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Shares will fly again in 2011

High-risk sectors such as emerging markets have defied the odds and still continue to shine, reports
Melanie Wright

FORTUNE favours the brave, and investors who backed high-risk sectors certainly reaped the biggest rewards in 2010.

As the FTSE broke through 6,000, its highest level since 2008, last week, advisers said investors could look forward to more of the same next year.

Despite many investors choosing to shun America because of its economic woes, North American smaller companies was the best-performing funds sector over the year, said Morningstar, the research firm. This sector returned an impressive 30% in 2010, followed by UK smaller companies at 26%. Global emerging markets also did well, returning 19%.

The latter two have continued their winning streak from 2009, when they delivered returns of 50% and 54% respectively. As far as individual investments go, gold was the standout performer, with political and economic bad news helping to boost demand. Prices are up more than 25%, rising from \$1,097 (£712) at the start of the year, to \$1,383 last week. Some predict it could go as high as \$2,000 an ounce by 2012.

Not all sectors have fared so well. The average money market fund returned 0.31% in 2010, while the average absolute return fund returned just 4%.

Most sectors have experienced a bumpy ride. May proved particularly turbulent for the FTSE 100, when it fell below the 5,000 mark for the first time since November 2009 following Greece's request for a bailout from the International Monetary Fund and the European Union.

Here, we examine how the various sectors have performed over the past year, and whether some of 2010's winners will be lucky again in 2011.

OVERSEAS (EXCLUDING US)

Emerging markets performed particularly well last year but it would be highly unusual for them to continue to defy gravity for a third year in a row. Despite that, the Association of Investment Companies said 20% of investment trust managers still tip emerging markets to be the best performing region in 2011.

Investors have flocked into the sector in recent months, as economies such as Brazil, India, China and Russia have beaten the US and European markets. According to the Investment Management Association (IMA), global emerging markets sales in October were the highest on record, with net retail sales of £336m.

The average fund returned nearly 19% over the year, while the top fund, Templeton Emerging Markets, returned nearly 33%. Even the worst-performing fund in this sector, the GLG Global Emerging Markets, returned nearly 7% over the year.

Dan Morris at JP Morgan Asset Management said: "In contrast to the challenges faced by much of the developed world, emerging markets will continue to see robust growth."

However, managers are divided. David Coombs at Rathbone said: "With emerging markets looking expensive, inflated by hot money, now is the time to take profits and buy the US where valuations look realistic and tax cuts for companies are likely."

In Europe, the German recovery was driven by emerging market demand and beat expectations in 2010. However, many eurozone countries, particularly Spain,

France and Italy, continue to overestimate growth prospects, according to Bill O'Neill at Merrill Lynch Wealth Management.

Despite this, the average European fund was still up nearly 6% over the year. Smaller companies again fared the best, with the average European Smaller Companies fund returning nearly 20% in 2010.

Morris said: "Regardless of the ultimate fate of the euro, the struggle to manage the eurozone sovereign debt crisis suggests volatility will stay high in the region."

UK

The average UK all companies fund has risen in value by nearly 16% in 2010. The worst performer is the L&G Growth fund, which is still up nearly 3.5% over the year.

The top-performing UK fund is MFM Slater Growth, up 74% over the year. The fund, managed by Mark Slater, son of financier Jim Slater, has a bias towards small cap stocks. The fund's largest holding is drugs development business Hutchison China MediTech and it has recently acquired Entertainment One, the international entertainment company.

Smaller companies have undoubtedly fared best, with the average fund returning nearly 26% over the year. The best performer is Scottish Widows UK Smaller Companies, which has returned over 56%.

Martin Bamford at Informed Choice, an adviser, said: "Even with the recent downwardly revised forecasts from the Office for Budget Responsibility, the UK economy looks in reasonably good shape."

"While the UK stock market could be quite volatile next year, it is likely to repre-

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sent a safer prospect than overseas equities, which will come with a big dose of currency risk. A good fund for next year is M&G Recovery, managed by Tom Dobell."

US

The situation in Britain was replicated in America this year, with funds investing in smaller companies again providing the best returns. The average fund is up more than 29% over the year.

