by a determined push by the new US Federal Reserve Chairman to tighten monetary policy. These brought forward investors' concerns about the debt sustainability of the weakest emerging market sovereigns such as Turkey and Argentina. These two countries alone saw their currency lose more than 70% of their value in the nine months to September.[1] Fortunately, we did not see contagion risks to neighbouring countries.

While emerging market spreads have widened significantly since the beginning of the year due to indiscriminate selling, mostly as a result of 'tourist money' or short-term traders leaving the market, we still have a cautious outlook going into 2019 and continue to position ourselves defensively. However, we have been selectively increasing our allocation to solid high yield names where spreads have overshot and do not reflect the fundamentals. In our view the main risks for the first half of 2019 will continue to be external and similar in nature to the ones we have already seen this year. These are:

- US-China tensions to persist beyond just trade issues, with mounting accusations by the Trump administration of intellectual property theft, political meddling and investment restrictions continuing well into 2019. We also need to monitor the Chinese economy very closely. It has started to show signs of a slowdown and we need to continue to monitor how far the Chinese authorities are willing to loosen monetary and fiscal policies without jeopardizing their long-term goals of deleveraging. We don't expect a hard landing.

- Rising US interest rates will continue to drive US dollar strength putting pressure on indebted nations and companies. We believe though that the US Federal Reserve will come to the end of its tightening cycle by the middle of 2019 four years after it first started raising rates. This development would be positive for emerging markets and we would see it as a first sign of our ability to add more risk to our portfolio.

Overall, we still believe emerging market fundamentals remain strong, with growth expected to continue above 4% in 2019 mostly driven by a Latin American recovery with inflation largely under control.

Finding equilibrium: a return to "normal?" – Talib Sheikh, manager of the Jupiter Flexible Income Fund

In 2019 we will be looking to see whether global markets can move to a new equilibrium, balancing an acceptance of higher interest rates and the draining of extraordinary liquidity against what we believe are decent prospects for steady, if unspectacular global economic growth. If the last four months of 2018 are anything to go by, expect a bumpy ride.

For the last 10 years, central banks have supported markets by keeping interest rates at historic lows, and by using quantitative easing to pump around $15tn into the global economy to boost growth after the financial crisis of 2007-08. These measures have led to a significant distortion in asset prices: in the fixed income market alone, we now have some $8.5 trillion of government bonds with 27.5% of Eurozone bonds[2] currently trading with a negative yield – in other words, investors are paying to own them.

Central banks, led by the US Federal Reserve, know such a situation cannot be sustainable in the long term; indeed, this had always been termed "unconventional" policy. If rates have been rising over the past two years, it's because the Federal Reserve believes, as we do, that global economic growth has strengthened enough to be able to cope with higher borrowing costs. Clearly the

[1] Source: Bloomberg, 30th November 2018

[2] JP Morgan 11/08/18

transition has been difficult with market volatility and most asset classes outside cash posting negative returns year to date. Emerging markets have been particularly hard-hit countries and companies in the region have built up a significant US-dollar debt that becomes more expensive to pay back as the US dollar rises on higher rates.

The question is: will markets eventually learn to adjust to higher rates if economic growth continues to hold up?

In the meantime, while the market remains volatile, we choose to keep our fund invested in higher quality assets such as US bonds and equities, both boosted by the exceptional economic growth of the US. We work hard on diversification and retain a nimble approach. Other areas we favour include emerging market corporate debt and financial related debt instruments. Overall though equities make up a smaller proportion of our portfolio than they might normally do because of the current market climate. The recent heavy sell-off in the markets in the last few months has created some value; there are obviously points where assets become so cheap that we might be tempted to take a bit more risk in our portfolios. We are not quite there yet, but when we are, it will likely signal that markets have re-calibrated to achieve a new equilibrium between liquidity and economic growth.

An eye on the Fed for 2019 – Guy de Blonay, manager of the Jupiter Financial Innovation Fund

Up until recently I feared the US Federal Reserve (the Fed) may overplay its hand in 2019 and raise US interest rates to a point where the global economy might grind to a halt. Recent pronouncements by several Federal Reserve officials have changed my view. Under Jerome "Jay" Powell, we have a central bank that has been pursuing a very US-centric monetary policy. While it is entirely appropriate the Federal Reserve should have the health of the US economy at the heart of its decision-making process, previous chairs including Ben Bernanke and Janet Yellen, always had an eye on the global impact of their actions –weighing up the need for rate rises against their impact on global growth and the potential knock-effect on for the US economy. If the world slows, so does the US.

We have had three US interest rate rises in 2018 so far and we have seen the impact. Global stock markets have sold off, with emerging markets most affected on concern too many companies in the region hold US denominated-debt they will struggle to pay as the dollar rises. This weakness seems to have prompted a recent shift in sentiment at the US central bank: Federal Reserve Vice Chair Richard Clarida acknowledged "the global economy is something the Fed has to pay to attention to…" while Atlanta Federal Reserve President Raphael Bostic hinted a pause in interest rate rises may be coming when he said the bank is not "too far from a neutral policy, and neutral is where we want to be." Even the Federal Reserve Chairman Jerome Powell has weighed in, saying in a recent speech that is was the bank's duty "to be thinking about how much further to raise rates, and the pace at which we will raise rates."

Given these comments, it seems increasingly clear, in my view, that the central bank won't ignore the pressures the global economy is under and will moderate the number of rate hikes, with the possibility of one rate increase this month, a likely further two in 2019, and then pausing. If, on the other hand, it chooses to keep its focus on the US economy, worried about rising inflationary pressures linked to a tight labour market, a more aggressive interest rate hike scenario may play out at the expense of global growth.

China: Biting change creates opportunity – Charles Sunnucks, fund manager, Emerging Markets Strategy

This year has been one of material reform in China: policy makers have rolled out biting change within the financial sector, there has been tightened regulation around online activity and a continued reduction of excessive supply in key industries. These moves, against a background of uncertainty over the trading outlook for the country, has had a clear effect on domestic confidence, putting pockets of the economy under pressure. China, however, has a highly diverse economy, so while change can be a challenge, it also creates opportunities. The overhaul within the financial sector, for instance, will likely create material stress on some business models, but is also likely to mean more deposit and lending opportunities for firms already in-line with regulation. Similarly, for online commerce platforms, new requirements on merchant registration and 'shared liability' on products sold is a sizeable risk for certain sites, but an overdue tailwind for those with already evolved risk processes. More broadly, ongoing supply reductions driven by rising standards will materially harm some businesses, and yet for others it supports an improving competitive landscape and more pricing power. In our view, these changes are far from reflected in equity valuations. We are going into 2019 with a less supportive macro-economic backdrop, but we believe the increasingly divergent outlook within China's corporate universe should gradually be reflected via a decoupling in valuations across the market. This will likely be most apparent in the small/mid cap part of the market, where considerable underperformance has created several highly attractive bottom-up opportunities.

Japan: avoiding the global slowdown – Dan Carter, manager of Jupiter Japan Select Fund

In a climate of rising US interest rates and mounting trade tensions, talk of a global economic slowdown fills the airwaves. For Japan, we need to consider the degree to which the country may participate in this next down-cycle whenever it comes. The answer to this question may lie in the changes we have seen in Japan over the last 10 years.

First, Japanese companies hold much less debt on their balance sheet that they did when they entered the global financial crisis. In December 2007 the overall net debt to equity for the TOPIX index was 1x whereas as now it stands at just 0.1x with more than half of Japanese companies outside of the financial sector in a net cash position. In addition, the proportion of Japanese book value which is tangible, i.e. consisting of physical assets, is considerably higher than other global markets, notably the US. By rights this greater financial stability should be to Japan's benefit in the next downturn.

Second, corporate Japan is much more profitable than 10 years ago. Japanese companies walked into the last crisis with an aggregate pre-tax profit margin in line with previous peaks, of around 4%. Today that number is above 6% and, we believe, the result of structural improvements in the corporate sector rather than merely due to the strength and length of the cycle. We would argue that these structural improvements should stand Japanese companies in good stead when the cycle turns, and that the next trough in profits is unlikely to be as deep as the last.

Thirdly, through the adoption of formal codes for corporate governance and stewardship Japan has sown the seeds for better executive behaviour. The spectacular downfall of Nissan's talismanic Chairman Carlos Ghosn stands as a stark counterpoint to the broader market which is strengthening governance structures and moving towards more shareholder-friendly policies.

Finally, a much overlooked but equally important factor has been its improving trade relationship with China. From 2011, trade between the two countries had been in the doldrums as politics – particularly the 2012 spat over the Senkaku Islands – stood in the way of economic cooperation. Recently, however, Sino-Japanese trade has been on the rise and the rhetoric between the two nations has been increasingly friendly and trade-focused. It is not unreasonable to expect that a continued normalisation of relations, and associated uptick in trade between Japan and China, could help soften the impact of the next global slowdown.

A difficult balancing act - John Chatfeild-Roberts, Head of Strategy, Independent Funds

The question for the year ahead will be whether central banks, led by the US Federal Reserve (The Fed), are able to pull off the trick of raising interest rates and reducing the money supply without engendering further significant weakness in stock and bond markets. If 2018 is anything to go by, it's likely to prove a difficult balancing act.

In Asia and Latin America this year, we have seen areas of weakness as countries and companies with too much US dollar-debt on their books have seen borrowing costs increase on a rising dollar and rising interest rates, shaking investor confidence and sending stock markets tumbling. Some emerging markets have fallen back so far there is a talk they cannot fall much further, creating attractive 'entry points' for investors like us who have largely kept our distance. While we remain unconvinced a 'floor' has been reached, we are likely to give emerging markets a closer look in 2019.