The top performer was the SWIP North American Smaller Companies fund, which returned over 37%. Even the worst performer in this sector, the F&C US Smaller Companies fund, returned nearly 19%.

In the North American sector generally, the best-performing fund over a year was CF Greenwich, returning 31%, while the worst performer, the JPM US Dynamic fund, managed nearly 7%. The average US fund grew by 14% over the year.

Looking to 2011, O'Neill said: "US growth is expected to slow to 2.1%, from 2.7% this year, but we expect a swing up in the second half of the year."

Philippa Gee at Philippa Gee Wealth Management, an adviser, said there are plenty of opportunities in America for next year. "I like Vanguard US Equity Index as a

passive tracker fund and for those seeking an actively-managed fund I would go for JPM US Smaller Companies or Threadneedle American Smaller Companies."

COMMODITIES

Commodities of all kinds have proved hugely popular this year, as investors rushed to escape devaluing currencies. Gold was the runaway winner, having risen by more than 25%. On the last trading day of 2009 the price of gold stood at \$1,097 an ounce; it has subsequently soared to about \$1,390.

The SF t1ps Smaller Companies Gold fund was the top-performing commodity fund this year, returning a phenomenal

113%. It aims for capital growth by investing at least 80% of its core portfolio in companies that are predominantly involved in mining, exploration, development and production of gold.

Looking to 2011, some experts claim the surge in the price of gold has now run its course. "Gold is now back to where it was 22 years ago relative to US equities," O'Neill said. "That anomaly has ended. Equities are

just as good a hedge against inflation."

However, Darius McDermott at Chelsea Financial Services said: "If you adjust for inflation, then gold is nowhere near its high and I think it has further to go. My favoured funds are the Investec Global Gold and Black Rock Gold and General funds."

BONDS

Bond markets have had a strong year, especially high yield and emerging market debt. The IMA said the third quarter was the highest selling for global bonds on record, with net retail sales of £947 billion.

The top global bond fund was Investec Emerging Markets bond, up 16%. It invests in debt securities and loan instruments of issuers in emerging markets.

Most managers claim global index-linked bonds will give the best value. Tom Becket at PSigma said: "We are favouring short-duration, high-yield credit over investment grade bonds and global index-linked bonds over conventional gilts."



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THE BEST AND WORST FUNDS

TOP Fund

Return* Sector

SF Smaller Companies Gold	113.4%	Specialist
MFM Slater Growth	74.2%	UK all companies
Smith & Williamson Global Gold & Resources	59.8%	Specialist
Scottish Widows HIFML UK Smaller Companies	56.2%	UK small companies
CF Ruffer Baker Steel Gold	51.2%	Specialist

BOTTOM Fund

Return* Sector

CF Octopus Absolute UK Equity	-9.9%	Absolute return
BGF New Energy	-10.4%	Specialist
TRI European Residential Property	-24.5%	Property
MFM Tait Walker Cautious	-30.5%	Unclassified
MFM Tait Walker Balanced	-33.1%	Unclassified

* Returns from December 31, 2009 to December 22, 2010

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BEST AND WORST SECTORS

TOP

Sector	*Return
North American smaller firms	29.5%
UK smaller companies	25.9%
Technology and telecoms	20.1%
European smaller companies	19.8%
Global emerging markets	18.7%

BOTTOM

Sector	*Return
Protected funds	5.2%
UK index-linked gilts	5.2%
UK gilts	4.6%
Absolute return	4%
Money market	0.3%

* Returns from December 31, 2009 to December 22, 2010
 Source: Morningstar

BEST AND WORST MARKETS

TOP

Market	*Return
Argentina	82.9%
Sri Lanka	75.4%
Thailand	60.3%
Peru	57.7%
Colombia	49.8%

BOTTOM

Market	*Return
Jordan	-10.7%
Italy	-11.1%
Ireland	-15.4%
Spain	-17.3%
Greece	-38.5%

* Returns from December 31, 2009 to December 22, 2010
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STUART and Naomi Hill, both 49, from Southampton, invested in Fidelity's China Special Situations fund at launch this year. The couple, with children Matthew, 17, Georgina, 16, Hannah, 14, and Dan, 6, picked the fund because they believe there is going to be good growth in China and the Far East