Geopolitics are usually only of contextual interest to investors, but occasionally they take on a direct relevance. Now is such a time with President Trump's economic and foreign policies inextricably linked, notably his administration's attempt to use trade as a weapon to rebalance its relationship with China. The Chinese economy has been slowing since 2017 and is expected to slow further in 2019. As tariffs bite, how will Chinese authorities react both to mitigate against the effects of these additional frictional costs to global trade, and to try to stimulate domestic demand? The Chinese central bank has already devalued its currency by 10% and there has been some limited stimulus applied at home but, facing a mountain of debt, Chinese authorities are sensitive to finding a balance between keeping a tight rein on the purse-strings while understanding that, even though China is an autocracy, there is a political dimension to a slowing economy.

With its substantial $300bn annual trade surplus with the US, China has more to lose than the US in this economic struggle. However, the US itself is not immune from harm and, although the US economy has been buoyant this year as growth accelerated towards 3%, economists are increasingly assuming it will soften in 2019. In the meantime, Europe too is losing momentum. These three blocs – the US, China and the Eurozone – between them account for 55% of global GDP; all are forecast still to grow but the growth rate may decelerate.

As for the UK, Brexit will continue its tortured path to an uncertain conclusion. Politically and economically Brexit is important, but it remains just one factor among many that we need to consider when deciding how to allocate our portfolios.

What is on your wish list for 2019?

Be careful what you wish for – James Clunie, manager of the Jupiter Global Absolute Return Fund

"Be careful what you wish for, James" my Head of Risk warned me, as we discussed Jupiter's Absolute Return Fund one morning by the coffee machine. I had mentioned that our fund would probably benefit from falling share prices, because it had a negative correlation with equity markets. My Head of Risk was, rightly, reminding me that falling markets are, in general, unhelpful for the investment community. Of course, I wasn't actually *wishing* for falling markets – I just believed that our fund would be robust to this scenario.

My colleague, Ivan Kralj, and I try hard *not to do* the following: think of a likely scenario, position the fund to benefit from it, and then wish very hard for it to happen. Wishful thinking can lead to all sorts of problems.

Instead, we try to consider many possible futures. Rather than structure the fund around some world view, we instead buy, sell and short-sell stocks based on a sensible process, observe the risks we get at the portfolio level and then try to hedge some of the scarier scenarios. In a way, this approach is 'floppy'. We're not actually *wishing* for anything, though we certainly end up with exposures to different scenarios, as a result of our stock-picking. Currently, the fund would enjoy a rotation from 'growth' into 'value' stocks; a rotation from US equities towards shares outside the USA; and a general fall in share prices. When we look back over stock market cycles, we see that growth stocks currently look stretched against value stocks in historic terms; as do US equities compared to the rest of the world. Consequently, we think that the risks we're taking make sense. We try not to wish for anything, but we're highly engaged and extremely interested to see what happens next in markets!"

A return to fundamentals - Ross Teverson, Manager of the Jupiter Global Emerging Markets Equity Unconstrained Fund

After a year when political events have driven extreme moves in some markets and growing ETF flows have driven more and more investors into widely-held index constituents, we would like to see the markets return to fundamentals in 2019. We believe if that markets recognise what many companies in emerging markets are doing fundamentally, there is an attractive opportunity at current valuation levels. On a P/E basis, emerging markets are trading at their widest discount to US companies in 15 years. Companies outside the index have become even more overlooked – trading on low valuation multiples but are delivering good operational performance. Take one of our top holdings, Kenya Commercial Bank (KCB), for example. KCB is exposed to what we believe is a long-term structural growth driver – financial inclusion. Supportive demographics in Sub-Saharan Africa, coupled with rapid developments in technology indicate that the ability of individuals to access basic financial products and services will only grow over time. We believe KCB is well placed to benefit from this trend. The company recently reported good earnings growth and is trading on a single-digit P/E and generating 20%+ return on equity. Current valuations are unwarranted, in our view, so if the market can take a longer-term perspective, we believe there is a bright outlook for companies which are currently being overlooked by the market.

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About Jupiter:

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To Jupiter's core competencies belong multi-asset- and fixed-income-strategies as well as European and Emerging Markets equities. Besides convertibles and global financial equities also count Social Responsible Investments since over 30 years to the investment themes. The company is committed to an active fund management, aiming to generate investment outperformance over the medium to long term without unnecessary risks.

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The Jupiter Dynamic Bond Fund: The fund can invest a significant portion of the portfolio in high yield and non-rated bonds. These bonds may offer a higher income but carry a greater risk of default, particularly in volatile markets. Quarterly income payments will fluctuate. In difficult market conditions, it may be harder for the manager to sell assets at the quoted price, which could have a negative impact on performance. In extreme market conditions, the Fund's ability to meet redemption requests on demand may be affected. Some share classes charge all of their expenses to capital, which can reduce the potential for capital growth. Please see the Prospectus for information. The KIID and Prospectus are available from Jupiter on request. This fund can invest more than 35% of its value in securities issued or guaranteed by an EEA state.

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